PAPER – 5: ADVANCED ACCOUNTING

PART – I: ANNOUNCEMENTS STATING APPLICABILITY & NON-APPLICABILITY For NOVEMBER, 2018 EXAMINATION

A. Applicable for November, 2018 Examination

I. Companies Act, 2013

Relevant sections of the Companies Act, 2013 notified up to 30th April, 2018 will be applicable for November, 2018 Examination.

II. Amendments made by MCA in the Companies (Accounting Standards) Rules, 2006

Amendments made by MCA on 30.3.2016 in the Companies (Accounting Standards) Rules, 2006 have been made applicable for November, 2018 examination.

MCA has issued Companies (Accounting Standards) Amendment Rules, 2016 to amend Companies (Accounting Standards) Rules, 2006 by incorporating the references of the Companies Act, 2013, wherever applicable. Also, the Accounting Standard (AS) 2, AS 4, AS 10, AS 13, AS 14, AS 21 and AS 29 as specified in these Rules will substitute the corresponding Accounting Standards with the same number as specified in Companies (Accounting Standards) Rules, 2006.

Following table summarizes the changes made by the Companies (Accounting Standards) Amendment Rules, 2016 vis a vis the Companies (Accounting Standards) Rules, 2006 in the accounting standards relevant for Paper 5:

Name of the standard	Para no.	As per the Companies (Accounting Standards) Rules, 2006	As per the Companies (Accounting Standards) Amendment Rules, 2016	Implication
AS 4	Footnote to AS 4	Pursuant to AS 29, Provisions, Contingent Liabilities and Contingent Assets, becoming mandatory in respect of accounting periods commencing on or after 1-4-2004, all paragraphs of this Standard that deal	All paragraphs of this Standard that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central	Footnote has been modified.

		with contingencies (viz. paragraphs 1(a), 2, 3.1, 4 (4.1 to 4.4), 5 (5.1 to 5.6), 6, 7 (7.1 to 7.3), 9.1 (relevant portion), 9.2, 10, 11, 12 and 16) stand withdrawn except to the extent they deal with impairment of assets not covered by other Indian Accounting Standards. For example, impairment of receivables (commonly referred to as the provision for bad and doubtful debts), would continue to be covered by AS 4.	Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by this Standard.	
	8.5	There are events which, although they take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. Such items include the amount of dividend proposed or declared by the enterprise after the balance sheet date in respect of the period covered by the financial statements.	There are events which, although take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. For example, if dividends are declared after the balance sheet date but before the financial statements are	No liability for proposed dividends must be created now. Such proposed dividends are to be disclosed in the notes.

			approved for issue, the dividends are not recognized as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes.	
	14	Dividends stated to be in respect of the period covered by the financial statements, which are proposed or declared by the enterprise after the balance sheet date but before approval of the financial statements, should be adjusted.	If an enterprise declares dividends to shareholders after the balance sheet date, the enterprise should not recognize those dividends as a liability at the balance sheet date unless a statute requires otherwise. Such dividends should be disclosed in notes.	No liability for proposed dividends should be created now. Such proposed dividends are to be disclosed in the notes.
AS 14	3(a)	Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 1956 or any other statute which may be applicable to companies.	Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies and includes 'merger'.	Definition of Amalgamatio n has been made broader by specifically including 'merger'.

	18 and 39	In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Account') which is 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 are reversed.	In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Reserve') which is presented as a separate line item. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.	Corresponding debit on account of statutory reserve in case of amalgamation in the nature of purchase is termed as 'Amalgamation Adjustment Reserve' and is now to be presented as a separate line item since there is not sub-heading like 'miscellaneous expenditure' in Schedule III to the Companies Act, 2013
AS 29	35 (An extract)	The amount of a provision should not be discounted to its present value.	The amount of a provision should not be discounted to its present value except in case of decommissioning, restoration and similar liabilities that are recognized as cost of Property, Plant and Equipment. The discount rate (or rates) should be a pre-tax rate (or rates) that	Now discounting of provision for decommissioning, restoration and similar liabilities should be done as per the pre-tax discount rate as mentioned therein.

			reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted. Periodic unwinding of discount should be recognized in the statement of profit and loss.	
	73		**Transitional Provisions** All the existing provisions for decommissioning, restoration and similar liabilities (see paragraph 35) should be discounted prospectively, with the corresponding effect to the related item of property, plant and equipment.	Discounting of above existing provisions and similar liabilities should be prospectively, with the correspondin g effect to the related item of property, plant and equipment.

III Provisions of the Companies Act, 2013 related with Liquidation of Companies

As per Section 2 (94A) of the Companies Act, 2013, winding up means winding up under this Act. As per section 270, the provision of Part I should apply to the winding up of a company by the Tribunal under this Act.

Circumstances in which Company may be wound up by Tribunal [Section 271]

(a) The company has resolved that the company be wound up by the Tribunal.

(b) The company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality

(c) The Registrar or any other person authorized by the Central Government by notification under this Act can make an application to tribunal. The Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up.

(d) The company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding 5 consecutive financial years.

(e) The Tribunal is of the opinion that it is just and equitable that the company should be wound up.

A company may file petition for winding up under section 272 of the Companies Act, 2013. Petition for winding up to Tribunal cab neb made by the company, any contributory or contributories, the registrar, any person authorized by Central Govt. in that behalf or Ii case affairs of the company have been conducted in a Fraudulent manner, by the Central Government or a State Government.

Petition by Contributory

A contributory should be entitled to present a petition for the winding up of a company. Shares in respect of which he is a contributory were either originally allotted to him or have been held by him for at least 6 months during the 18 months immediately before the commencement of the winding up and registered in his name or have transferred to him through the death of a former holder.

Petition by Registrar

The Registrar should be entitled to present a petition for winding up under section 271, except on the grounds specified in section 271 (a) or (e). The Registrar should obtain the previous sanction of the Central Government to the presentation of a petition. The Central Government should not accord its sanction unless the company has been given a reasonable opportunity of making representations.

Petition by Company

A petition presented by the company for winding up before the Tribunal should be admitted only if accompanied by a statement of affairs in such form and in such manner as may be prescribed.

A copy of the petition made under this section should also be filed with the Registrar and the Registrar should, without prejudice to any other provisions, submit his views to the Tribunal within 60 days of receipt of such petition.

A company may be wound up voluntarily [Section 304[1]],:

(a) if the company in general meeting passes a resolution requiring the company to be wound up voluntarily as a result of the expiry of the period for its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company should be dissolved; or

(b) if the company passes a special resolution that the company be wound up.

Liquidators' Statement of Account

In case of Compulsory wound-up, the Company Liquidator should keep proper books in such manner, as may be prescribed, in which he should cause entries or minutes to be made of proceedings at meetings and of such other matters as may be prescribed.

Any creditor or contributory may, subject to the control of the Tribunal, inspect any such books, personally or through his agent.

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

(a) Amount realized from assets are included in the prescribed order.

(b) In case of assets specifically pledged in favour of creditors, only the surplus from it, if any, is entered as 'surplus from securities'.

(c) In case of partly paid up shares, the equity shareholders should be called up to pay necessary amount (not exceeding the amount of uncalled capital) if creditors' claims/claims of preference shareholders can't be satisfied with the available amount. Preference shareholders would be called upon to contribute (not exceeding the amount as yet uncalled on the shares) for paying of creditors.

(d) Amounts received from calls to contributories made at the time of winding up are shown on the Receipts side.

(e) Receipts per Trading Account are also included on the Receipts side.

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

Payments are made and shown in the following order:

(a) Legal charges;

---

[1]*Applicable until 31 March 2017; with effect from 1 April 2017, Section 59 of the Insolvency and Bankruptcy Code, 2016 is applicable.*

(b) Liquidator's expenses;

(c) Debenture holders (including interest up to the date of winding up if the company is insolvent and to the date of payment if it is solvent);

(d) Creditors:

(i) Preferential (in actual practice, preferential creditors are paid before debenture holders having a floating charge);

(ii) Unsecured creditors;

(e) Preferential shareholders (Arrears of dividends on cumulative preference shares should be paid up to the date of commencement of winding up); and

(f) Equity shareholders.

Commencement of Winding Up by Tribunal [Section 357]

Where, before the presentation of a petition for the winding up of a company by the Tribunal, a resolution has been passed by the company for voluntary winding up, the winding up of the company should be deemed to have commenced at the time of the passing of the resolution, and unless the Tribunal, on proof of fraud or mistake, thinks fit to direct otherwise, all proceedings taken in the voluntary winding up should be deemed to have been validly taken.

In any other case, the winding up of a company by the Tribunal should be deemed to commence at the time of the presentation of the petition for the winding up.

Exclusion of Certain Time in Computing Period of Limitation [Section 358]

Notwithstanding anything in the Limitation Act, 1963, or in any other law for the time being in force, in computing the period of limitation specified for any suit or application in the name and on behalf of a company which is being wound up by the Tribunal, the period from the date of commencement of the winding up of the company to a period of one year immediately following the date of the winding up order should be excluded.

Statement of Affairs

In case of winding up by Tribunal, Section 272(5) of the Companies Act, 2013 provides that a petition presented by the company for winding up before the Tribunal shall be admitted only if accompanied by a statement of affairs in such form and in such manner as may be prescribed.

In accordance with Section 274(1), where a petition for winding up is filed before the Tribunal by any person other than the company, the Tribunal shall, if satisfied that a prima facie case for winding up of the company is made out, by an order direct the company to file its objections along with a statement of its affairs within thirty days of the order in such form and in such manner as may be prescribed. The Tribunal may allow a further period of thirty days in a situation of contingency or special circumstances.

The broad lines on which the Statement of Affairs is prepared are the following —

(1) Include assets on which there is no fixed charge at the value they are expected to realize. Students should note to include calls in arrear but not uncalled capital.

(2) Include assets on which there is a fixed charge. The amount expected to be realized would be compared with the amount due to the creditor concerned. Any **surplus** is to be extended to the other column. A **deficit** (the amount owed to the creditor exceeding the amount realizable from the asset) is to be added to unsecured creditors.

(3) The total of assets in point (1) and any surplus from assets mentioned in point (2) is available for all the creditors (except secured creditors already covered by specifically mortgaged assets).

(4) From the total assets available, the following should be deducted one by one:-

   (i) Preferential creditors,

   (ii) Debentures having a floating charge, and

   (iii) Unsecured creditors.

   If a minus balance emerges, there would be deficiency as regards creditors, otherwise there would be a surplus.

(5) The amount of total paid-up capital (giving details of each class of shares) should be added and the figure emerging will be deficiency (or surplus) as regards members.

Note: Statement of affairs should accompany eight lists:

List A Full particulars of every description of property not specifically pledged and included in any other list are to be set forth in this list.

List B Assets specifically pledged and creditors fully or partly secured.

List C Preferential creditors for rates, taxes, salaries, wages and otherwise.

List D List of debenture holders secured by a floating charge.

List E Unsecured creditors.

List F List of preference shareholders.

List G List of equity shareholders.

List H Deficiency or surplus account.

Deficiency Account

The official liquidator will specify a date for period (minimum three years) beginning with the date on which information is supplied for preparation of an account to explain the deficiency or surplus. On that date either assets would exceed capital plus liabilities, that is, there would be a reserve or there would be a deficit or debit balance in the Profit and Loss Account. The Deficiency account is divided into two parts:

1. The first part starts with the deficit (on the given date) and contains every item that increases deficiency (or reduces surplus such as losses, dividends etc.).
2. The second part starts with the surplus on the given date and includes all profits.

If the total of the first exceeds that of the second, there would be a deficiency to the extent of the difference, and if the total of the second part exceeds that of the first, there would be a surplus.

Overriding Preferential Payments [Section 326]: In the winding up of a company under this Act, the following debts should be paid in priority to all other debts:

a. workmen's dues; and
b. where a secured creditor has realized a secured asset, so much of the debts due to such secured creditor as could not be realized by him or the amount of the workmen's portion in his security (if payable under the law), whichever is less, pari- passu with the workmen's dues:

Explanation: For the purposes of this section, and section 327 -

a) **Workmen,** in relation to a company, means the employees of the company, being workmen within the meaning of Section 2 (s) of the Industrial Disputes Act, 1947;
b) **Workmen's dues,** in relation to a company, means the aggregate of the following sums due from the company to its workmen, namely:
   (i) All wages or salary including wages payable;
   (ii) all accrued holiday remuneration becoming payable to any workman
   (iii) unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company or unless the company has, at the commencement of the winding up, under such a contract with insurers as is mentioned in section 14 of the Workmen's Compensation Act, 1923 (19 of 1923), rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any workman of the company;
   (iv) all sums due to any workman from provident fund, pension fund, gratuity fund or any other fund maintained by the company.

   The following payment should be made in priority to secured creditors:

   (i) All wages or salary including wages payable;
   (ii) all accrued holiday remuneration becoming payable to any workman

(iii) If the above payments are payable for a period of 2 years preceding the winding up order then the same shall be paid in priority to all other debts (including debts due to secured creditors), within a period of 30 days of sale of assets and shall be subject to such charge over the security of secured creditors.

c) **Workmen's portion,** in relation to the security of any secured creditor of a company, means the amount which bears to the value of the security the same proportion as the amount of the workmen's dues bears to the aggregate of the amount of workmen's dues and the amount of the debts due to the secured creditors.

Preferential Creditors

In a winding up there should be paid in priority to all other debts subject to the provisions of section 326.

Preferential Creditors are as follows:

a. **Government Taxes:** All revenues, taxes, cess and rates due from the company to the Central Government or a State Government or to a local authority at the relevant date, and having become due and payable within the twelve months immediately before that date;

b. **Salary and Wages:** All wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any employee in respect of services rendered to the company and due for a period not exceeding four months within the 12 months immediately before the relevant date, subject to the condition that the amount payable under this clause to any workman should not exceed such amount as may be notified;

c. **Holiday Remuneration:** All accrued holiday remuneration becoming payable to any employee, or in the case of his death, to any other person claiming under him, on the termination of his employment before, or by the winding up order, or, as the case may be, the dissolution of the company;

d. **Contribution under ESI Act:** Unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company, all amount due in respect of contributions payable during the period of twelve months immediately before the relevant date by the company as the employer of persons under the Employees' State Insurance Act, 1948 or any other law for the time being in force;

e. **Compensation in respect of death of disablement:** Unless the company has, at the commencement of winding up, under such a contract with any insurer as is mentioned in section 14 of the Workmen's Compensation Act, 1923, rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any employee of the company: Where any compensation under the said Act is a weekly payment, the amount payable under this clause should be taken to be the amount of the lump sum for which such weekly payment could, if redeemable, be redeemed, if the employer has made an application under that Act;

f. **PF, Pension Fund or Gratuity Fund:** All sums due to any employee from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the employees, maintained by the company; and

g. **Expenses of Investigation:** The expenses of any investigation held in pursuance of sections 213 and 216, in so far as they are payable by the company.

Where any advance payment has been made to any employee of a company on account of wages or salary or accrued holiday remuneration himself by some person for that purpose. The person by whom the money was advanced should have a right of priority in respect of the money so advanced and paid-up to the amount. The sum in respect of which the employee or other person in his right would have been entitled to priority in the winding up has been reduced by reason of the payment having been made.

The debts enumerated in this section should—

h. rank equally among themselves and be paid in full, unless the assets are insufficient to meet them, in which case they should abate in equal proportions; and

i. so far as the assets of the company available for payment to general creditors are insufficient to meet them, have priority over the claims of holders of debentures under any floating charge created by the company, and be paid accordingly out of any property comprised in or subject to that charge.

The debts under this section should be discharged forthwith so far as the assets are sufficient to meet them, subject to the retention of such sums as may be necessary for the costs and expenses of the winding up.

In the event of a landlord or other person distraining or having distrained on any goods or effects of the company within three months immediately before the date of a winding up order, the debts to which priority is given under this section should be a first charge on the goods or effects so distrained on or the proceeds of the sale thereof: Provided that, in respect of any money paid under any such charge, the landlord or other person should have the same rights of priority as the person to whom the payment is made. Any remuneration in respect of a period of holiday or of absence from work on medical grounds through sickness or other good cause should be deemed to be wages in respect of services rendered to the company during that period.

Explanations: For the purposes of this section,

- **Accrued Holiday Remuneration includes,** in relation to any person, all sums which, by virtue either of his contract of employment or of any enactment including any order made or direction given thereunder, are payable on account of the remuneration which would, in the ordinary course, have become payable to him in respect of a period of holiday, had his employment with the company continued until he became entitled to be allowed the holiday;

- **Employee** does not include a workman; and
- **Relevant Date** means in the case of a company being wound up by the Tribunal, the date of appointment or first appointment of a provisional liquidator, or if no such appointment was made, the date of the winding up order, unless, in either case, the company had commenced to be wound up voluntarily before that date under the Insolvency and Bankruptcy Code, 2016.

Effect of Floating Charge [Section 332]

Where a company is being wound up, a floating charge on the undertaking or property of the company created within the 12 months immediately preceding the commencement of the winding up, should be invalid unless it is proved that the company immediately after the creation of the charge was solvent except for the amount of any cash paid to the company at the time of and in consideration for or subsequent to the creation of the charge together with interest on that amount at the rate of 5 per cent per annum or such other rate as may be notified by the Central Government in this behalf.

B List Contributories

(a) **Persons**: Shareholders who had transferred Partly Paid Shares (otherwise than by operation of law or by death) within one year, prior to the date of winding up may be called upon to pay an amount to pay off such Creditors as existed on the date of transfer of shares. These Transferors are called as B List Contributories.

(b) **Liability**: Their liability is restricted to the amount not called up when the shares were transferred. They cannot be called upon to pay more than the entire face value of the share. For example, if Shares having Face Value ₹ 100 were paid up ₹ 60, the B List Contributory can be called up to pay a maximum of ₹ 40 only.

(c) **Conditions**: Liability of B List Contributories will crystallize only (a) when the existing assets available with the liquidator are not sufficient to cover the liabilities; (b) when the existing shareholders fail to pay the amount due on the shares to the Liquidator.

IV. Maintenance of Statutory Liquidity Ratio (SLR)

Section 24 and Section 56 of the Banking Regulation Act, 1949 – Maintenance of SLR and holdings of SLR in HTM category

It has been decided to reduce the SLR requirement of banks from 20.0 per cent of their Net Demand and Time Liabilities (NDTL) to 19.5 per cent from the fortnight commencing October 14, 2017 as announced in the Fourth Bi-monthly Monetary Policy Statement, 2017-18 on October 04, 2017. The related notification is DBR.No.Ret.BC.91/12.02.001/2017-18 dated October 4, 2017.

Currently, the banks are permitted to exceed the limit of 25 per cent of the total investments under HTM category, provided the excess comprises of SLR securities and total SLR securities held under HTM category are not more than 20.5 per cent of NDTL. In order to align this ceiling on the SLR holdings under HTM category with the mandatory SLR, it has been decided to reduce the ceiling from 20.5 per cent to 19.5 per cent in a phased manner, i.e. 20 per cent by December 31, 2017 and 19.5 per cent by March 31, 2018.

As per extant instructions, banks may shift investments to/from HTM with the approval of the Board of Directors once a year, and such shifting will normally be allowed at the beginning of the accounting year. In order to enable banks to shift their excess SLR securities from the HTM category to AFS/HFT to comply with instructions as indicated in paragraph 3 above, it has been decided to allow such shifting of the excess securities and direct sale from HTM category. This would be in addition to the shifting permitted at the beginning of the accounting year, i.e., in the month of April. Such transfer to AFS/HFT category as well as sale of securities from HTM category, to the extent required to reduce the SLR securities in HTM category in accordance with the regulatory instructions, would be excluded from the 5 per cent cap prescribed for value of sales and transfers of securities to/from HTM category under paragraph 2.3 (ii) of the Master Circular on Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks.

V. Maintenance of Cash Reserve Ratio (CRR)

Reserve Bank of India has decided to reduce the Cash Reserve Ratio (CRR) of Scheduled Commercial Banks by 25 basis points from 4.25 per cent to *4.00 per cent of their Net Demand and Time Liabilities (NDTL)* with effect from the fortnight beginning February 09, 2013 vide circular DBOD.No.Ret.BC.76/ 12.01.001 /2012-13 dated January 29, 2013. The Local Area Banks shall also maintain CRR at 3.00 per cent of its net demand and time liabilities up to February 08, 2013 and 4.00 per cent of its net demand and time liabilities from the fortnight beginning from February 09, 2013.

VI. Relevant Provisions of the Insurance Act [updated as per the Insurance (Amendment) Act, 2015]

The provisions of sections 10 and 11 have been modified vide the Insurance Laws (Amendment) Act, 2015. These amendments have necessitated changes to the IRDA (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations 2002. The significant provisions are as follows:

(1) Forms for final accounts [Section 11(1)]. Every insurer, on or after the date of the commencement of the Insurance Laws (Amendment) Act, 2015, in respect of insurance business transacted by him and in respect of his shareholders' funds, should, at the expiration of each financial year, prepare with reference to that year, balance sheet, a profit and loss account, a separate account of receipts and payments, a revenue account in accordance with the regulations as may be specified.

(2) Audit [Section 12]: The balance sheet, profit and loss account, revenue account and profit and loss appropriation account of every insurer, in respect of all insurance business transacted by him, should, unless they are subject to audit under the Companies Act, 2013, be audited annually by an auditor, and the auditor should in the audit of all such accounts have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by Section 147 of the Companies Act, 2013.

(3) Register of policies [Section 14(1)]: Every insurer, in respect of all business transacted by him, should maintain— (a) a record of policies, in which should be entered, in respect of every policy issued by the insurer, the name and address of the policyholder, the date when the policy was effected and a record of any transfer, assignment or nomination of which the insurer has notice; (b) a record of claims, every claim made together with the date of the claim, the name and address of the claimant and the date on which the claim was discharged, or, in the case of a claim which is rejected, the date of rejection and the grounds thereof; and (c) a record of policies and claims in accordance with clauses (a) and (b) may be maintained in any such form, including electronic mode, as may be specified by the regulations made under this Act.

(4) Approved investments (Section 27B(1)): A company carrying on general insurance business must invest its funds only in approved securities listed in this section.

(5) Payment of commission to authorized agents (Section 40(1)): As per the Insurance (Amendment) Act 2015, no person should, pay or contract to pay any remuneration or reward, whether by way of commission or otherwise for soliciting or procuring insurance business in India to any person except an insurance agent or an intermediary or insurance intermediary in such manner as may be specified by the regulations.

(6) Limit on expenditure (Sections 40B and 40C): As per the Insurance (Amendment) Act 2015 No insurer should, in respect of insurance business transacted by him in India, spend as expenses of management in any financial year any amount exceeding the amount as may be specified by the regulations made under this Act and every insurer transacting insurance business in India should furnish to the Authority, the details of expenses of management in such manner and form as may be specified by the regulations made under this Act."

(7) Sufficiency of assets [Section 64VA(1)]: Every insurer and re-insurer should at all times maintain an excess of value of assets over the amount of liabilities of, not less than fifty per cent. of the amount of minimum capital as stated under section 6 and arrived at in the manner specified by the regulations.

(8) Segregation of Policyholders' and Shareholders' Funds by the insurers carrying on General Insurance, Health Insurance and Reinsurance business: Section 11 (2) of

the Insurance Laws (Amendment) Act, 2015 mandates that every insurer shall keep separate funds of shareholders and policyholders.

(9) Unearned Premium Reserve (UPR): A Reserve for Unearned Premium shall be created as the amount representing that part of the premium written which is attributable to, and is to be allocated to the succeeding accounting periods. Such Reserves shall be computed as under:

a) Marine Hull: 100 percent of Net Written Premium during the preceding twelve months;

b) Other Segments: Insurers have an option to create UPR either at 50 percent of Net Written Premium of preceding twelve months or on the basis of 1/365th method on the unexpired period of the respective policies.

The insurers can follow either percentage or 1/365th method for computation of UPR of the other segments. However, Insurers shall follow the method of provisioning of UPR in a consistent manner. Any change in the method of provisioning can be done only with the prior written approval of the Authority.

10. Recoupment of the Deficit: Every Insurer shall ensure that the policyholders' fund is fully supported by the policyholders' investments shown in Schedule-SA. Therefore, any deficit/shortfall in policyholders' investments arising out of the loss in the Revenue Account or otherwise shall be recouped by transfer of securities from the shareholders' investments to the policyholders' investments on a half yearly basis. The valuation of such securities shall be in accordance with the valuation norms as specified in the IRDA (Preparation of Financial Statements and Auditors' Report) Regulations, 2002.

11. Investment made out of the policyholders' funds: Investment made out of the policyholders' funds shall be shown in a separate schedule i.e., 8 A. The format of the same is given as below:

Annexure

SCHEDULE- 8A

INVESTMENTS-POLICYHOLDERS

Particulars	Current Year	Previous Year
	('000)	**('000)**
LONG TERM INVESTMENTS		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other Approved Securities		
3. Other Investments		

(a) Shares - i) Equity; ii) Preference (b) Mutual Funds (c) Debentures/ Bonds (d) Investment Property-Real Estate (e) Other Securities (to be specified)		
4. Investments in Infrastructure and Housing		
Sub-Total		
SHORT TERM INVESTMENTS		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other Approved Securities		
3. Other Investments		
(a) Shares- i) Equity ii) Preference (b) Mutual Funds (c) Debentures/ Bonds (d) Other Securities (to be specified)		
4. Investments in Infrastructure and Housing		
Sub-Total		
Total		

Note: The above amendments have also been covered in the respective chapters (2, 4, 5 and 6) webhosted at the BOS Knowledge portal.

B. <u>Not applicable for November, 2018 examination</u>

Non-Applicability of Ind AS for November, 2018 Examination

The Ministry of Corporate Affairs has notified Companies (Indian Accounting Standards) Rules, 2015 on 16th February, 2015, for compliance by certain class of companies. These Ind AS are not applicable for November, 2018 Examination.

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

Dissolution of partnership firm

1. A, B and C are in partnership sharing profits and losses in the ratio of 5:4:4. The Balance Sheet of the firm as on 31st March, 2018 is as below:

Liabilities	₹	Assets	₹
A's Capital	1,20,000	Factory Building	1,93,280
B's Capital	80,000	Plant and Machinery	1,30,200
C's Capital	1,00,000	Trade Receivable	43,200
B's Loan	36,000	Inventories	99,120
Trade Payable	1,32,000	Cash at Bank	2,200
	4,68,000		4,68,000

On Balance Sheet date, all the three partners have decided to dissolve their partnership. The partners decided to distribute amounts as and when feasible and for this purpose they appoint C who was to get as his remuneration 1% of the value of the assets realised other than cash at bank and 10% of the amount distributed to the partners.

Assets were realised piecemeal as under:

	₹
First instalment	1,49,200
Second instalment	1,38,602
Third instalment	80,000
Last instalment	56,000

Dissolution expenses were provided for estimated amount of	₹ 24,000
The trade payables were were settled finally for	₹ 1,27,200

You are required to prepare a statement showing distribution of cash amongst the partners by "Highest Relative Capital Method".

Amalgamation of Partnership firms

2 P and Q are partners of P & Co., sharing Profit and Losses in the ratio of 3:1 and Q and R are partners of R & Co., sharing Profits and Losses in the ratio of 2:1. On 31st March, 2018, they decide to amalgamate and form a new firm M/s PQR & Co. wherein P, Q and R would be partners sharing profits and losses in the ratio of 3:2:1. The Balance Sheets of two firms on the above date are as under:

Liabilities	*P & Co.*	*R & Co.*	*Assets*	*P & Co.*	*R & Co.*
	(₹)	*(₹)*		*(₹)*	*(₹)*
Capitals:			Fixed assets:		
P	2,50,000	-	Building	50,000	60,000
Q	1,80,000	2,20,000	Plant & Machinery	1,60,000	1,70,000

R		1,20,000	Office Equipment	50,000	46,000
Reserves	60,000	1,50,000	Current assets:		
Sundry Creditors	1,30,000	1,36,000	Stock-in-trade	1,20,000	1,40,000
Due to P & Co.	-	1,00,000	Sundry Debtors	1,60,000	2,00,000
Bank Overdraft	80,000	-	Bank Balance	40,000	1,00,000
			Cash in hand	20,000	10,000
			Due from R& Co.	1,00,000	-
	7,00,000	7,26,000		7,00,000	7,26,000

The amalgamated firm took over the business on the following terms:

(a) Building of P & Co. was valued at ₹ 1,50,000.

(b) Plant & Machinery of P & Co. was valued at ₹ 2,75,000 and that of R & Co. at ₹ 2,50,000.

(c) All stock in trade is to be appreciated by 20%.

(d) Goodwill of P & Co. was valued at ₹ 1,20,000 and of R & Co. at ₹ 60,000, but the same will not appear in the books of PQR & Co.

(e) Partners of new firm will bring the necessary cash to pay other partners to adjust their capitals according to the profit sharing ratio.

(f) Provisions for doubtful debts has to be carried forward at ₹ 15,000 in respect of debtors of P & Co. and ₹ 30,000 in respect of debtors of R & Co.

You are required to prepare the Balance Sheet of new firm and capital accounts of the partners in the books of old firms.

Sale of Partnership firm to Company

3. Ali and Beta were carrying on business, sharing profits and losses equally. The firm's balance sheet as at 31-12-2017 was:

Liabilities		₹	Assets		₹
Sundry Creditors		1,44,000	Stock		1,44,000
Bank Overdraft		84,000	Machinery		3,60,000
Capital A/cs:			Debtors		1,68,000
			Joint Life Policy		21,600
Ali	3,36,000		Leasehold Premises		81,600
Beta	3,12,000	6,48,000	Profit & Loss A/c		62,400

			Drawing A/c:		
			Ali	24,000	
			Beta	14,400	38,400
		8,76,000			8,76,000

The business was carried on till 30-06-2018. On 30-06-2018, the firm sold the business to a limited company. The partners withdrew the amounts equal to half the amount of profit made during the period of six months ended on 30-06-2018, in equal proportion. The profit was calculated after charging depreciation at 10% p.a. on machinery and after writing off 5% on leasehold premises. In the half year, sundry creditors were reduced by ₹ 24,000 and bank overdraft by ₹ 36,000.

On 30-06-2018, stock was valued at ₹ 1,80,000 and debtors at ₹ 1,44,000; the Joint Life Policy had been surrendered for ₹ 21,600 before 30-06-2018 and other items remained the same as at 31-12-2017.

At the time of sale to company, the value of goodwill was fixed at ₹ 2,40,000 and the rest of the assets were valued on the basis of the balance sheet as at 30-06-2018. The company paid the purchase consideration in equity shares of ₹ 10 each.

You are required to prepare:

(a) Balance Sheet of the firm as at 30-06-2018;

(b) Realisation Account; and

(c) Partners' Capital Accounts showing the final settlement between them.

LLP

4. Write short note on Designated Partner in a Limited Liability Partnership and explain the liabilities of designated partners.

ESOPs

5. JKS Ltd. has its share capital divided into equity shares of ₹ 10 each. On 1.1.2018 it granted 5,000 employee stock options at ₹ 30 per share, when the market price was ₹ 50 per share. The options were to be exercised between 15th March, 2018 and 31st March, 2018. The employees exercised their options for 3,600 shares only and the remaining options lapsed. The company closes its books on 31st March every year. Show Journal entries (with narration) as would appear in the books of the company up to 31st March, 2018.

Buy Back of Securities

6. The following summarized Balance Sheet Pee Limited (a non-listed company) furnishes as at 31st March, 2017:

	₹	₹
Equity & Liabilities		
Share capital:		
Authorised capital		
2,50,000 Equity shares of ₹ 10 each fully paid up	25,00,000	
5,000, 10% Preference shares of ₹ 100 each	5,00,000	30,00,000
Issued and subscribed capital:		
2,40,000 Equity shares of ₹ 10 each fully paid up	24,00,000	
3,000, 10% Preference shares of ₹ 100 each	3,00,000	27,00,000
(Issued two months back for the purpose of buy back)		
Reserves and surplus:		
Capital reserve	10,00,000	
Revenue reserve	25,00,000	
Securities premium	27,00,000	
Profit and loss account	35,00,000	97,00,000
Current liabilities		
Trade payables	13,00,000	
Other current Liabilities	3,00,000	16,00,000
		1,40,00,000
Assets		
Tangible assets		
Building	25,00,000	
Machinery	31,00,000	
furniture	20,00,000	76,00,000
Non-current Investments		30,00,000
Current assets		
Inventory	12,00,000	
Trade receivables	7,00,000	
cash and bank balance	15,00,000	34,00,000
		1,40,00,000

On 1st April, 2017, the company passed a resolution to buy back 20% of its equity capital @ ₹ 60 per share. For this purpose, it sold all of its investment for ₹ 25,00,000.

The company achieved its target of buy-back. You are required to:

(a) Pass necessary journal entries and

(b) Prepare the Balance Sheet of the company after buy back of shares.

Redemption of Debentures

7. The summarized Balance Sheet of Spices Ltd. as on 31st March, 2018 read as under:

	₹
Liabilities:	
Share Capital: 9,000 equity shares of ₹ 10 each fully paid up	90,000
General Reserve	38,000
Debenture Redemption Reserve	35,000
12% Convertible Debentures : 1,200 Debentures of ₹ 50 each	60,000
Unsecured Loans	28,000
Short term borrowings	19,000
	2,70,000
Assets:	
Fixed Assets (at cost less depreciation)	72,000
Debenture Redemption Reserve Investments	34,000
Cash and Bank Balances	86,000
Other Current Assets	78,000
	2,70,000

The debentures are due for redemption on 1st April, 2018. The terms of issue of debentures provided that they were redeemable at a premium 10% and also conferred option to the debenture holders to convert 40% of their holding into equity shares at a predetermined price of ₹ 11 per share and the balance payment in cash.

Assuming that:

(i) Except for debentureholders holding 200 debentures in aggregate, rest of them exercised the option for maximum conversion,

(ii) The investments realized ₹ 56,000 on sale,

(iii) All the transactions were taken place on 1st April, 2018,

(iv) Premium on redemption of debentures is to be adjusted against General Reserve.

You are required to

(a) Redraft the Balance Sheet of Spices Ltd. as on 01.04.2018 after giving effect to the redemption.

(b) Show your calculations in respect of the number of equity shares to be allotted and the cash payment necessary.

Underwriting of Shares

8. M/s. Abhi Ltd. issued 2,00,000 shares of ₹ 10 each at a premium of ₹ 20. The entire issue was underwritten as follows:

Amit – 1,20,000 shares (Firm underwriting 10,000 shares)

Sumit – 50,000 shares (Firm underwriting 6,000 shares)

Lalit – 30,000 shares (Firm underwriting 4,000 shares)

Unmarked applications received by the company (excluding firm underwriting) were 25,000 shares.

The marked applications (excluding firm underwriting) were as follows:

Amit – 80,000 shares

Sumit – 35,000 shares

Lalit– 24,800 shares

Commission payable to underwriters is at 5% of the issue price. The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten and benefit of firm underwriting is to be given to individual underwriters.

(i) Determine the liability of each underwriter (number of shares);

(ii) Compute the amounts payable or due from underwriters; and

(iii) Pass Journal Entries in the books of the company relating to underwriting.

Amalgamation of Companies

9. The financial position of two companies Alex Ltd. and Beta Ltd. as on 31st March, 2017 was as under:

Assets	*ALex Ltd. (₹)*	*Beta Ltd. (₹)*
Goodwill	1,40,000	70,000
Building	8,40,000	2,80,000
Machinery	14,00,000	4,20,000
Inventory	7,00,000	4,90,000
Trade receivables	5,60,000	2,80,000
Cash at Bank	1,40,000	56,000
	37,80,000	15,96,000
Liabilities	*ALex Ltd. (₹)*	*Beta Ltd. (₹)*
Share Capital:		
Equity Shares of ₹ 10 each	28,00,000	8,40,000
8% Preference Shares of ₹ 100 each	2,80,000	–
10% Preference Shares of ₹ 100 each	–	2,80,000
General Reserve	1,96,000	1,96,000

Retirement Gratuity fund	1,40,000	56,000
Trade payables	3,64,000	2,24,000
	37,80,000	15,96,000

Beta Ltd.is absorbed by Alex Ltd. on the following terms:

(a) 10% Preference Shareholders are to be paid at 10% premium by issue of 8% Preference Shares of Alex Ltd.

(b) Goodwill of Beta Ltd. is valued at ₹ 1,40,000, Buildings are valued at ₹ 4,20,000 and the Machinery at ₹ 4,48,000.

(c) Inventory to be taken over at 10% less value and Provision for Doubtful Debts to be created @ 7.5%.

(d) Equity Shareholders of Beta Ltd. will be issued Equity Shares of Alex Ltd. @ 5% premium.

You are required to:

(a) Prepare necessary Ledger Accounts to close the books of Beta Ltd.

(b) Show the acquisition entries in the books of Alex Ltd.

(c) Also draft the Balance Sheet after absorption as at 31st March, 2017.

Internal Reconstruction of a Company

10. The summarized balance sheet of Z Limited as on 31st March, 2017 is as under:

Liabilities	**Amount in ₹**
Share Capital:	
5,00,000 Equity shares of ₹ 10 each fully paid up	50,00,000
9%, 20,000 Preference shares of ₹ 100 each fully paid up	20,00,000
Reserves and Surplus:	
Profit and Loss Account	(14,60,000)
Non-Current Liabilities:	
10% Secured Debentures	16,00,000
Current Liabilities:	
Interest due on Debentures	1,60,000
Trade Payables	5,00,000
Loan from Directors	1,00,000
Bank Overdraft	1,00,000
Provision for Tax	1,00,000
Total	**81,00,000**

Assets:	
Non-Current Assets:	
Fixed Assets:	
(a) Tangible Assets:	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000
(b) Intangible Assets:	
Goodwill	10,00,000
Patents	5,00,000
Current Assets:	
Trade Investments	5,00,000
Trade Receivables	5,00,000
Inventory	10,00,000
Discount on issue of debentures	1,00,000
Total	**81,00,000**

Note: Preference dividend is in arrears for last 2 years.

Mr. Y holds 60% of debentures and Mr. Z holds 40% of debentures. Moreover ₹ 1,00,000 and ₹ 60,000 were also payable to Mr. Y and Mr. Z respectively as trade payable.

The following scheme of reconstruction has been agreed upon and duly approved.

(i) All the equity shares to be converted into fully paid equity shares of ₹ 5.00 each.

(ii) The Preference shares be reduced to ₹ 50 each and the preference shareholders agreed to forego their arrears of preference dividends, in consideration of which 9% preference shares are to be converted into 10% preference shares.

(iii) Mr. Y and Mr. Z agreed to cancel 50% each of their respective total debt including interest on debentures. Mr. Y and Mr. Z also agreed to pay ₹ 1,00,000 and ₹ 60,000 respectively in cash and to receive new 12% debentures for the balance amount.

(iv) Persons relating to trade payables, other than Mr. Y and Mr. Z also agreed to forgo their 50% claims.

(v) Directors also waived 60% of their loans and accepted equity shares for the balance.

(vi) Capital commitments of ₹ 3.00 lacs were cancelled on payment of ₹ 15,000 as penalty.

(vii) Directors refunded ₹ 1,00,000 of the fees previously received by them.

(viii) Reconstruction expenses paid ₹ 15,000.

(ix) The taxation liability of the company was settled for ₹ 75,000 and was paid immediately.

(x) The Assets were revalued as under:

Land and Building	32,00,000
Plant and Machinery	6,00,000
Inventory	7,50,000
Trade Receivables	4,00,000
Furniture and Fixtures	1,50,000
Trade Investments	4,50,000

You are required to pass journal entries for all the above-mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit and Loss account arid Discount on issue of debentures. And also, prepare Bank Account and Reconstruction Account.

Liquidation of Company

11. Liquidation of YZ Ltd. commenced on 2nd April, 2018. Certain creditors could not receive payments out of the realisation of assets and out of the contributions from A list contributories. The following are the details of certain transfers which took place in 2017and 2018:

Shareholders	No. of Shares transferred	Date of Ceasing to be a member	Creditors remaining unpaid and outstanding on the date of such transfer
A	2,000	1st March, 2017	₹ 5,000
P	1,500	1st May, 2017	₹ 3,300
Q	1,000	1st October, 2017	₹ 4,300
R	500	1st November, 2017	₹ 4,600
S	300	1st February, 2018	₹ 6,000

All the shares were of ₹ 10 each, ₹ 8 per share paid up. Show the amount to be realised from the various persons listed above ignoring expenses and remuneration to liquidator etc.

Financial Statements of Insurance Companies

12. From the following information furnished to you by Bharat Insurance Co. Ltd., you are required to pass Journal entries relating to unexpired risk reserve and show in columnar form "Unexpired Risks Reserve Account" for 2017.

(a) On 1.04.2016, it had reserve for unexpired risks amounting to ₹ 55 crores. It comprised of ₹ 21 crores in respect of marine insurance business, ₹ 28 crores in respect of fire insurance business and ₹ 6 crores in respect of miscellaneous insurance business.

(b) Bharat Insurance Co. Ltd. creates reserves at 100% of net premium income in respect of marine insurance policies and at 50% of net premium income in respect of fire and miscellaneous income policies.

(c) During 2016-17, the following business was conducted:

	(₹ in crores)		
	Marine	Fire	Miscellaneous
Premium collected from:			
(a) Insured in respect of policies issued (Direct Business)	22.0	46.00	13.00
(b) Other insurance companies in respect of risks undertaken:			
Received during the year	11.5	9.2	5.5
Receivable – 01.04.16	7.0	3.0	1.5
Receivable – 31.03.17	4.0	1.0	1.0
Premium paid/payable to other insurance companies on business ceded	7.5	5.3	8.0

Financial Statements of Banking Companies

13. From the following information, calculate the amount of Provisions and Contingencies and prepare Profit and Loss Account of 'Supreme Bank Limited' for the year ending 31st March, 2018:

Income	₹ in lakhs	**Expenditure**	₹ in lakhs
Interest and discount	1,835	Interest expended	1,136
Interest accrued on Investments	8	Printing & stationery	18
Commission, exchange and brokerage	12	Repair & maintenance	2
Profit on sale of investments	1	Payment to and provision for employees (salaries, bonus etc.)	80
Rent received	2	Other Operating Expenses	5

Additional Information:

		₹ in lakhs
(i)	Rebate on bills discounted to be provided for	3
(ii)	Classifications of Advances:	
	Standard Assets	4,100
	Sub-Standard Assets (fully secured)	380
	Doubtful Assets not covered by security	155
	Doubtful Assets covered by security	
	For 1 year	10
	More than 1 year, but less than 2 years	18
	More than 2 years, but less than 3 years	35
	More than 3 years	22
	Loss Assets	50
(iii)	Make tax provisions @ 35% of the profit.	
(iv)	Profit and Loss Account (Cr.) brought forward from the previous year	65

Departmental Accounts

14. The following balances were extracted from the books of M/s Division. You are required to prepare Departmental Trading Account and Profit and Loss account for the year ended 31st December, 2017 after adjusting the unrealized department profits if any.

	Deptt. A ₹	*Deptt. B* ₹
Opening Stock	50,000	40,000
Purchases	6,50,000	9,10,000
Sales	10,00,000	15,00,000

General expenses incurred for both the departments were ₹ 1,25,000 and you are also supplied with the following information: (a) Closing stock of Department A ₹ 1,00,000 including goods from Department B for ₹ 20,000 at cost of Department A. (b) Closing stock of Department B ₹ 2,00,000 including goods from Department A for ₹ 30,000 at cost to Department B. (c) Opening stock of Department A and Department B include goods of the value of ₹ 10,000 and ₹ 15,000 taken from Department B and Department A respectively at cost to transferee departments. (d) The rate of gross profit is uniform from year to year.

Branch Accounting

15. Pass necessary Journal entries in the books of an independent Branch of M/s TPL Sons, wherever required, to rectify or adjust the following transactions:

(i) Branch paid ₹ 5,000 as salary to a Head Office Manager, but the amount paid has been debited by the Branch to Salaries Account.

(ii) A remittance of ₹ 1,50,000 sent by the Branch has not received by Head Office on the date of reconciliation of Accounts.

(iii) Branch assets accounts retained at head office, depreciation charged for the year ₹ 15,000 not recorded by Branch.

(iv) Head Office expenses ₹ 75,000 allocated to the Branch, but not yet been recorded by the Branch.

(v) Head Office collected ₹ 60,000 directly from a Branch Customer. The intimation of the fact has not been received by the Branch.

(vi) Goods dispatched by the Head office amounting to ₹ 50,000, but not received by the Branch till date of reconciliation.

(vii) Branch incurred advertisement expenses of ₹ 10,000 on behalf of other Branches, but not recorded in the books of Branch.

(viii) Head office made payment of ₹ 16,000 for purchase of goods by branch, but not recorded in branch books.

Framework for Preparation and Presentation of Financial Statements

16. (a) Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss.

(b) Mohan started a business on 1st April 2017 with ₹ 12,00,000 represented by 60,000 units of ₹ 20 each. During the financial year ending on 31st March, 2018, he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Mohan in the year 2017-18 if Financial Capital is maintained at historical cost.

Accounting Standards

AS 4 Contingencies and Events Occurring after the Balance Sheet Date

17. (a) While preparing its final accounts for the year ended 31st March, 2017, a company made provision for bad debts @ 5% of its total debtors. In the last week of February, 2017 a debtor for ₹ 20 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April, 2017 the debtor became a bankrupt. Can the company provide for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March, 2017? You are required to comment with reference to AS 4.

AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Polices

(b) The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2017. Please advise him in the following situations in accordance with the provisions of AS 5;

(i) Provision for doubtful debts was created @ 2% till 31st March, 2016. From the Financial year 2016-2017, the rate of provision has been changed to 3%.

(ii) During the year ended 31st March, 2017, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.

(iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.

(iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

(v) During the year ended 31st March, 2017, there was change in cost formula in measuring the cost of inventories.

AS 12 Government Grants

18\. (a) A specific government grant of ₹ 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Diary plant of ₹ 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 10.50 lakhs and written down value of plant was ₹ 66.50 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2014-15 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2017?

AS 16 Borrowing Costs

(b) Superbright Ltd. issued 10% secured debentures of ₹ 25 Lakhs on 30.06.2016. These debentures have floating charge on fixed assets. Money raised from debentures to be utilized as under:

Particulars	Amount (₹ in lakhs)
Construction of factory building	8
Purchase of Machinery	10
Working Capital	7

Additional information

(i) Interest on debentures for the year 2016-17 was paid by the company.

(ii) In March 2017, machinery was installed and ready for its intended use.

(iii) During the year the company had invested idle fund of ₹4 lakhs (out of money raised from debentures) in banks' fixed deposit and had earned an interest of ₹ 24,000.

(iv) Construction of the factory building was completed after July 2017.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

AS 19 Leases

19. (a) ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being ₹ 10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays ₹ 3,50,000. The lessee has guaranteed a residual value of ₹ 40,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the residential value of the machinery will be ₹ 35,000 only. The implicit rate of return is 16% and PV factors at 16% for year 1, year 2, year 3 and year 4 are 0.8621, 0.7432, 0.6407 and 0.5523 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year.

AS 20 Earnings Per Share

(b) The following information is available for TON Ltd. for the accounting year 2015-16 and 2016-17:

Net profit for		₹
Year	2015-16	35,00,000
Year	2016-17	45,00,000

No of shares outstanding prior to right issue 15,00,000 shares.

Right issue : One new share for each 3 shares outstanding i.e. 5,00,000 shares.

: Right Issue price ₹ 25

: Last date to exercise right 31st July, 2016

Fair value of one equity share immediately prior to exercise of rights on 31.07.2016 is ₹ 35.

You are required to compute:

(i) Basic earnings per share for the year 2015-16.

(ii) Restated basic earnings per share for the year 2015-16 for right issue.

(iii) Basic earnings per share for the year 2016-17.

AS 26 Intangible Assets

20 (a) Desire Ltd. acquired a patent at a cost of ₹ 1,00,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset on SLM. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be ₹ 45,00,000, ₹ 42,00,000, ₹ 40,00,000, ₹ 38,00,000 and ₹ 35,00,000. Patent is renewable and company changed amortization method from 3rd year (i.e. from SLM to ratio of expected new cash flows).

You are required to compute the amortization cost of the patent for each of the years. (1st year to 7th year)

AS 29 Provisions, Contingent Liabilities and Contingent Assets

(b) M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 lakhs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29? Explain in brief giving reasons for your answer.

SUGGESTED ANSWERS

1. Statement showing distribution of cash amongst the partners

		Trade Payable	*B's Loan*	*A (₹)*	*B (₹)*	*C (₹)*
Balance Due Including 1st Instalment amount with the firm		1,32,000	36,000	1,20,000	80,000	1,00,000

₹ (2,200 + 1,49,200)	1,51,400					
Less: Dissolution expenses provided for	(24,000)					
	1,27,400					
Less: C's remuneration of 1% on assets realized (1,49,200 x 1%)	(1,492)					
	1,25,908					
Less: Payment made to Trade Payables	1,25,908	1,25,908				
Balance due	NIL	6,092				
2nd instalment realised	1,38,602					
Less: C's remuneration of 1% on assets realized (1,38,602 x 1%)	(1,386) 1,37,216					
Less: Payment made to Trade Payables	(1,292)	(1,292)				
Transferred to P& L A/c		4,800				
	1,35,924					
Less: Payment for B's loan A/c	(36,000)		36,000			
Amount available for distribution to partners	99,924		NIL			
Less: C's remuneration of 10% of the amount distributed	(9,084)					

to partners (99,924 x 10/110)						
Balance to be distributed to partners on the basis of HRCM	90,840					
Less: Paid to C (W.N.)	(4,000)					(4,000)
	86,840					96,000
Less: Paid to A and C in 5:4 (W.N.)	(36,000)			(20,000)	____	(16,000)
Balance due	50,840			1,00,000	80,000	80,000
Less: Paid to A, B & C in 5:4:4	50,840			(19,554)	15,643	(15,643)
	Nil					
Amount of 3rd instalment	80,000			80,446	64,357	64,357
Less: C's remuneration of 1% on assets realized (80,000 x 1%)	(800)					
	79,200					
Less: C's remuneration of 10% of the amount distributed to partners (79,200 x 10/110)	(7,200)					
	72,000					
Less: Paid to A,B, C in 5:4:4 for (W.N.)	(72,000)			(27,692)	22,154	(22154)
	nil			52,754	42,203	42203
Amount of 4th and last instalment	56,000					

Less: C's remuneration of 1% on assets realized (56,000 x 1%)	(560)					
	55,440					
Less: C's remuneration of 10% of the amount distributed to partners (55,440 x 10/110)	(5,040)					
Less: Paid to A, B and C in 5:4:4	50,400					
	Nil			(19,384)	15,508	(15508)
Loss suffered by partners				33,370	26,695	26695

Working Note:

(i) ₹ 2,200 added to the first instalment received on sale of assets represents the Cash in Bank

(ii) The amount due to Creditors at the end of the utilization of First Instalment is ₹ 6,092. However, since the creditors were settled for ₹ 1,27,200 only the balance ₹ 1,292 were paid and the balance ₹ 4,800 was transferred to the Profit & Loss Account.

(iii) **Highest Relative Capital Basis**

	A ₹	*B* ₹	*C* ₹
Balance of Capital Accounts (1)	1,20,000	80,000	1,00,000
Profit sharing ratio	5	4	4
Capital Profit sharing ratio	24,000	20,000	25,000
Capital in profit sharing ratio taking B's Capital as base (2)	1,00,000	80,000	80,000
Excess of A's Capital and C's Capital 1-2) = (3)	20,000	nil	20,000
Again repeating the process			
Profit sharing ratio	5		4
Capital Profit sharing ratio	4,000		5,000

Capital in profit sharing ratio taking A's Capital as base (4)	20,000		16,000
Excess of C's Capital (3-4)=(5)	nil		4,000

Therefore, firstly ₹4,000 is to be paid to C, then A and C to be paid in proportion of 5:4 up to ₹ 36,000 to bring the capital of all partners A, B and C in proportion to their profit sharing ratio. Thereafter, balance available will be paid in the profit sharing ratio 5:4:4 to all partners viz A, B and C.

2. **Balance Sheet of M/s PQR & Co. as at 31st March, 2018**

Liabilities		₹	*Assets*		₹
Capitals:			Building		
P	6,41,000		(1,50,000 + 60,000)		2,10,000
Q	4,27,333		Plant & machinery (2,75,000+2,50,000)		5,25,000
R	2,13,667	12,82,000	Office equipment (50,000+46,000)		96,000
Sundry creditors (1,30,000+1,36,000)		2,66,000	Stock-in-trade (1,44,000+1,68,000)		3,12,000
Bank overdraft		80,000	Sundry debtors (1,60,000+2,00,000)	3,60,000	
			Less: Provision for doubtful debts (15,000 +30,000)	(45,000)	3,15,000
			Bank balance (40,000+1,00,000)		1,40,000
			Cash in hand		30,000*
		16,28,000			16,28,000

In the books of P & Co.
Partners' Capital Accounts

	Particulars	*P* ₹	*Q* ₹		*Particulars*	*P* ₹	*Q* ₹
To	Capital A/cs M/s PQR & Co.	5,53,000	2,81,000	By	Balance b/d	2,50,000	1,80,000
				By	Reserve (3:1)	45,000	15,000

* ₹ 20,000+ 10,000+ 1,78,000+ 27,667– 2,05,667= ₹ 30,000.

			By Profit on Realisation A/c (W.N.3)	2,58,000	86,000
	5,53,000	2,81,000		5,53,000	2,81,000

In the books of R & Co.

Partners' Capital Accounts

	Particulars	Q ₹	R ₹		*Particulars* ₹	Q ₹	R ₹
To	Capital A/cs – M/s PQR & Co.	4,12,000	2,16,000	By	Balance b/d	2,20,000	1,20,000
				By	Reserve (2:1)	1,00,000	50,000
				By	Profit on Realisation (W.N.4)	92,000	46,000
		4,12,000	2,16,000			4,12,000	2,16,000

Working Notes:

1. **Computation of purchase considerations**

	P & Co. ₹	*R & Co.* ₹
Assets:		
Goodwill	1,20,000	60,000
Building	1,50,000	60,000
Plant & machinery	2,75,000	2,50,000
Office equipment	50,000	46,000
Stock-in-trade	1,44,000	1,68,000
Sundry debtors	1,60,000	2,00,000
Bank balance	40,000	1,00,000
Cash in hand	20,000	10,000
Due from R & Co.	1,00,000	-
(A)	10,59,000	8,94,000
Liabilities:		
Creditors	1,30,000	1,36,000
Provision for doubtful debts	15,000	30,000
Due to P & Co.	-	1,00,000

Bank overdraft	80,000	-
(B)	2,25,000	2,66,000
Purchase consideration (A-B)	8,34,000	6,28,000

2. **Computation of Capital Adjustments**

	P	*Q*	*R*	*Total*
	₹	₹	₹	₹
Balance transferred from P & Co.	5,53,000	2,81,000		8,34,000
Balance transferred from R & Co.		4,12,000	2,16,000	6,28,000
	5,53,000	6,93,000	2,16,000	14,62,000
Less: Goodwill written off in the ratio of 3:2:1	(90,000)	(60,000)	(30,000)	(1,80,000)
Existing capital	4,63,000	6,33,000	1,86,000	12,82,000
Proportionate capital (3:2:1)	6,41,000	4,27,333	2,13,667	12,82,000
Amount to be brought in (paid off)	1,78,000	(2,05,667)	27,667	

3. **In the books of P & Co.**

Realisation Account

	₹		₹
To Building	50,000	By Creditors	1,30,000
To Plant & machinery	1,60,000	By Bank overdraft	80,000
To Office equipment	50,000	By M/s PQR & Co.	8,34,000
To Stock-in-trade	1,20,000	(purchase consideration)	
To Sundry debtors	1,60,000	(W.N.1)	
To Bank balance	40,000		
To Cash in hand	20,000		
To Due from R & Co.	1,00,000		
To Partners' capital A/cs			
P 2,58,000			
Q 86,000	3,44,000		
	10,44,000		10,44,000

4. **In the books of R & Co.**

Realisation Account

	₹		₹
To Building	60,000	By Creditors	1,36,000
To Plant & machinery	1,70,000	By Due to P & Co.	1,00,000
To Office equipment	46,000	By M/s PQR & Co. (purchase consideration) (W.N.1)	6,28,000
To Stock-in-trade	1,40,000		
To Sundry debtors	2,00,000		
To Bank balance	1,00,000		
To Cash in hand	10,000		
To Partners' capital A/cs			
Q 92,000			
R 46,000	1,38,000		
	8,64,000		8,64,000

Note:

The adjustments in the Capital Accounts of P, Q and R (both for Goodwill and the amounts paid to Q by P and R) can also be shown in their Capital Accounts in the Books of P & Co. and R & Co respectively. In such a case, the Capital Accounts of the partners carried to PQR & Co will be the same amounts as shown in the Balance Sheet of PQR & Co.

3. (a) Balance Sheet of the Firm as at 30.6.2018

Liabilities	₹	₹	*Assets*	₹	₹
Capital Accounts:			Machinery	3,60,000	
Ali balance as on 1.1.2018	2,80,800		*Less*: Depreciation		
Add: Profit for 6 months	28,320		@10% p.a. for 6 months	(18,000)	3,42,000
	3,09,120		Leasehold premises	81,600	
Less: Drawings for 6 months	(14,160)	2,94,960	*Less*: Written-off @ 5%		
Beta balance as on 1.1.2018	2,66,400		for 6 months	(4,080)	77,520
Add: Profit for 6 months	28,320		Stock		1,80,000
	2,94,720		Sundry Debtors		1,44,000
Less: Drawings for 6 months	(14,160)	2,80,560			
Sundry Creditors (1,44,000 – 24,000)		1,20,000			
Bank overdraft (84,000 – 36,000)		48,000			
		7,43,520			7,43,520

(b) Realization Account

	Particulars	₹		*Particulars*	₹
To	Machinery A/c	3,42,000	By	Sundry Creditors A/c	1,20,000
To	Leasehold Premises A/c	77,520	By	Bank Overdraft A/c	48,000
To	Stock A/c	1,80,000	By	Purchasing Company A/c (W.N.1)	8,15,520
To	Sundry Debtors A/c	1,44,000			
To	Ali Capital A/c	1,20,000			
To	Beta Capital A/c	1,20,000			
		9,83,520			9,83,520

(c) Partners' Capital Accounts

Date	*Particulars*	*Ali*	*Beta*	*Date*	*Particulars*	*Ali*	*Beta*
		₹	₹			₹	₹
1.1.18	To Profit & Loss A/c	31,200	31,200	1.1.18	By Balance b/d	3,36,000	3,12,000
	To Drawings A/c	24,000	14,400				
29.6.18	Balance c/d	2,80,800	2,66,400				
		3,36,000	3,12,000			3,36,000	3,12,000
30.6.18	To Drawings A/c	14,160	14,160	30.6.18	By Balance b/d	2,80,800	2,66,400
	To Shares in Purchasing Company A/c	4,14,960	4,00,560	30.6.18	By Profit & Loss Appropriation A/c	28,320	28,320
					By Realization A/c	1,20,000	1,20,000
		4,29,120	4,14,720			4,29,120	4,14,720

Working Notes:

(1) Ascertainment of purchase consideration

	₹	₹
Assets:		
Stock		1,80,000
Sundry Debtors		1,44,000
Machinery less depreciation		3,42,000
Leasehold premises less written off		77,520
		7,43,520

Less: Liabilities:		
Sundry Creditors	1,20,000	
Bank overdraft	48,000	(1,68,000)
Closing Net Assets		5,75,520
Add: Goodwill		2,40,000
Purchase Consideration		8,15,520

(2) Ascertainment of profit for the 6 month ended 30th June, 2018

	₹	₹
Closing Net Assets		5,75,520
Less: Opening Combined Capital		
Ali – (3,36,000- 31,200-24,000)	2,80,800	
Beta – (3,12,000-31,200-14,400)	2,66,400	5,47,200
Profit after adjustment of Drawings		28,320
Add: Combined drawings during the 6 month (equal to profit)		28,320
Profit for 6 months		56,640

4. **"Designated partner"** means any partner designated as such pursuant to section 7 of the Limited Liability Partnerships (LLPs) Act; 2008. As per section 7 of the LLP Act, every limited Liability Partnership shall have at least 2 designated Partners who are individuals and at least one of them shall be a resident in India.

Provided that in case of Limited Liability Partnership in which all the partners are bodies corporate or in which one or more partners are Individuals and bodies corporate, at least 2 individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners

"Liabilities of designated partners"

As per Section 8 of LLP Act, unless expressly provided otherwise in this Act, a designated partner shall be-

(a) responsible for the doing of all acts, matters and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the limited liability partnership agreement; and;

(b) liable to all penalties imposed on the limited liability partnership for any contravention of those provisions.

5. Journal Entries in the books of JKS Ltd

			₹	₹
15.03.2018	Bank A/c	Dr.	1,08,000	
to 31.3.18	Employee compensation expense A/c	Dr.	72,000	
	To Equity share capital A/c			36,000
	To Securities premium A/c			1,44,000
	(Being shares issued to the employees against the options vested to them in pursuance of Employee Stock Option Plan)			
31.3.18	Profit and Loss A/c	Dr.	72,000	
	To Employee compensation expenses A/c			72,000
	(Being transfer of employee compensation expenses transfer to Profit and Loss Account)			

Working Notes:

1. No entry is passed when stock options are granted to employees. Hence, no entry will be passed on 1st January 2018;
2. Market Price = ₹ 50 per share and stock option price = ₹ 30, Hence, the difference ₹ 50 – ₹ 30 = ₹ 20 per share is equivalent to employee cost or employee compensation expense and will be charged to P&L Account as such for the number of options exercised i.e. 3,600 shares.

6. Journal Entries in the books of Pee Limited

	Particulars		*Dr.*	*Cr.*
(i)	Bank Account	Dr.	25,00,000	
	Profit and Loss Account	Dr.	5,00,000	
	To Investment Account			30,00,000
	(Being the investments sold at loss for the purpose of buy back)			
(ii)	Equity Share capital account	Dr.	4,80,000	
	Premium payable on buy back Account	Dr.	24,00,000	
	To Equity shares buy back Account			28,80,000
	(Being the amount due on buy back)			
(iii)	Securities Premium Account	Dr.	24,00,000	
	To Premium payable on buy back Account			24,00,000

	(Being the premium payable on buy back adjusted against securities premium account)			
(iv)	Revenue Reserve Account	Dr.	1,80,000	
	To Capital Redemption Reserve Account			1,80,000
	(Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account (4,80,000-3,00,000)			
(v)	Equity shares buy-back Account	Dr.	28,80,000	
	To Bank Account			28,80,000
	(Being the payment made on buy back)			

Balance Sheet of Pee Limited as on 1st April, 2017

(After buy back of shares)

Particulars	*Note No*	*(₹)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	22,20,000
(b) Reserves and Surplus	2	68,00,000
(2) Current Liabilities		16,00,000
Total		1,06,20,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets		76,00,000
(2) Current assets		30,20,000
Total		1,06,20,000

Notes to Accounts

			₹
1	**Share Capital**		
	Authorised capital:		30,00,000
	Issued and subscribed capital:		
	1,92,000 Equity shares of ₹ 10 each fully paid up	1,92,0000	
	3,000 10% Preference shares of ₹ 100 each fully paid up	3,00,000	22,20,000
	Reconciliation of share capital		
	Opening no. of shares	2,40,000	

	Buy-back of shares during the year		48,000	1,92,000
	During the year the company has buy back of 48,000 shares			
2	**Reserves and Surplus**			
	Capital reserve		10,00,000	
	Capital redemption reserve		1,80,000	
	Securities Premium	27,00,000		
	Less: Premium payable on buy back of shares	24,00,000	3,00,000	
	Revenue reserve	25,00,000		
	Less: Transfer to Capital redemption reserve	1,80,000	23,20,000	
	Profit and loss A/c	35,00,000		
	Less: Loss on investment	5,00,000	30,00,000	68,00,000

7. **Spices Ltd.**

Balance Sheet as on 01.04.2018

Particulars	Note No.	Figures as at the end of current reporting period
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,10,000
(b) Reserves and Surplus	2	91,000
(2) Non-Current Liabilities		
(a) Long-term borrowings - Unsecured Loans		28,000
(3) Current Liabilities		
(a) Short-term borrowing		19,000
Total		2,48,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets		72,000
(2) Current assets		
(a) Cash and cash equivalents		98,000
(b) Other current assets		78,000
Total		2,48,000

Notes to Accounts

			₹
1	**Share Capital**		
	11,000 Equity Shares of ₹ 10 each		1,10,000
	(Out of these shares, 2,000 shares issued to debentureholders who opted for conversion into Equity shares)		
2	**Reserve and Surplus**		
	General Reserve	38,000	
	Add: Debenture Redemption Reserve transfer	35,000	
		73,000	
	Add: Profit on sale of investments	22,000	
		95,000	
	Less: Premium on redemption of debentures (1,200 x ₹ 5)	(6,000)	89,000
	Securities Premium Account (2,000 x ₹ 1)		2,000
			91,000

Working Notes:

(i) Calculation of number of shares to be allotted ₹

Total number of debentures	1,200
Less : Number of debentures not opting for conversion	(200)
	1,000
40% of 1,000	400
Redemption value of 400 debentures (400 x ₹ 55)	₹ 22,000

Number of Equity Shares to be allotted 22,000/11 = 2,000 shares of ₹ 10 each.

(ii) Calculation of cash to be paid ₹

Number of debentures	1,200
Less: Number of debentures to be converted into equity shares	(400)
	800

Redemption value of 800 debentures (800 × ₹ 55) ₹ 44,000

(iii) Cash and Bank Balance ₹

Balance before redemption	86,000
Add : Proceeds of investments sold	56,000
	1,42,000

Less : Cash paid to debenture holders	(44,000)
	98,000

8. (i) Computation of total liability of underwriters in shares

	(In shares)			
	Amit	Sumit	lalit	*Total*
Gross liability	1,20,000	50,000	30,000	2,00,000
Less: Marked applications (excluding firm underwriting)	(80,000)	(35,000)	(24,800)	(1,39,800)
	40,000	15,000	5,200	60,200
Less: Unmarked applications in the ratio of gross liabilities of 12:5:3 (excluding firm underwriting)	(15,000)	(6,250)	(3,750)	(25,000)
	25,000	8,750	1,450	35,200
Less : Firm underwriting	(10,000)	(6,000)	(4,000)	(20,000)
	15,000	2,750	(2,550)	15,200
Less: Surplus of Lalit adjusted by Amit and Sumit in 12:5	(1,800)	(750)	2,550	____
Net liability	13,200	2,000	-	15,200
Add: Firm underwriting	10,000	6,000	4,000	20,000
Total liability	23,200	8,000	4,000	35,200

(ii) Calculation of amount payable to or due from underwriters

	Amit	*Sumit*	*Lalit*	*Total*
Total Liability in shares	23,200	8,000	4,000	35,200
Amount receivable @ ₹ 30 from underwriter (in ₹)	6,96,000	2,40,000	1,20,000	10,56,000
Less: Underwriting Commission payable @ 5% of ₹ 30 (in ₹)	(1,80,000)	(75,000)	(45,000)	(3,00,000)
Net amount receivable (in ₹)	5,16,000	1,65,000	75,000	7,56,000

(iii) Journal Entries in the books of the company (relating to underwriting)

			₹	₹
1.	Amit	Dr.	6,96,000	
	Sumit	Dr.	2,40,000	
	Lalit	Dr.	1,20,000	

	To Share Capital A/c			3,52,000
	To Securities Premium A/c			7,04,000
	(Being allotment of shares to underwriters)			
2.	Underwriting commission A/c	Dr.	3,00,000	
	To Amit			1,80,000
	To Sumit			75,000
	To Lalit			45,000
	(Being amount of underwriting commission payable)			
3.	Bank A/c	Dr.	7,56,000	
	To Amit			5,16,000
	To Sumit			1,65,000
	To Lalit			75,000
	(Being net amount received by underwriters for shares allotted less underwriting commission)			

9. (a) In the Books of Beta Ltd.

Realisation Account

	₹		₹
To Sundry Assets	15,96,000	By Retirement Gratuity Fund	56,000
To Preference Shareholders (Premium on Redemption)	28,000	By Trade payables	2,24,000
		By Alex Ltd. (Purchase Consideration)	14,84,000
To Equity Shareholders (Profit on Realisation)	1,40,000		
	17,64,000		17,64,000

Equity Shareholders Account

	₹		₹
To Equity Shares of Alex Ltd.	11,76,000	By Share Capital	8,40,000
		By General Reserve	1,96,000
		By Realisation Account (Profit on Realisation)	1,40,000
	11,76,000		11,76,000

Preference Shareholders Account

	₹		₹
To 8% Preference Shares of Alex Ltd.	3,08,000	By Preference Share Capital	2,80,000
		By Realisation Account (Premium on Redemption of Preference Shares)	28,000
	3,08,000		3,08,000

Alex Ltd. Account

	₹		₹
To Realisation Account	14,84,000	By 8% Preference Shares	3,08,000
		By Equity Shares	11,76,000
	14,84,000		14,84,000

(b) In the Books of Alex Ltd.

Journal Entries

		Dr.	Cr.
		₹	₹
Business Purchase A/c	Dr.	14,84,000	
To Liquidators of Beta Ltd. Account			14,84,000
(Being business of Beta Ltd. taken over)			
Goodwill Account	Dr.	1,40,000	
Building Account	Dr.	4,20,000	
Machinery Account	Dr.	4,48,000	
Inventory Account	Dr.	4,41,000	
Trade receivables Account	Dr.	2,80,000	
Bank Account	Dr.	56,000	
To Retirement Gratuity Fund Account			56,000
To Trade payables Account			2,24,000
To Provision for Doubtful Debts Account			21,000
To Business Purchase A/c			14,84,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Beta Ltd. A/c	Dr.	14,84,000	

To 8% Preference Share Capital A/c		3,08,000
To Equity Share Capital A/c		11,20,000
To Securities Premium A/c		56,000
(Being Purchase Consideration satisfied as above).		

(c) Balance Sheet of Alex Ltd. (after absorption)

as at 31st March, 2017

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	A	Share capital	1	45,08,000
	B	Reserves and Surplus	2	2,52,000
2		**Non-current liabilities**		
	A	Long-term provisions		1,96,000
3		**Current liabilities**		
	A	Trade Payables		5,88,000
	B	Short term provision		21,000
		Total		**55,65,000**
		Assets		
1		**Non-current assets**		
	A	Fixed assets		
		Tangible assets	3	31,08,000
		Intangible assets		2,80,000
2		**Current assets**		
	A	Inventories		11,41,000
	B	Trade receivables		8,40,000
	C	Cash and cash equivalents		1,96,000
		Total		**55,65,000**

Notes to accounts

		₹
1	**Share Capital**	
	Equity share capital	
	3,92,000 Equity Shares of ₹ 10 each fully paid (Out of above 1,12,000 Equity Shares were issued in consideration other than for cash)	39,20,000

	Preference share capital	
	5,880 8% Preference Shares of ₹ 100 each (Out of above 3,080 Preference Shares were issued in consideration other than for cash)	5,88,000
	Total	**45,08,000**
2	**Reserves and Surplus**	
	Securities Premium	56,000
	General Reserve	1,96,000
	Total	**2,52,000**
3	**Tangible assets**	
	Buildings	12,60,000
	Machinery	18,48,000
	Total	**31,08,000**

Working Notes:

Purchase Consideration:	₹
Goodwill	1,40,000
Building	4,20,000
Machinery	4,48,000
Inventory	4,41,000
Trade receivables	2,59,000
Cash at Bank	56,000
Less: Liabilities:	
Retirement Gratuity	(56,000)
Trade payables	(2,24,000)
Net Assets/ Purchase Consideration	14,84,000
To be satisfied as under:	
Preference Shareholders of Beta Ltd.	2,80,000
Add: 10% Premium	28,000
Satisfied by issue of 3,080 no. of 8% Preference Shares of Alex Ltd.	3,08,000
Equity Shareholders of Beta Ltd. to be satisfied by issue of 1,12,000	
Equity Shares of Alex Ltd. at 5% Premium	11,76,000
Total	14,84,000

10. Journal Entries in the Books of Z Ltd.

			Dr.	Cr.
			₹	₹
(i)	Equity Share Capital (₹ 10 each) A/c	Dr.	50,00,000	
	To Equity Share Capital (₹ 5 each) A/c			25,00,000
	To Reconstruction A/c			25,00,000
	(Being conversion of 5,00,000 equity shares of ₹ 10 each fully paid into same number of fully paid equity shares of ₹ 5 each as per scheme of reconstruction.)			
(ii)	9% Preference Share Capital (₹ 100 each) A/c	Dr.	20,00,000	
	To 10% Preference Share Capital (₹ 50 each) A/c			10,00,000
	To Reconstruction A/c			10,00,000
	(Being conversion of 9% preference share of ₹ 100 each into same number of 10% preference share of ₹ 50 each and claims of preference dividends settled as per scheme of reconstruction.)			
(iii)	10% Secured Debentures A/c	Dr.	9,60,000	
	Trade payables A/c	Dr.	1,00,000	
	Interest on Debentures Outstanding A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000
	(Being ₹ 11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(iv)	10% Secured Debentures A/c	Dr.	6,40,000	
	Trade Payables		60,000	
	Interest on debentures outstanding A/c		64,000	
	Bank A/c		60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000

	(Being ₹ 7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of their claim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (₹ 5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of ₹ 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of ₹ 3 Lakhs.)			
(viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000
	(Being refund of fees by directors credited to reconstruction A/c.)			
(ix)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of reconstruction expenses.)			
(x)	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			75,000
	To Reconstruction A/c			25,000
	(Being payment of tax liability in full settlement against provision for tax)			
(xi)	Land and Building A/c	Dr.	2,00,000	
	To Reconstruction A/c			2,00,000
	(Being appreciation in value of Land & Building recorded)			

(xii)	Reconstruction A/c	Dr.	49,85,000	
	To Goodwill A/c			10,00,000
	To Patent A/c			5,00,000
	To Profit and Loss A/c			14,60,000
	To Discount on issue of Debentures A/c			1,00,000
	To Plant and Machinery A/c			6,50,000
	To Furniture & Fixture A/c			1,00,000
	To Trade Investment A/c			50,000
	To Inventory A/c			2,50,000
	To Trade Receivables A/c			1,00,000
	To Capital Reserve (bal. fig.)			7,75,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)			

Bank Account

	₹		₹
To Reconstruction (Y)	1,00,000	By Balance b/d	1,00,000
To Reconstruction(Z)	60,000	By Reconstruction A/c	15,000
To Reconstruction A/c (refund of earlier fees by directors)	1,00,000	(capital commitment penalty paid)	
		By Reconstruction A/c (reconstruction expenses paid)	15,000
		By Provision for tax A/c (tax paid)	75,000
		By Balance c/d	55,000
	2,60,000		2,60,000

Reconstruction Account

	₹		₹
To Bank (penalty)	15,000	By Equity Share	
To Bank (reconstruction expenses)	15,000	Capital A/c	25,00,000

To Goodwill	10,00,000	By 9% Pref. Share Capital A/c	10,00,000
To Patent	5,00,000	By Mr. Y (Settlement)	5,78,000
To P & L A/c	14,60,000	By Mr. Z (Settlement)	3,82,000
To Discount on issue of debentures	1,00,000	By Trade Payables A/c	1,70,000
To P & M	6,50,000	By Director's loan	60,000
To Furniture and Fixtures	1,00,000	By Bank	1,00,000
To Trade investment	50,000	By Provision for tax	25,000
To Inventory	2,50,000	By Land and Building	2,00,000
To Trade Receivables	1,00,000		
To Capital Reserve (bal. fig.)	7,75,000		
	50,15,000		50,15,000

11. Statement of liabilities of B list contributories

Share-holders	*No. of shares transferred*	*Maximum liability (upto ₹ 2 per share)*	*Division of Liability as on*				
			1.5. 2017	*1.10. 2017*	*1.11. 2017*	*1.2. 2018*	*Total*
		₹	₹	₹	₹	₹	₹
P	1,500	3,000	1,500	–	–	–	1,500
Q	1,000	2,000	1,000	555	–	–	1,555
R	500	1,000	500	278	188	–	966
S	300	600	300	167	112	21	600
	3,300	6,600	3,300	1,000	300	21	4,621

Working Note:

Date	*Cumulative liability*	*Increase in liability*	*Ratio of no. of shares held by the members*
1.5.2017	3,300	–	30 : 20 : 10 : 6
1.10.2017	4,300	1,000	20 : 10 : 6
1.11.2017	4,600	300	10 : 6
1.2.2018	6,000	1,400	Only S

Liability of S has been restricted to the maximum allowable limit of ₹ 600, therefore amount payable by S is restricted to ₹ 21 only, on 1.2.2018.

Notes:

1. A will not be liable to pay to the outstanding creditors since he transferred his shares prior to one year preceding the date of winding up.
2. P will not be responsible for further debts incurred after 1st May, 2017 (from the date when he ceases to be member). Similarly, Q and R will not be responsible for the debts incurred after the date of their transfer of shares.

12. In the books of Bharat Insurance Co. Ltd.

Journal Entries

Date	*Particulars*		*(₹ in crores)*	
			Dr.	*Cr.*
1.4.2016	Unexpired Risk Reserve (Fire) A/c	Dr.	28	
	Unexpired Risk Reserve (Marine) A/c	Dr.	21	
	Unexpired Risk Reserve (Miscellaneous) A/c	Dr.	6	
	To Fire Revenue Account			28
	To Marine Revenue Account			21
	To Miscellaneous Revenue Account			6
	(Being unexpired risk reserve brought forward from last year)			
31.03.2017	Marine Revenue A/c	Dr.	23	
	To Unexpired Risk Reserve A/c			23
	(Being closing reserve for unexpired risk created at 100% of net premium income amounting to ₹23 crores i.e.22+8.5-7.5)			
	Fire Revenue A/c	Dr.	23.95	
	To Unexpired Risk Reserve A/c			23.95
	(Being closing reserve for unexpired risk created at 50% of net premium income of ₹ 47.90 crores i.e.46+7.2-5.3)			
	Miscellaneous Revenue A/c	Dr.	5	
	To Unexpired Risk Reserve A/c			5
	(Being closing reserve for unexpired risk created at 50% net premium income of ₹10 crores i.e. 13+5-8)			

Unexpired Risk Reserve Account

Date		Particulars	Marine	Fire (₹)	Misc. (₹)	Date		Particulars	Marine (₹)	Fire (₹)	Misc. (₹)
1.4.2016	To	Revenue A/c	21	28	6	1.4.2016	By	Balance b/d	21	28	6
31.3.2017	To	Balance c/d	23	23.95	5	31.3.2017	By	Revenue A/c	23	23.95	5
			44	51.95	11				44	51.95	11

Working Note:

Premium from other insurance companies in respect of risk undertaken:

Received during the year	11.5	9.2	5.5
Less: Receivable – 01.04.16	(7.0)	(3.0)	(1.5)
Add: Receivable – 31.03.17	4.0	1.0	1.0
	8.5	*7.2*	*5.0*

13. (a) Calculation of Provisions and Contingencies

(i) **Provision on Non-Performing Assets**

			₹*in lakhs*
Particulars	*Amount*	*% of Provision*	*Provision*
Standard Assets	4,100	0.4	16.40
Sub-standard Assets	380	15	57
Doubtful Assets not covered by security	155	100	155
Doubtful Assets covered by security:			
For 1 year	10	25	2.50
More than 1 year, but less than 2 years	18	40	7.20
More than 2 years, but less than 3 years	35	40	14
More than 3 years	22	100	22
Loss Assets	50	100	50
	4,770		324.10

(ii) Calculation of Provision for tax = 35% of [Total Income – Total Expenditure (excluding tax)]

= 35% of [(1,840 +15) – (1,136+105+324.10)] = ₹ 101.47 lakhs

Total Provisions and contingencies = Provisions on NPAs + Provisions for tax

= 324.10 + 101.47 = ₹ 425.57 lakhs

(b) **Supreme Bank Limited**

Profit and Loss Account for the year ended 31st March, 2018

	Particulars	*Schedule No.*	*₹ in lakhs*
I	**Income**		
	Interest Earned	13	1,840
	Other Income	14	15
			1,855
II	**Expenditures**		
	Interest Expended		1,136
	Operating Expenses	16	1,05
	Provisions & Contingencies		425.57
			1,666.57
III	**Profit/Loss**		
	Net Profit/Loss for the year		188.43
	Profit/Loss brought forward		65
			253.43
IV	**Appropriations**		
	Transfer to Statutory Reserve @ 25% of 188.43		47.11
	Transfer to Other Reserves		-
	Balance carried over to Balance Sheet		206.32
			253.43
	Schedule 13 – Interest earned		
I	Interest & Discount (1,835 – 3)		1,832
II	Interest on Investments		8
			1,840
	Schedule 14- other income		
	Commission, exchange and brokerage		12
	Profit on sale of investments		1
	Rent received		2
			15

Schedule 16- Operating Expenses	
Printing & stationery	18
Repair & maintenance	2
Payment to and provision for employees (salaries, bonus etc.)	80
Other Operating Expenses	5
	105

14. **Departmental Trading and Profit and Loss Account of M/s Division**

For the year ended 31st December, 2017

	Deptt. A	*Deptt. B*		*Deptt. A*	*Deptt. B*
	₹	₹		₹	₹
To Opening stock	50,000	40,000	By Sales	10,00,000	15,00,000
To Purchases	6,50,000	9,10,000	By Closing stock	1,00,000	2,00,000
To Gross profit	4,00,000	7,50,000			
	11,00,000	17,00,000		11,00,000	17,00,000
To General Expenses (in ratio of sales)	50,000	75,000	By Gross profit	4,00,000	7,50,000
To Profit ts/f to general profit and loss account	3,50,000	6,75,000			
	4,00,000	7,50,000		4,00,000	7,50,000

General Profit and Loss Account

	₹		₹
To Stock reserve required (additional:		By Profit from:	
Stock in Deptt. A		Deptt. A	3,50,000
50% of (₹ 20,000 - ₹ 10,000) (W.N.1)	5,000	Deptt. B	6,75,000
Stock in Deptt. B			
40% of (₹ 30,000 - ₹ 15,000) (W.N.2)	6,000		
To Net Profit	10,14,000		
	10,25,000		10,25,000

Working Notes:

1. Stock of department A will be adjusted according to the gross profit rate applicable to department B = [(7,50,000 ÷ 15,00,000) x 100] = 50%

2. Stock of department B will be adjusted according to the gross profit rate applicable to department A = [(4,00,000 ÷ 10,00,000) x 100] = 40%

15. Books of Branch

Journal Entries

			Amounts ₹	
			Dr.	*Cr.*
(i)	Head Office Account	Dr.	5,000	
	To Salaries Account			5,000
	(Being rectification of salary paid on behalf of Head Office)			
(ii)	No entry in Branch Books is required.			
(iii)	Depreciation A/c	Dr.	15,000	
	To Head Office Account			15,000
	(Being depreciation of assets accounted for)			
(iv)	Expenses Account	Dr.	75,000	
	To Head Office Account			75,000
	(Being allocated expenses of Head Office recorded)			
(v)	Head Office Account	Dr.	60,000	
	To Debtors Account			60,000
	(Being adjustment entry for collection from Branch Debtors directly by Head Office)			
(vi)	Goods –in- transit Account	Dr.	50,000	
	To Head Office Account			50,000
	(Being goods sent by Head Office still in-transit)			
(vii)	Head Office Account	Dr.	10,000	
	To expenses Account			10,000
	(Being expenditure incurred, wrongly recorded in books)			
(vii)	Purchases account A/c	Dr.	16,000	
	To Head Office Account			16,000
	(Being purchases booked)			

16. (a) The Framework for Recognition and Presentation of Financial statements recognizes four alternative measurement bases for the purpose of determining the value at which an element can be recognized in the balance sheet or statement of profit and loss. These bases are: (i)Historical Cost; (ii)Current cost (iii) Realizable (Settlement) Value and (iv) Present Value.

A brief explanation of each measurement basis is as follows:

1. <u>Historical Cost</u>: Historical cost means acquisition price. According to this, assets

are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition. Liabilities are generally recorded at the amount of proceeds received in exchange for the obligation.

2. Current Cost: Current cost gives an alternative measurement basis. Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

3. Realizable (Settlement) Value: As per realizable value, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the assets in *an orderly disposal*. Liabilities are carried at their settlement values; i.e. the undiscounted amount of cash or cash equivalents paid to satisfy the liabilities in the normal course of business.

4. Present Value: Under present value convention, assets are carried at present value of future net cash flows generated by the concerned assets in the normal course of business. Liabilities under this convention are carried at present value of future net cash flows that are expected to be required to settle the liability in the normal course of business.

(b)

Particulars	*Financial Capital Maintenance at Historical Cost (₹)*
Closing equity (₹ 30 x 60,000 units)	18,00,000 represented by cash
Opening equity	60,000 units x ₹ 20 = 12,00,000
Permissible drawings to keep Capital intact	6,00,000 (18,00,000 – 12,00,000)

Thus, in order to maintain the capital intact, Mohan can withdraw ₹ 6,00,000 as the maximum amount.

17. (a) As per AS 4 'Contingencies and Events Occurring After the Balance Sheet Date', adjustment to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

A debtor for ₹ 20,00,000 suffered heavy loss due to earthquake in the last week of February, 2017 which was not covered by insurance. This information with its implications was already known to the company. The fact that he became bankrupt in April, 2017 (after the balance sheet date) is only an additional information related to the condition existing on the balance sheet date.

Accordingly, full provision for bad debts amounting ₹ 20,00,000 should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2017. Since the company has already made 5% provision of its total debtors, additional provision amounting ₹ 19,00,000 should be made (20,00,000 x 95%) in the books for the year ended 31st March, 2017.

(b) (i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2016. Subsequently in 2016-17, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.

(ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in an accounting policy.

(iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.

(iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.

(v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.

18. (a) As per para 21 of AS 12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is ₹ 15 lakhs and balance in deferred income is ₹ 10.50 lakhs, ₹ 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2014-15 then, AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 15 lakhs. The increased cost of ₹ 15 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2017-18 shall be (56+15)/7 years = ₹ 10.14 lakhs presuming the depreciation is charged on SLM.

(b) According to AS 16 "Borrowing Costs", borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

Also AS 16 "Borrowing Costs" states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Total interest on debentures for the financial year ended 31.03.2017 was 1,87,500 (₹ 25 lakh x 10% x 9/12)

Total interest earned on FD was 24,000

Thus, eligible borrowing cost

= ₹ 1,87,500 – ₹ 24,000

= ₹ 1,63,500

Sr. No.	*Particulars*	*Nature of assets*	*Interest to be Capitalized (₹)*	*Interest to be charged to Profit & Loss Account (₹)*
i	Construction of factory building	Qualifying Asset*	1,63,500x8/25 = ₹ 52,320	NIL
ii	Purchase of Machinery	Not a Qualifying Asset	NIL	1,63,500 x 10/25 = ₹ 65,400
iii	Working Capital	Not a Qualifying Asset	NIL	1,63,500 x7/25 = ₹ 45,780
	Total		₹ 52,320	₹ 1,11,680

*A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

19. (a) As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

Value of machinery

In the given case, fair value of the machinery is ₹ 10, 00,000 and the net present value of minimum lease payments is ₹ 10,01,497 (Refer working Note). As the present value of the machine is more than the fair value of the machine, the machine and the corresponding liability will be recorded at fair value of ₹ 10,00,000.

Calculation of finance charges for each year

Year	*Finance charge (₹)*	*Payment (₹)*	*Reduction in outstanding liability (₹)*	*Outstanding liability (₹)*
1st year beginning	-	-	-	10,00,000
End of 1st year	1,60,000	3,50,000	1,90,000	8,10,000
End of 2nd year	1,29,600	3,50,000	2,20,400	5,89,600
End of 3rd year	94,336	3,50,000	2,55,664	3,33,936
End of 4th year	53,430	3,50,000	2,96,570	37,366*

Working Note:

Present value of minimum lease payments

Annual lease rental x PV factor ₹ 3,50,000 x (0.8621 + 0.7432 + 0.6407+ 0.5523)	₹ 9,79 ,405
Present value of guaranteed residual value ₹ 40,000 x (0.5523)	₹ 22,092
	₹ 10,01,497

(b) Computation of Basic Earnings per Share

		Year 2015-16 (₹)	*Year 2016-17 (₹)*
(i)	EPS for the year 2015-16 as originally reported = Net profit for the year attributable to equity share holder / weighted average number of equity shares outstanding during the year ₹ 35,00,000/ 15,00,000 shares	2.33	

* *The difference between this figure and guaranteed residual value is due to rounding off.*

(ii)	EPS for the year 2015-16 restated for the right issue ₹ 35,00,000/15,00,0000 shares x 1.08	2.16	
(iii)	EPS for the year 2016-17 (including effect of right issue) ₹ 45,00,000/[(15,00,000 x 1.08x4/12)+(20,00,000 x 8/12)]		2.40

Working Notes:

1. Computation of theoretical ex-rights fair value per share =

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights+total amount received from exercise}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

[(₹ 35 x15,00,000) + (₹ 25 x 5,00,000)] / (15,00,000 + 5,00,000) = ₹ 32.5

2. Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}}$$

= ₹ *35 /32.50* = 1.08 (approx.)

20. (a) Desire Limited amortised ₹ 20,00,000 per annum for the first two years i.e. ₹ 40,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	*Net cash flows ₹*	*Amortization Ratio*	*Amortization Amount ₹*
I	-	0.200	20,00,000
II	-	0.200	20,00,000
III	45,00,000	0.225	13,50,000
IV	42,00,000	0.21	12,60,000
V	40,00,000	0.20	12,00,000
VI	38,00,000	0.19	11,40,000
VII	35,00,000	0.175	10,50,000
Total	2,00,00,000	1.000	1,00,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹ 60,00,000 has been amortized in the ratio of net cash flows arising from the product of Desire Ltd.

(b) As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹ 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

PAPER – 6: AUDITING AND ASSURANCE

PART – I : ACADEMIC UPDATE

(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority)

1. Duty to report on Frauds

I. Reporting to the Central Government- As per sub-section (12) of section 143 of the Companies Act, 2013, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.

In this regard, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has been prescribed. Sub-rule (1) of the said rule states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

The manner of reporting the matter to the Central Government is as follows:

(a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;

(b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;

(c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

(d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

(e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and

(f) the report shall be in the form of a statement as specified in Form ADT-4.

II. Reporting to the Audit Committee or Board - Sub-section (12) of section 143 of the Companies Act, 2013 further prescribes that in case of a fraud involving lesser than the specified amount [i.e. less than ₹ 1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

In this regard, sub-rule (3) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that in case of a fraud involving lesser than the amount specified in sub-rule (1) [i.e. less than ₹ 1 crore], the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:

(a) Nature of Fraud with description;

(b) Approximate amount involved; and

(c) Parties involved.

III. Disclosure in the Board's Report - Sub-section (12) of section 143 of the Companies Act, 2013 furthermore prescribes that the companies, whose auditors have reported frauds under this sub-section (12) to the audit committee or the Board, but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

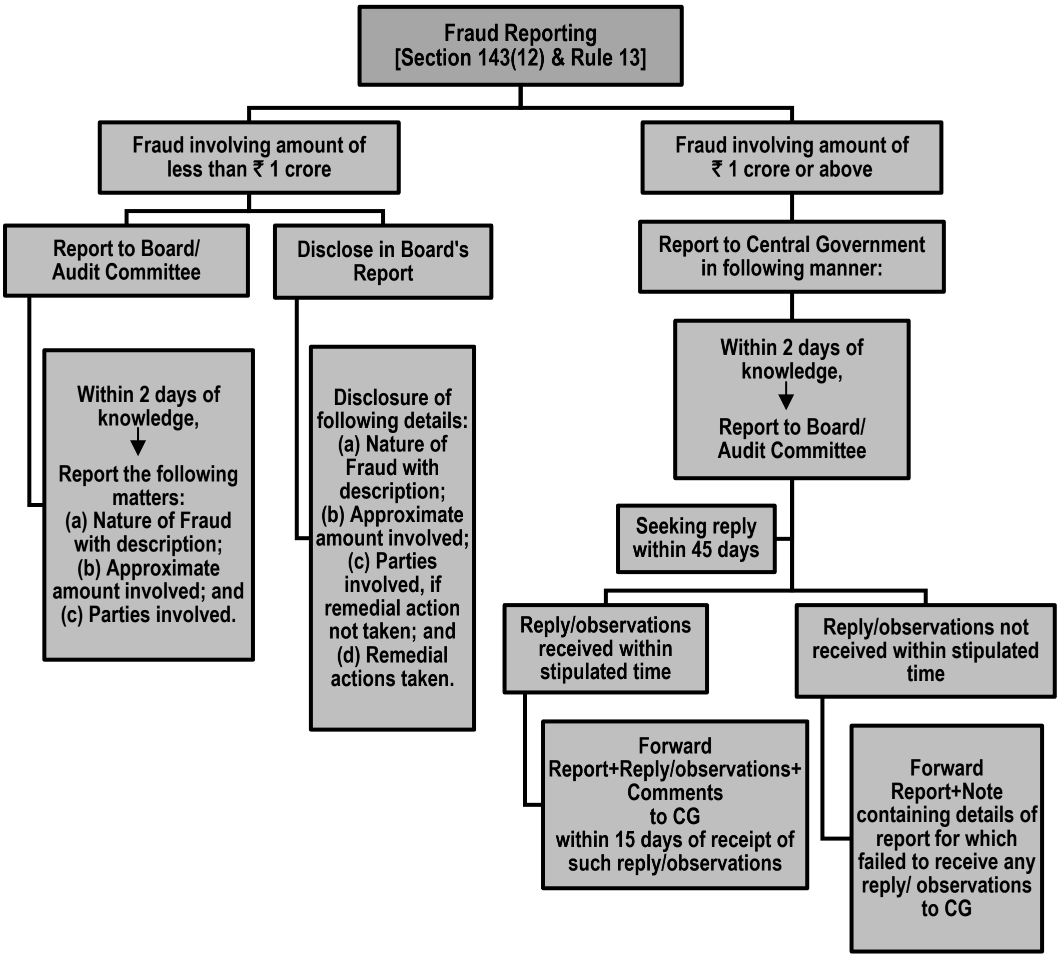
In this regard, sub-rule (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that the auditor is also required to disclose in the Board's Report the following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year:

(a) Nature of Fraud with description;

(b) Approximate Amount involved;

(c) Parties involved, if remedial action not taken; and

(d) Remedial actions taken.



2. Ceiling on Number of Company Audits

As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies, other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.

3. Reporting under Companies (Auditor's Report) Order, 2016 [CARO, 2016]

In exercise of the powers conferred by sub-section (11) of section 143 of the Companies Act, 2013 (18 of 2013) and in supersession of the Companies (Auditor's Report) Order, 2015 published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (ii), vide number S.O. 990 (E), dated the 10th April, 2015, except as respects things done or omitted to be done before such supersession, the Central Government, after consultation with the, committee constituted under proviso to sub-section (11) of section 143 of the Companies Act, 2013 hereby makes the following Order dated 29th March, 2016, namely:—

I. Short title, application and commencement-

(1) This Order may be called the Companies (Auditor's Report) Order, 2016.

(2) **Applicability of the Order:** The CARO, 2016 is an additional reporting requirement Order. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2O13 [hereinafter referred to as the Companies Act],

However, the Order specifically <u>exempts</u> the following class of companies-

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

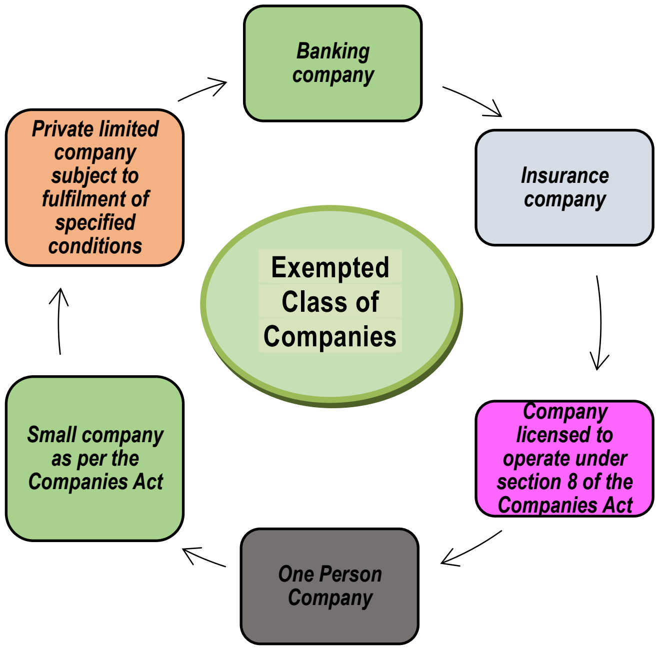
(ii) an insurance company as defined under the Insurance Act,1938 (4 of 1938);

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and

(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

Exempted Class of Companies



II. Auditor's report to contain matters specified in paragraphs 3 and 4 - Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited by him, to which this Order applies, for the financial years commencing on or after 1st April, 2015, shall in addition, contain the matters specified in paragraphs 3 and 4, as may be applicable:

It may be noted that the Order shall not apply to the auditor's report on consolidated financial statements.

III. Matters to be included in the auditor's report - The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:-

(i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

(b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

(c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

(ii) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;

(iii) whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,

(a) whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(b) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

(c) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

(iv) in respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.

(v) in case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed there under, where applicable, have been complied with? If not, the nature of such contraventions be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

(vi) whether maintenance of cost records has been specified by the Central Government under section 148(1) of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.

(vii) (a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).

(viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

(ix) whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

(x) whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;

(xi) whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;

(xii) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1: 20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

(xiii) whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;

(xiv) whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

(xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with;

(xvi) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

IV. Reasons to be stated for unfavourable or qualified answers -

(1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.

(2) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

4. Amendment in Companies (Cost Records and Audit) Rules, 2014

(I) Maintenance of Cost Records: Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of ₹ 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of section 2 of the Act, but exclude a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006.

The said rule has divided the list of companies into regulated sectors (Part A) and non-regulated sectors (Part B).

Additionally, as per clause (vi) to Paragraph 3 of the CARO, 2016, where maintenance of cost records has been specified by the Government under section 148(1) of the Companies Act, 2013, the auditor has to report whether such accounts and records have been made and maintained.

(II) Appointment of Cost Auditor: Rule 6 of the Companies (Cost Records and Audit) Rules, 2014 requires the companies prescribed under the said Rules to appoint an auditor within one hundred and eighty days of the commencement of every financial year. However, before such appointment is made, the written consent of the cost auditor to such appointment and a certificate from him or it shall be obtained.

The certificate to be obtained from the cost auditor shall certify that the-

(a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Companies Act, 2013, the Cost and Works Accountants Act, 1959 and the rules or regulations made thereunder;

(b) the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Companies Act, 2013 so far as may be applicable;

(c) the proposed appointment is within the limits laid down by or under the authority of the Companies Act, 2013; and

(d) the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

(III) Removal of Cost Auditor: The cost auditor may be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard to the cost auditor and recording the reasons for such removal in writing.

It may be noted that the Form CRA-2 to be filed with the Central Government for intimating appointment of another cost auditor shall enclose the relevant Board Resolution to the effect.

It may further be noted that the above provisions shall not prejudice the right of the cost auditor to resign from such office of the company.

(IV) Submission of Cost Audit Report to the Central Government: A company shall within thirty days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 in Extensible Business Reporting Language (XBRL) format in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

(V) Cost Audit Rules not to apply in certain cases: The requirement for cost audit under these rules shall not be applicable to a company which is covered under rule 3, and,

(i) whose revenue from exports, in foreign exchange, exceeds 75% of its total revenue; or

(ii) which is operating from a special economic zone.

(iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant.

5. Direction by Tribunal in case auditor acted in a fraudulent manner

As per sub-section (5) of the section 140, the Tribunal either *suo motu* or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

6. Curtailing right of the auditor regarding circulation of copy of representation in the case of appointment of Auditor other than retiring Auditor under section 140(4) of the Companies Act, 2013

If the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by section 140(4) of the Companies Act, 2013 are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.

7. Re-opening of accounts on Court's or Tribunal's Orders

Section 130 of the Companies Act, 2013 states that a company shall not re-open its books of account and not recast its financial statements, unless an application in this regard is made by the Central Government, the Income-tax authorities, the Securities and Exchange Board, any other statutory regulatory body or authority or any person concerned and an order is made by a court of competent jurisdiction or the Tribunal to the effect that—

(i) the relevant earlier accounts were prepared in a fraudulent manner; or

(ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.

However, a notice shall be given by the Court or Tribunal in this regard and shall take into consideration the representations, if any.

8. **Voluntary revision of financial statements or Board's report**

   Section 131 of the Companies Act, 2013 states that if it appears to the directors of a company that—

   (a) the financial statement of the company; or

   (b) the report of the Board,

   do not comply with the provisions of section 129 (Financial statement) or section 134 (Financial statement, Board's report, etc.) they may prepare revised financial statement or a revised report in respect of any of the three preceding financial years after obtaining approval of the Tribunal on an application made by the company in such form and manner as may be prescribed and a copy of the order passed by the Tribunal shall be filed with the Registrar.

9. In exercise of powers conferred by section 143 read with sub-sections (1) and (2) of section 469 of the Companies Act, 2013 (18 of 2013), the Central Government hereby inserted the clause "(d) whether the company had provided requisite disclosures in its financial statements as to holdings as well as dealings in Specified Bank Notes during the period from 8th November, 2016 to 30th December, 2016 and if so, whether these are in accordance with the books of accounts maintained by the company.", after clause (c) in rule 11 of the Companies (Audit and Auditors) Rules, 2014.

10. In exercise of the powers conferred by section 139 read with sub-sections (1) and (2) of section 469 of the Companies Act, 2013 (18 of 2013), the Central Government hereby makes the following rules further to amend the Companies (Audit and Auditors) Rules, 2014, namely:—

    "In the Companies (Audit and Auditors) Rules, 2014, in rule 5, in clause (b), for the word "twenty", the word "fifty" shall be substituted"

    The impact of this amendment on the study material would be :

    1. Point no. (II) - para 7.3.1 on page number 7.10 be read as -

       all private limited companies having paid up share capital of rupees fifty crores or more;

    2. In diagram appearing at page number 7.10, line in the middle box be read as -

       all private limited companies having paid up share capital ≥ ₹ 50 crore

11. Additional requirement for claiming exemption under section 141(3)(g) for counting ceiling limit is available only if such company has not committed default in filing its financial statements under section 137 and annual returns under section 92 of the Act to the registrar as per notification dated 13 June 2017.

12. MCA vide Notification S.O. 2218(E) dated 13th July 2017 with respect to the Notification G.S.R. 583(E) Dated 13th June, 2017 (Corrigendum), stated that for the words “statement or” to read as “statement and” under section 143(3)(i).

13. Notification No. G.S.R. 583(E) stated that requirements of reporting under section 143(3)(i) read Rule 10 A of the Companies (Audit and Auditors) Rules, 2014 of the Companies Act 2013 shall not apply to certain private companies. Clarification regarding applicability of exemption given to certain private companies under section 143(3)(i) (vide circular no. 08/2017) clarified that the exemption shall be applicable for those audit reports in respect of financial statements pertaining to financial year, commencing on or after 1st April, 2016, which are made on or after the date of the said notification.

14. As per provisions of Section 143(3)(i) of companies Act, the Auditor Report shall state whether the Company has adequate internal financial controls system in place and the operating effectiveness of such controls. MCA vide its notification dated 13th June 2017 (G.S.R. 583(E)) amended the notification of the Government of India, In the ministry of corporate of affair, vide no G.S.R. 464(E) dated 05th June 2015 providing exemption from Internal Financial Controls to following private companies which is one person Company (OPC) or a Small Company; or Which has turnover less than ₹ 50 Crores as per latest audited financial statement or which has aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year less then ₹ 25 Crore. The above exemption shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 of the Companies Act 2013 or annual return under section 92 of Act with the Registrar. Further, in section 143 of the principal Act,(*i*) in sub-section (*1*), in the proviso, for the words "its subsidiaries", at both the places, the words "its subsidiaries and associate companies" shall be substituted; (*ii*) in sub-section (*3*), in clause (*i*), for the words "internal financial controls system", the words "internal financial controls with reference to financial statements" shall be substituted; (*iii*) in sub-section (*14*), in clause (*a*), for the words "cost accountant in practice", the words "cost accountant" shall be substituted.

15. Amendment due to Companies (Amendment) Act 2017

(i) By virtue of notification dated 21st March 2018, in exercise of the powers conferred by sub-section (3) of section 1 of the Companies Act, 2013 (18 of 2013), the Central Government hereby appoints the 21st March, 2018 as the date on which the provisions of subsections (3) and (11) of section 132 of the said Act shall come into force.

(ii) As per section 140(2), the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form ADT–3 (as per Rule 8 of CAAR) with the company and the Registrar, and in case of the companies referred to in section 139(5) i.e. Government company, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor shall be punishable with fine which shall not be less than fifty thousand rupees *or the remuneration of the auditor, whichever is less*, but which may extend to five lakh rupees as per section 140(3).

(iii) Under sub-section (3) of section 141 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company shall not be eligible for appointment as an auditor of a company

(iv) By virtue of notification dated February 23, 2018, the Central Government has exempted the companies engaged in defence production to the extent of application of relevant Accounting Standard on segment reporting.

(v) The Order for reopening of accounts not to be made beyond eight financial years immediately preceding the current financial year unless and until Government has, under Section 128(5) issued a direction for keeping books of account longer than 8 years, reopening of accounts can be made for such longer period.

(vi) As per Section 143(3)(i) The auditors of all the companies shall report on the adequacy of internal financial control systems and its operating effectives. As per the recent amendment, the auditors are required to report on Internal Financial Control with reference to financial statements.

(vii) Right of access by the auditor of a holding company to the accounts and records of the associate company, whose accounts are required to be consolidated. As per the recent amendment, this right has been extended to associates also.

(viii) Enabling provisions for opportunity of being heard in Section 130 for auditor/ Chartered Accountant of the Company. As of now, there is no provision in the section for serving notice to the auditor/ chartered accountant in case of reopening of accounts. As per the recent amendment in the section has been brought enabling the Court/ Tribunal to give notice to any other party/ person concerned.

(ix) Section 147 of the Companies Act, 2013 prescribes following punishments for contravention:

(1) If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees, or with both.

(2) If an auditor of a company contravenes any of the provisions of section 139 section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend

to five lakh rupees ***or four times the remuneration of the auditor, which ever is less.***

It may be noted that if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall ***not be less than fifty thousand rupees*** but which may extend to twenty-five lakh rupees ***or eight times the remuneration of the auditor, which every is less***

(3) Where an auditor has been convicted under sub-section (2), he shall be liable to:-

(i) refund the remuneration received by him to the company;

(ii) and pay for damages to the company statutory bodies or authorities or to ***members or the creditors of the Company*** for loss arising out of incorrect or misleading statements of particulars made in his audit report.

(4) The Central Government shall, by notification, specify any statutory body or authority of an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages the such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

(5) Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in an fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil criminal as provided in this Act or in any other law for the time being in force, for such act shall be the partner or partners concerned of the audit firm and of the firm jointly and severally Provided that in case of criminal liability of an audit firm, in respect of liability other ***than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.***

16. Quality Control and Engagement Standards: The Council of the ICAI has inserted/ revised following Quality Control and Engagement Standards which are applicable for May 2018 and onward examination:

S. No.	No. of Standard	Title of the Standard
(1)	SA 260 (Revised)	Communication with Those Charged with Governance
(2)	SA 570 (Revised)	Going Concern

(3)	SA 610 (Revised)	Using the Work of Internal Auditors
(4)	SA 700 (Revised)	Forming an Opinion and Reporting on Financial Statements
(5)	SA701(New)	Communicating Key Audit Matters in the Independent Auditor's Report
(6)	SA 705 (Revised)	Modifications to the Opinion in the Independent Auditor's Report
(7)	SA 706 (Revised)	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

Note- Students are advised to refer Auditing Pronouncements for Intermediate Course – New Scheme.

Note: Students are also advised to refer RTP of Paper 1 Accounting and Paper 5 Advanced Accounting (for AS, Ind AS etc.) and Paper 2 Business Laws, Ethics and Communication (for academic updates relating to Company Law).

PART – II: QUESTIONS AND ANSWERS

QUESTIONS

1. State with reason (in short) whether the following statements are true or false:

   (i) The preparation of financial statements does not involve judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity.

   (ii) Audit procedures used to gather audit evidence may be effective for detecting an intentional misstatement.

   (iii) An audit is an official investigation into alleged wrongdoing.

   (iv) The matter of difficulty, time, or cost involved is in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.

   (v) There is no relation between Audit Plans and knowledge of the client's business

   (vi) Planning is not a discrete phase of an audit, but rather a continual and iterative process.

   (vii) Audit documentation is a substitute for the entity's accounting records.

   (viii) AB & Co. is an audit firm having partners Mr. A and Mr. B. Mr. C, the relative of Mr. B is holding securities having face value of ₹ 2,00,000 in XYZ Ltd. AB & Co. is qualified for being appointed as an auditor of XYZ Ltd.

(ix) When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall not perform substantive procedures that are specifically responsive to that risk.

(x) The SAs ordinarily refer to inherent risk and control risk separately.

Nature of Auditing

2. (a) "Statements" and "Guidance Notes" of ICAI- whether mandatory or recommendatory?

   (b) Inquiry from Management is helpful for Auditor to evaluate subsequent events. Discuss specific enquiries in reference of SA 560, which might have effect on the financial statements.

   (c) The discipline of behavioural science is closely linked with the subject of auditing. Discuss.

3. Discuss with reference to SAs:

   (a) What do you mean by "Written Representations"? As an auditor, how you will deal if management does not provide requested written representations?

   (b) "Operating Conditions" that may cast doubt about going concern assumption.

   (c) The auditor is responsible for maintaining an attitude of professional skepticism throughout the audit. Do you agree with the statement?

4. (a) With reference of SA 250, give some examples or matters indicating to the auditor about non compliance of laws & regulations by management.

   (b) The auditor may exercise his judgement to identify which risks are significant risks. Explain the above in context of SA-315.

Basic Concepts in Auditing

5. (a) What is “Audit Evidence”?

   (b) What are the various audit procedures to obtain audit evidence? Mention the same in brief.

   (c) Discuss the principles, which are useful in assessing the reliability of audit evidence.

6. “Risk of material misstatement at the assertion level for classes of transactions, account balances and disclosures need to be considered.” Explain stating the different categories of assertions used by the auditor.

7. (a) What do you mean by Analytical procedures? How such procedures are helpful in auditing?

   (b) Explain concept of ‘Materiality’.

Preparation for an Audit

8. (a) Mention any four areas where surprise checks can significantly improve the effectiveness of an audit.

   (b) In a system based audit, test checking approach provides a good base for the auditor to form his opinion on the financial statements. Give your comments.

   (c) "It is not mandatory to send a new engagement letter in recurring audit, but sometimes it becomes mandatory to send new letter". Explain those situations where new engagement letter is to be sent.

9. (a) How does an audit programme help to plan and perform the audit?

   (b) Draft an audit programme to audit the receipts of a cinema theatre owned by a partnership firm.

Internal Control

10. (a) In a medium size trading organisation the accountant was given additional responsibility of making recoveries from the trade receivables. On one occasion, when an insurance claim of ₹ 45,000 was received, he credited the same to the account of a trade receivable and misappropriated the cash which he had recovered from the said trade receivable. Pinpoint weaknesses in the internal control system which led to this situation. Comment.

    (b) What are the inherent limitations of Internal Control system?

11. (a) 'Doing an audit in a Computerised Information System (CIS) environment is simpler since the trial balance always tallies'. Analyse critically.

    (b) Why are Computer Aided Audit Techniques (CAATs) required in Computerised Information System (CIS) environment? What are the advantages of CAATs?

Vouching & Verification of Assets and Liabilities

12. (a) How will you vouch/verify Rental Receipts.

    (b) 'In vouching payments, the auditor does not merely check proof that money has been paid away.' Discuss.

13. How will you vouch and/or verify the following:

    (a) Purchase of quoted investment.

    (b) Discounted bill receivable dishonoured.

    (c) Retirement Gratuity to Employees.

    (d) Receipt of special backward area subsidy from Government.

14. (a) Accounting is a continuous process because the business never comes to halt. It is, therefore, necessary that transactions of one period would be separated from those in the ensuing period so that the results of the working of each period can be correctly

ascertained. Explain.

(b) While conducting the audit of accounts of a manufacturing company, you discover that the rate of Gross Profit on Sales has sharply decreased in comparison to the previous year. State the steps you would take to satisfy yourself.

The Company Audit

15. Explain the following:

(a) Appointment of First Auditor of a Non-Government Company.

(b) Appointment of First Auditor of a Government Company.

(c) Appointment of Subsequent Auditor of a Non-Government Company.

(d) Appointment of Subsequent Auditor of a Government Company.

16. As an auditor comment on the following situations/statements:

(a) The company due to liquidity crises sold and leased back the same vehicles from leasing companies. In the notes to accounts, the company stated 'Vehicles taken on lease repayable in 46 instalments of ₹ 36,650 each'.

(b) A portion of Share Premium utilised to declare 40% dividend.

17. (a) Why Central Government permission is required, when the auditors are to be removed before expiry of their term, but the same is not needed when the auditors are changed after expiry of their term?

(b) What are the special considerations in an audit of a Limited Company?

18. Strong Ltd. holding 60% of the equity shares in Weak Ltd. purchased goods worth ₹ 50 Lakhs from Weak Ltd. during the financial year 2016-17. 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. Comment.

Special Audits

19. An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations.

20 (a) Mention any eight special points which you as an auditor would look into while auditing the books of a partnership firm.

(b) What special steps will you take into consideration in auditing the receipts from entry fees of an amusement part? Mention any four points specific to the issue.

SUGGESTED ANSWERS / HINTS

1. **(i) Incorrect:** The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

   (ii) Incorrect: Fraud may involve sophisticated and carefully organised schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.

   (iii) Incorrect: An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

   (iv) Incorrect: The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.

   Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.

   (v) Incorrect: The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business

   (vi) Correct: According to SA-300, "Planning an Audit of Financial Statements", planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement.

   (vii) Incorrect: The auditor may include copies of the entity's records (for example, significant and specific contracts and agreements) as part of audit documentation. Audit documentation is not a substitute for the entity's accounting records.

   (viii) Incorrect: As per the provisions of the Companies Act, 2013, a person is disqualified to be appointed as an auditor of a company if his relative is holding any security of or interest in the company of face value exceeding ₹ 1 lakh.

   Therefore, AB & Co. shall be disqualified for being appointed as an auditor of XYZ Ltd. as Mr. C, the relative of Mr. B who is a partner in AB & Co., is holding securities in XYZ Ltd. having face value of ₹ 2 lakh.

(ix) **Incorrect:** When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details.

(x) **Incorrect:** The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

2. (a) **Statements and Guidance Notes of ICAI – whether Mandatory or Recommendatory:**

(i) **Statements:** The 'Statements' have been issued with a view to securing compliance by members on matters which, in the opinion of the Council, are critical for the proper discharge of their functions. 'Statements' therefore are mandatory.

Accordingly, while discharging their attest function, it will be the duty of the members of the Institute to ensure that statements are followed and complied with.

(ii) **Guidance Notes:** 'Guidance Notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so.

Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary.

There are, however a few guidance notes in case of which the Council has specifically stated that they should be considered as mandatory on members while discharging their attest function.

(b) **Inquiring from Management to Evaluate Subsequent Event**: As per SA 560 "Subsequent Events", in inquiring of management and, where appropriate, those charged with governance, as to whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire as to the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matters-

(i) Whether new commitments, borrowings or guarantees have been entered into.

(ii) Whether sales or acquisitions of assets have occurred or are planned.

(iii) Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.

(iv) Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.

(v) Whether there have been any developments regarding contingencies.

(vi) Whether any unusual accounting adjustments have been made or are contemplated.

(vii) Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.

(viii) Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.

(ix) Whether any events have occurred that are relevant to the recoverability of assets.

(c) The Discipline of Behavioural Science is Closely Linked with the Subject of Auditing: The field of auditing as a discipline involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. Thus, it is quite logical and natural that the function of audit can be performed if and only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.

The discipline of behavioural science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organisation. As against the financial auditor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures. One of the basic elements in designing the internal control system is personnel. Howsoever, if a sound internal control structure is designed, it cannot work until and unless the people who are working in the organisation are competent and honest. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties.

3. (a) **Written Representations:** As per SA 580, "Written Representation" is a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. These representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist. Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

Requested Written Representations not provided by Management: If management does not provide one or more of the requested written representations, the auditor shall-

(i) discuss the matter with management;

(ii) re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and

(iii) take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

The auditor shall disclaim an opinion on the financial statements if management does not provide the written representations.

(b) **Operating Conditions Casting Doubt About Going Concern Assumption:** The following are examples of operating events or conditions that, may cast significant doubt about the going concern assumption as per SA 570 "Going Concern"-

(i) Management intentions to liquidate the entity or to cease operations.

(ii) Loss of key management without replacement.

(iii) Loss of a major market, key customer(s), franchise, license, or principal supplier(s).

(iv) Labour difficulties.

(v) Shortages of important supplies.

(vi) Emergence of a highly successful competitor.

(c) **Professional Skepticism:** As per SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", professional skepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

Therefore, professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of overlooking unusual circumstances, over generalising when drawing conclusions from audit observations or using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

Further, while obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. This requirement is also designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

Therefore, we do agree with the statement.

4. (a) Non-compliance of Laws and Regulations by Management: As per SA 250 on "Consideration of Laws and Regulation in an Audit of Financial Statements", the following are examples or matters indicating to the auditor about non-compliance with laws and regulations by management-

(i) Investigations by regulatory organisations and government departments or payment of fines or penalties.

(ii) Payments for unspecified services or loans to consultants, related parties, employees or government employees.

(iii) Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.

(iv) Purchasing at prices significantly above or below market price.

(v) Unusual payments in cash, purchases in the form of cashiers' cheques payable to bearer or transfers to numbered bank accounts.

(vi) Unusual payments towards legal and retainership fees.

(vii) Unusual transactions with companies registered in tax havens.

(viii) Payments for goods or services made other than to the country from which the goods or services originated.

(ix) Payments without proper exchange control documentation.

(x) Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.

(xi) Unauthorised transactions or improperly recorded transactions.

(xii) Adverse media comment.

(b) Identification of Significant Risks: SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment" defines 'significant risk' as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following-

(i) Whether the risk is a risk of fraud;

(ii) Whether the risk is related to recent significant economic, accounting or other developments like changes in regulatory environment etc. and therefore requires specific attention;

(iii) The complexity of transactions;

(iv) Whether the risk involves significant transactions with related parties;

(v) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and

(vi) Whether the risk involves significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.

5. (a) Audit Evidence: As per SA 500 "Audit evidence", it is theinformation used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

(b) Audit Procedures to Obtain Audit Evidence: According to SA 500 "Audit Evidence", the auditor may obtain evidence by one or more of the following audit procedures-

Inspection: Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records for evidence of authorisation.

Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a inventory or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition.

Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

Observation: Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

External Confirmation: An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions, for example, the absence of a "side agreement" that may influence revenue recognition.

Recalculation: Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

Reperformance: Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

Analytical Procedures: Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

Inquiry: Inquiry consists of seeking information of knowledgeable persons, both, financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

(c) Reliability of Audit Evidence: SA 500 on "Audit Evidence" provides thatthe reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity. While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

(1) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.

(2) The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.

(3) Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

(4) Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).

(5) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

6. **Risk of Material Misstatement at the Assertion Level:** According to SA 315 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. In identifying and assessing risks of material misstatement at the assertion level, the auditor may conclude that the identified risks relate more pervasively to the financial statements as a whole and potentially affect many assertions.

Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms-

(I) Assertions about classes of transactions and events for the period under audit:

(i) Occurrence—transactions and events that have been recorded have occurred and pertain to the entity.

(ii) Completeness—all transactions and events that should have been recorded have been recorded.

(iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately.

(iv) Cut-off—transactions and events have been recorded in the correct accounting period.

(v) Classification—transactions and events have been recorded in the proper accounts.

(II) Assertions about account balances at the period end:

(i) Existence—assets, liabilities, and equity interests exist.

(ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

(iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded.

(iv) Valuation and allocation—assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

(III) Assertions about presentation and disclosure:

(i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.

(ii) Completeness—all disclosures that should have been included in the financial statements have been included.

(iii) Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.

(iv) Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.

7. (a) SA 520 'Analytical Procedures': As per SA 520, the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. The auditor's choice of procedures, methods and level of application is a matter of professional judgement.

Analytical procedures include the consideration of comparisons of the entity's financial information with, for example: comparable information for prior periods; anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation; and similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

Analytical procedures also include consideration of relationships, for example: among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages; and between financial information and relevant non-financial information, such as payroll costs to number of employees.

Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

Analytical procedures are used for the following purposes:

(a) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and

(b) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

(b) Concept of Materiality: According to SA 320 "Materiality in Planning and Performing an Audit", financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

- Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
- Judgments about materiality are made in the light of surrounding circumstances, and are affected by the auditor's perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both; and
- Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

(1) Such a discussion, if present in the applicable financial reporting framework, provides a frame of reference to the auditor in determining materiality for the audit. If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred above provides the auditor with such a frame of reference.

(2) The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

(a) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;

(b) Understand that financial statements are prepared, presented and audited to levels of materiality;

(c) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and

(d) Make reasonable economic decisions on the basis of the information in the financial statements.

(3) The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

8. (a) Areas where Surprise Checks can significantly improve the effectiveness of an Audit: Surprise checks constitute an important part of normal audit procedure. An element of surprise both with regard to the time of checking and selection of items, significantly improves the effectiveness of an audit. Normally, areas over which surprise check can be employed are-

(i) Verification of cash and investments.

(ii) Inventory.

(iii) Internal control and internal checks.

(iv) Books of prime entries and statutory registers.

(b) Test Checking in System Based Audit: System-based audit is done by evaluating the accounting system and internal control and ascertaining their reliability through audit tests. Depending upon the size and nature of the business concerned, an accounting system will incorporate necessary internal control to provide assurance that-

(i) All the transactions and information have been recorded,

(ii) Fraud and errors, if any, in preparing the accounts will be identified,

(iii) All the assets and liabilities recorded in the books of account do exist and are shown at correct amounts,

(iv) There is compliance with statutory regulations.

After the auditor has ascertained the client's accounting system, he should assess it to satisfy the above-mentioned requirements. The auditor, therefore, after evaluating internal control system, tests the same to ascertain whether it is actually in operation. For this purpose, he assorts to actual testing of the system in operation. This he does on a selective basis, i.e., he adopts test checking technique. He plans this testing in such a manner that all the important areas stated above are covered. The test checking is done by application of procedural test and/or by auditing in depth. This approach is adopted in system based audit which is the modern audit approach. The system-based audit approach begins by evaluating the accounting system and internal control and then by testing them to ascertain their reliability. By this, the auditor first establishes how reliable the system is and then decides how much detailed checking of the transactions and verification of assets and liabilities he must undertake. If the system is found to be good, the detailed checking could be curtailed, but if system is week, more detailed checking would be necessary. However, checking cannot be completely eliminated; it can only be scaled down if state of the system is satisfactory. In case the initial evaluation itself shows weaknesses, extensive checking should invariably be undertaken.

(c) Issue of Audit Engagement Letter in Recurring Audits: As per SA 210, "Agreeing the Terms of Audit Engagements", on recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

It is not necessary to issue audit engagement letter each year for repetitive audit. It is enough if the same had been issued at the time of taking initial engagement. However, in the following situations it is appropriate to revise the terms of the audit engagement or to remind the entity of existing terms-

(i) Any indication that the entity misunderstands the objective and scope of the audit.

(ii) Any revised or special terms of the audit engagement.

(iii) A recent change in senior management or board of directors.

(iv) A significant change in ownership.

(v) A significant change in nature or size of the entity's business.

(vi) A change in legal or regulatory requirements.

(vii) A change in the financial reporting framework adopted in the preparation of the financial statements.

(viii) A change in other reporting requirements.

9. (a) The Role of Audit Programme in Audit Plan and Performance: The audit programme is helpful both in planning and performance stages of audit-

(i) The audit programme lists down areas of audit before commencement.

(ii) The audit timing is built therein; thereby it becomes a schedule of audit plan.

(iii) The staff who are entrusted with the audit assignment is also specified. It is a plan of resource allocation of the firm.

(iv) It specifies the procedures to be checked during the audit.

(v) As the audit work is split into various elements of procedures to be performed, the audit programme acts as a guiding chart or check list during the performance of audit.

(vi) Since the staff in charge of each work is specified and they sign the programme, it extracts the responsibility from the audit assistants.

(vii) The working papers of the audit staff can be reviewed against the audit programme which helps a base of reference for evaluation of the performance before reporting on the financial statements.

(viii) It also helps in preparing a diary of the performance and plan and also base for billing the clients for the time and manpower involved in the audit.

(b) Audit Programme for Receipts of Cinema Theatre of a Firm: Audit programme for checking the receipts of a cinema theatre of a partnership firm-

(i) The partnership deed should be first scrutinized.

(ii) The receipts of the cash from partners on capital and current accounts should be vouched with reference to the relative terms in the deed.

(iii) The internal control for collections from sale of tickets should be checked.

(iv) See that the tickets are serially numbered and effective custody of un-issued tickets are in existence.

(v) Check the rough cash book and reconcile from the inventory of ticket books issued, the cash to be collected each day.

(vi) Check that the cash balance and ticket sales from inventory is daily checked by the manager.

(vii) Check that the collections are banked daily, the very next day.

(viii) See rates for each class and the ticket rates are as per current prices.

(ix) The entertainment tax collected should be separately accounted for its subsequent payment to the government agencies.

(x) Check the relation between the amounts of tax collected and sales.

(xi) The collections from the advertising and publicity materials should be checked with reference to the terms of agreement.

(xii) Income from canteen, stalls, parking facilities should also be checked and see that the income are fairly booked without any seepage.

(xiii) The cash collections should not be used for meeting petty cash expenses. There should be separate impressed system.

(xiv) Do surprise checking of cash balances.

(xv) See that cash collections are insured and the policy is in force.

10. (a) Weaknesses in the Internal Control System: Following two essential features of internal control are relevant here-

(i) Breaking the chain of the work in a manner so that no single person can handle a transaction from the beginning to the end, and

(ii) Segregation of accounting and custodial functions.

Weakness in internal control system in the instant case-

(a) The accountant is receiving cash and also passing the entries in the books. The accountant should not have been allowed to effect recoveries.

(b) It also appears that system for issuing receipts for amount received - whether cash or cheque is also lacking.

(c) In a small and to some extent medium size organization, the supervision of the owner offsets the deficiencies in internal control system. But in this case, it appears, that supervision and personal control is also lacking.

Thus, in the given case, the main weakness of the system is that it is ignoring the basic requirements of a good internal control system.

(b) Inherent Limitations of Internal Control System: Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. This is because it suffers from some inherent limitations, such as-

(i) Management's consideration that cost of an internal control does not exceeds the expected benefits.

(ii) Most controls do not tend to be directed at unusual transactions.

(iii) The potential of human error due to carelessness, misjudgment and misunderstanding of instructions.

(iv) The possibility that control may be circumvented through collusion with employees or outsiders.

(v) The possibility that a person responsible for exercising control may abuse that authority.

(vi) Compliance with procedures may deteriorate because the procedures becoming inadequate due to change in condition.

(vii) Manipulation by management with respect to transactions or estimates and judgements required in the preparation of financial statements.

(viii) Inherent limitations of Audit.

11. (a) Audit in a Computerised Information System (CIS) Environment: Though it is true that in CIS environment the trial balance always tallies, the same cannot imply that the job of an auditor becomes simpler. There can still be some accounting errors like omission of certain entries, compensating errors, duplication of entries, errors of commission in the form of wrong account head is posted. Possibility of "Window Dressing" and/or "Creation of Secret Reserves" where the trial balance tallied. At present, due to complex business environment the importance of trial balance cannot be judged only upto the arithmetical accuracy but the nature of transactions recorded in the books and appear in the trial balance should be focused.

The emergence of new forms of financial instruments like options and futures, derivatives, off balance sheet financing etc have given rise to further complexities in recording and disclosure of transactions. In an audit, besides the tallying of a trial balance, there are also other issue like estimation of provision for depreciation, valuation of inventories, obtaining audit evidence, ensuring compliance procedure and carrying out substantive procedure, verification of assets & liabilities their valuation etc. which still requires judgement to be exercised by the auditor.

Responsibility of expressing an audit opinion and objectives of an audit are not changed in the audit in CIS environment. Therefore, it can be said that simply because of CIS environment and the trial balance has tallied it does not mean that the audit would become simpler.

(b) **Computer Aided Audit Techniques (CAATs):** The use of computers may result in the design of systems that provide less visible evidence than those using manual procedures. CAATs are such techniques applied through the computer which are used in the verifying the data being processed by it.

System characteristics resulting from the nature of Computerised Information System (CIS) environment that demand the use of Computer Aided Audit Techniques (CAAT) are:

(i) **Absence of input documents:** Data may be entered directly into the computer systems without supporting documents. In on-line transaction systems, written evidence of individual data entry authorization, e.g., credit limit approval may not be available.

(ii) **Lack of visible transaction trail:** Certain data may be maintained on computer files only. In a manual system, it is normally possible to follow a transaction through the system by examining source documents, books of account, records, files and reports. In CIS environment, however, the transaction trail may be partly in machine-readable form, and it may exist only for a limited period of time.

(iii) **Lack of visible output:** In a manual system, it is normally possible to examine visually the results of processing. In CIS environment, the results of processing may not be printed or only a summary data may be printed. Thus, the lack of visible output may result in the need to access data retained on machine readable files.

(iv) **Ease of Access to data and computer programmes:** Data and computer programmes may be altered at the computer or through the use of computer equipment at remote locations. Therefore, in the absence of appropriate controls, there is an increased potential for unauthorized access to, and allocation of, data and programmes by persons inside or outside the entity.

Advantages of CAAT

(i) **Audit effectiveness:** The effectiveness and efficiency of auditing procedures will be improved through the use of CAAT in obtaining and evaluating audit evidence, for example –

(a) Some transactions may be tested more effectively for a similar level of cost by using the computer.

(b) In applying analytical review procedures, transactions or balance details of unusual items may be reviewed and reports got printed more efficiently by using the computer.

(ii) **Savings in time**: The auditor can save time by reviewing the CIS controls using CAAT than through other audit procedures.

(iii) **Effective test checking and examination in depth**: CAAT permits effective examination in depth of selected transactions since the auditor constructs the lost audit trail.

12. (a) Rental Receipts:

(i) Check copies of bills or rent receipt issued to the tenant with reference to tenancy agreement and bills of charges paid by the landlord on behalf of tenants.

(ii) The entries in the rental register in respect of rent accrued should be traced with reference to copies of rental bills.

(iii) Scrutinize the account of collecting agent when the rent is collected by such agent.

(iv) Vouch the entries for rent received in advance and ensure proper adjustment is made.

(v) Investigate into abnormal rent outstanding.

(vi) Reconcile the outstanding rent and see that proper provision is made if unrecoverable.

(vii) If rent is received net of TDS, see that rent income is shown at gross and TDS is shown in Balance Sheet as advance Tax.

(b) Vouching- Backbone of Auditing: Vouching is a substantive audit procedure which aims at verifying the genuineness and validity of a transaction contained in the accounting records. It involves examination of documentary evidence to support the genuineness of transaction. Thus the object of vouching is not merely to ascertain that money has been paid away; but the auditor aims to obtain reasonable assurance in respect of following assertions in regard to transactions recorded in the books of account that –

(i) a transaction is recorded in the proper account and revenue or expense is properly allocated to the accounting period;

(ii) a transaction pertains to entity and took place during the relevant period;

(iii) all transactions which have actually occurred have been recorded;

(iv) all transactions were properly authorised; and

(v) transactions have been classified and disclosed in accordance with recognised accounting policies and practices.

Thus, it is through vouching that the auditor comes to know the genuineness of transactions recorded in the client's books of account wherefrom the financial statements are drawn up.

Apart from genuineness, vouching also helps the auditor to know the regularity and validity of the transaction in the context of the client's business, nature of the organisation and organisational rules.

Thus, the auditor's basic duty is to examine the accounts, not merely to see its arithmetical accuracy but also to see its substantial accuracy and then to make a report thereon.

This substantial accuracy of the accounts and emerging financial statements can be known principally by examination of vouchers which are the primary documents relating to the transactions. If the primary document is wrong or irregular, the whole accounting statement would, in turn, become wrong and irregular. Precisely auditor's role is to see whether or not the financial statements are wrong or irregular, and for this, vouching is simply imperative. Thus, vouching which has traditionally been the backbone of auditing does not merely involve checking arithmetical accuracy but goes much beyond and aims to check the genuineness as well as validity of transactions contained in accounting records.

13 (a) Purchase of Quoted Investment:

(i) Ascertain the date of purchase, rate of purchase, nature of investments purchased and nature of transaction, i.e., error cum-dividend/ interest/right/bonus.

(ii) Compare the rate of purchase with quotation available. Obtain suitable explanations in case of significant variations.

(iii) Verify the amount paid towards purchase of investments.

(iv) Trace the amount in the cheque book counterfoils and bank statements.

(v) Obtain a schedule of investment from Management for physical verification at the year end.

(vi) Verify the investment certificate to confirm title.

(vii) Confirm compliance with statutory provisions such as 143(1) of the Companies Act, 2013.

(viii) Verify whether investments are duly disclosed in financial statements in accordance with recognized accounting policies and practices and relevant statutory requirements.

(b) Discounted Bill Receivable Dishonoured:

(i) Obtain the schedule of discounted bills receivable dishonoured.

(ii) Check the entry in bank statement regarding the amount of bills dishonoured and see that the bank has debited the account of client.

(iii) Verify the bills receivable returned by the bank along with bank's advice.

(iv) See that the dishonoured bills have been noted and protested by following the proper procedure and the account of the drawee or the trade receivable is also debited.

(v) Check that bank commission, if any, charged by the bank has been recovered from the party.

(c) Retirement Gratuity to Employees:

(i) Examine the basis on which the gratuity payable to employees is worked out. The liability for gratuity may either be worked out on actuarial rules or agreement or on the presumption that all employees retire on the balance sheet date.

(ii) Verify computation of liability of gratuity on the aggregate basis.

(iii) Check the amount of gratuity paid to employees who retired during the year with reference to number of years of service rendered by them.

(iv) See that the annual premium has been charged to the Statement of Profit and Loss.

(v) Ensure that the accounting treatment is in accordance with AS 15 "Employee Benefits".

(d) Receipt of Special Backward Area Subsidy from Government:

(i) The claim for backward area subsidy submitted to the authorities should be studied.

(ii) It should be ascertained whether the grant is of a capital nature for funding assets or of a revenue nature. Mere computation formula of quantum of grant with reference to the cost of project of itself will not make the grant a capital nature is to facto.

(iii) The accounting of grant should be in accordance with AS 12 "Accounting for Government Grants". The revenue grant can be taken to income statement, with appropriate disclosure.

(iv) The capital grant may be adjusted against cost of asset or may be kept in a capital reserve to be transferred to Statement of Profit and Loss each year in proportion to depreciation of that asset charged in Statement of Profit and Loss.

(v) The receipt of the grant should be checked with bank statement, remittance challan etc.

(vi) The conditions attached to grant should be fulfilled by the company. The auditor should check whether any liability or refund of grant for breach of conditions could arise.

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

(i) Goods purchased, property in which passed on to the client, have in fact been included in the inventories and that the liability has been provided for in case credit purchase.

(ii) Goods sold have been excluded from the inventories and credit has been taken for the sales. If the value of sales is to be received, the concerned party has been debited.

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

(b) Decrease in Rate of Gross Profit on Sales: When rate of Gross Profit on Sales of a manufacturing company has sharply decreased in comparison to the previous year, the auditor should satisfy the reasons for the same. Following factors should be considered which might cause decrease in the Gross Profit of the manufacturing company-

(i) Undervaluation of closing inventory or overvaluation of opening inventory either due to wrong valuation of inventory or mistake in inventory taking.

(ii) Change in the basis of inventory valuation. For example, opening inventory was valued at market price above cost when closing inventory valued at cost which is below the market price.

(iii) Inclusion in the current year, the amount of goods purchased in the previous year, that were received and taken in the same year.

(iv) Reversal of fictitious sale entries recorded in the previous year to boost up profit.

(v) Sales return entry passed two times or entry for purchase return has not been passed whenever goods are returned to suppliers.

(vi) Excess provision for wages or direct expenses have been made.

(vii) Goods sent out for sale on approval or on a consignment basis not included in closing inventory.

(viii) Value of unusual inventory of consumable stores (fuel and packing materials) are not shown as inventory or not adjusted from corresponding expenses.

(ix) Expenses which should be charged in the Profit and Loss Account but wrongly charged to the Trading Account.

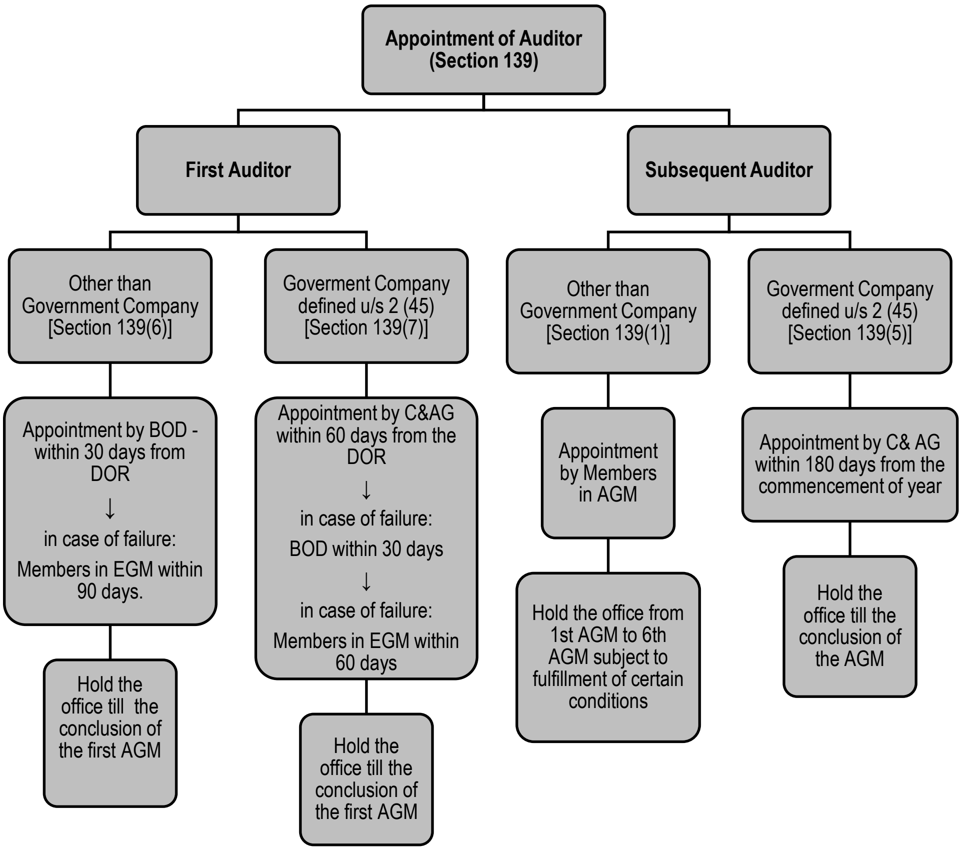
(x) Insurance claim received in respect of goods lost in transit or destroyed by fire, not credited in Trading Account.

(xi) Goods sold or given as samples or destroyed, not accounted for.

15. **Appointment of Auditors:** Section 139 of the Companies Act, 2013 contains provisions regarding appointment of Auditors. Provisions related to appointment of auditors may be grouped under two broad headings-

I Appointment of First Auditors.

II Appointment of Subsequent Auditors.



(a) Appointment of First Auditor of a Non-Government Company: As per Section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

(b) Appointment of First Auditor of a Government Company: Section 139(7) of the Companies Act, 2013 provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.

(c) **Appointment of Subsequent Auditor of a Non-Government Company:** As per section 139(1) of the Companies Act, 2013, every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

(d) **Appointment of Subsequent Auditor of a Government Company:** As per Section 139(5) of the Companies Act, 2013, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

16. (a) **Sale and Leaseback of Vehicles:** Under a lease agreement, the lessee acquires the right to use an asset for an agreed period of time in consideration for payment of rent to the lessor. The legal ownership of the asset remains with the lessor.

In the instant case, the company had sold vehicles to two leasing companies to meet its liquidity crises and took them back on lease. In the notes to the accounts it had disclosed about instalments payable to different leasing companies, but without disclosing the true nature of the transaction as covered by AS 19, “Leases”.

The transaction entered into by the company is a classic case of sale and leaseback transaction. In case of such transactions, the sale price of assets and lease rentals normally do not represent fair value since the same are negotiated as a package. In case such a transaction is an operating lease and it is clear that the rentals and the sale price are established at fair value, then in effect it is a normal sale transaction and any profit or loss is normally recognised immediately.

If the sale price is below fair value, any profit or loss is recognised immediately, except that, if the loss is compensated by future rentals at below market price, it is deferred and amortized in proportion to the rental payments over the useful life of the asset.

If the sale price is above fair value, the excess over fair value is deferred and amortized over the useful life or the asset.

Therefore, it would be important for the auditor to determine whether the amount of instalments payable is fair having regard to sale price of assets. In case the leaseback is a finance lease, it is not appropriate to regard an excess of sales proceeds over the carrying amount as income.

Such excess is deferred and amortised over the lease term in proportion to the depreciation of the leased asset. Similarly, it is not appropriate to regard a deficiency as loss. Such deficiency is deferred and amortised over the lease term.

Further, disclosure shall have to be made separately of such transaction in terms of AS 5.

The auditor should, therefore, suitably qualify his report since proper disclosures have not been made as per the requirement of accounting standards.

(b) Utilisation of Share Premium: Section 52 of the Companies Act, 2013 deals with application of premium received on issues of shares. Section 52(1) requires creation of Securities Premium Account and states that the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the premium account were paid-up share capital of the company. Section 52(2) lays down that the securities premium account may be applied by the company-

(a) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or

(e) for the purchase of its own shares or other securities under Section 68.

Thus, it is clear from the above that share premium can be utilised only for specific purposes. Further, section 123 of the Companies Act, 2013 also specifies the sources from which dividends can be paid and requires the same to be only paid out of past profits, general reserve or any other free reserve. Hence, declaration of dividends out of share premium is not proper and, consequently, the auditor shall have to qualify the audit report.

17. (a) Permission of Central Government for Removal of Auditor Under Section 140(1) of the Companies Act, 2013: Removal of auditor before expiry of his term i.e. before he has submitted his report is a serious matter and may adversely affect his independence.

Further, in case of conflict of interest the shareholders may remove the auditors in their own interest.

Therefore, law has provided this safeguard so that central government may know the reasons for such an action and if not satisfied, may not accord approval.

On the other hand if auditor has completed his term i.e. has submitted his report and thereafter he is not re-appointed then the matter is not serious enough for central government to call for its intervention.

In view of the above, the permission of the Central Government is required when auditors are removed before expiry of their term and the same is not needed when they are not re-appointed after expiry of their term.

(b) Special Consideration in an Audit of a Limited Company:

(i) Initial Verification

(a) Examine basic documents, viz., Memorandum of Association and Articles of Association of the company, prospectus issued, etc.

(b) Check the certificate of incorporation and certificate of commencement of business.

(c) Examine transactions entered into by the company with reference to the date of these certificates.

(d) Verify the contracts entered into with vendors or other persons for purchase of property, payment of commission, etc.

(ii) Board's Duties

(a) Ensure that Board of Directors act well within their powers and no *ultra vires* act is ratified.

(b) Also check that the Board has not exercised the powers that are to be exercised by the members in their General Meeting.

(c) Verify that only acts that can be delegated are in fact delegated to others and that the Board takes decisions only by resolutions at properly constituted meetings.

(d) Inspect minutes of meetings of Board of Directors.

(e) Verify whether the Board has obtained sanction of the Central Government, wherever applicable, e.g., increase in remuneration to Directors in excess of specified amounts.

(iii) Compliance with relevant provisions of the Companies Act, 2013 relating to share capital; provision relating to Board provisions relating to accounts and audit, etc.

(iv) Compliance with provisions relating to Sections 139 to 146 of the Companies Act, 2013.

18. Disclosure of Related Party Transaction: 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.

Further, as per Section 188 of the Companies Act, 2013 also prescribes to take the permission of the Board of Directors by resolution at board meeting for such related party transactions.

In the instant case since there is related party transaction the contention of Managing Director of Strong Ltd. is not correct. The auditor is required to verify the compliance of section 188 of the Companies Act and 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. The auditor is also required to report under Clause (xiii) of Para 3 of CARO, 2016.

19. Receipt of Donations:

(i) **Internal Control System:** Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.

(ii) **Custody of Receipt Books:** Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.

(iii) **Receipt of Cheques:** Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.

(iv) **Bank Reconciliation:** Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.

(v) **Cash Receipts:** Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.

(vi) **Foreign Contributions,** if any, to receive special attention to compliance with applicable laws and regulations.

Remittance of Donations to Different NGOs:

(i) **Mode of Sending Remittance:** All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.

(ii) **Confirming Receipt of Remittance:** All remittances are supported by receipts and acknowledgements.

(iii) **Identity:** Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.

(iv) **Direct Confirmation Procedure:** Send confirmation letters to entities to whom donations have been paid.

(v) **Donation Utilisation:** Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.

(vi) **System of NGOs' Selection:** System for selecting NGO to whom donations have been sent.

20. (a) Special Points in Audit of a Partnership Firm: Matters which should be specially considered in the audit of accounts of a partnership firm are as under-

(i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.

(ii) Examine the partnership deed signed by all partners and its registration with the registrar of firms. Also ascertain from the partnership deed about capital contribution, profit sharing ratios, interest on capital contribution, powers and responsibilities of the partners, etc.

(iii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans, purchase of assets, extraordinary contracts entered into and other such matters which are not of a routine nature.

(iv) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.

(v) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.

(vi) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreement.

(vii) Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners. Also see various requirements of legislations applicable to the partnership firm like Section 44(AB) of the Income-tax Act, 1961 have been complied with.

(viii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

(b) Audit of receipts from Entry Fees of an Amusement Park:

(i) Evaluate the internal control system regarding entry and collection for entry tickets including rotation of staff.

(ii) Ensure that tickets are pre numbered.

(iii) Ensure that the deposit of cash collected into the bank account very same next day.

(iv) Compute analytical ratios in respect of the receipts pattern i.e. on weekends, holidays, etc. and make comparisons to draw conclusions.

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

QUESTIONS

1. Define the following terms briefly:

   (i) Business Process Reengineering (BPR) Team

   (ii) Instruction Set

   (iii) Site Blocking

   (iv) System

   (v) Database Controls

   (vi) Office Management Software

   (vii) Business Information System

   (viii) Electronic Fund Transfer (EFT)

   (ix) Database Management Systems (DBMS)

   (x) Business Strategy

2. Differentiate between the following:

   (i) Boxes and Diamonds in E-R Diagram

   (ii) Sales Process and Purchase to Pay (P2P) Process

   (iii) Random Access Memory (RAM) and Read Only Memory (ROM)

   (iv) Memory Management and Task Management in Operating System

   (v) Fat Client and Thin Client

   (vi) Session Layer and Transport Layer of OSI Model

   (vii) Knowledge Level Systems and Operational Level Systems

   (viii) General-purpose Planning languages and Special-purpose Planning languages

   (ix) Batch Processing and Online Processing

   (x) Attendance Systems and Vehicle Tracking System

3. Write short note on the following:

   (i) Extranets

(ii) Mobile Commerce

(iii) Data Sharing in Grid Computing

(iv) Benefits of Business Process Automation (BPA)

(v) Android

(vi) Packet Switching in Switched Networks

(vii) Decentralized Computing

(viii) Data Resource Management Controls

(ix) File Management System

(x) Certificate Authority

BPM Life Cycle

4. Name and discuss various phases of Business Process Management Life Cycle (BPM Life Cycle) in logically correct order.

Control Objectives

5. Discuss Control and its objectives in detail.

Telecommunication Media

6. Discuss Transmission media in telecommunication networks.

Electronic Payments

7. What are the possible ways to make payments electronically?

Output Controls

8. Discuss Output Controls and their types under Application Controls.

Three Tier Architecture

9. Briefly explain all tiers in Three tier architecture.

Operating System

10. Discuss various activities that are performed by an Operating System.

Mobile Computing

11. Discuss Mobile Computing and its components.

e-Commerce

12. Discuss the risks involved in ‘e-Commerce’.

Office Automation Systems

13. Discuss some examples of Office Automation Systems.

Grid Computing

14. How Grid Computing is used from a user's perspective?

Flowchart

15. (a) Draw a flowchart to incorporate the following steps:

L1	N = 1
L2	PRINT N
L3	N = N x (N + 1)
L4	STOP when N exceeds 100
L5	GOTO L2

Note that is step L3, 'x' denotes multiplication sign.

(b) List the output for the above program.

(c) List the output if the above program is modified in the step L1 as N = 0.

SUGGESTED ANSWERS/HINTS

1. (i) Business Process Reengineering (BPR) Team: A BPR team is responsible to take the BPR project forward and make key decisions and recommendations. The BPR team includes active representatives from top management, business process owners, technical experts and users. The teams are of manageable size to ensure well-coordinated, effective and efficient completion of the entire BPR process.

(ii) Instruction Set: Instruction set is the set of machine code instructions that the processor can carry out CPU (Processor), the centre piece of the computer's architecture, is in charge of executing the instructions of the currently loaded program. Each processor has its own unique instruction set specifically designed to make best use of the capabilities of that processor. These Instruction Set tells the processor to carry out various calculations, to read and write values from and into the memory, and to conditionally jump to execute other instructions in the program.

(iii) Site Blocking: It is a software-based approach that prohibits access to certain websites that are deemed inappropriate by management. For example, sites that contain explicit objectionable material can be blocked to prevent employee's from accessing these sites from company Internet servers. In addition to blocking sites, companies can also log activities and determine the amount of time spent on the Internet and identify the sites visited.

(iv) System: The system can be defined as "a group of mutually related, cooperating elements with a defined boundary; working on reaching a common goal by taking inputs and producing outputs in organized transformation process." Not every system has a single goal and often a system contains several subsystems with sub goals, all contributing to meeting the overall system goal. For example, the finance, operations and marketing areas of an organization should all have goals which together help to achieve overall corporate objectives.

(v) Database Controls: The database subsystem is responsible for defining, creating, modifying, deleting, and reading data in an information system. It maintains declarative data, relating to the static aspects of real-world objects and their associations, and procedural data, relating to the dynamic aspects of real-world objects and their associations. Database Controls protect the integrity of a database when application software acts as an interface to interact between the user and the database.

(vi) Office Management Software: These applications help entities to manage their office requirements like word processors (MS Word), electronic spreadsheets (MS Excel), presentation software (PowerPoint), file sharing systems etc. The purpose is to automate the day-to-day office work and administration.

(vii) Business Information System: Business Information Systems (BIS) may be defined as systems integrating Information Technology, people and business. BIS bring business functions and information modules together for establishing effective communication channels which are useful for making timely and accurate decisions and in turn contribute to organizational productivity and competitiveness.

(viii) Electronic Fund Transfer (EFT): EFT represents the way the business can receive direct deposit of all payments from the financial institution to the company bank account. Once the user Signs Up, Money Comes to him directly and sooner than ever before. EFT is fast, safe, and means that the money will be confirmed in user's bank account quicker than if he had to wait for the mail, deposit the cheque, and wait for the funds to become available.

(ix) Database Management Systems (DBMS): DBMS are software that aid in organizing, controlling and using the data needed by the application programme. They provide the facility to create and maintain a well-organized database. Applications access the DBMS, which then accesses the data. Commercially available Data Base Management Systems are Oracle, My SQL, SQL Servers and DB2 etc.

(x) Business Strategy: At the highest level, the strategy of the company is specified, which describes its long-term concepts to develop a sustainable competitive advantage in the market. An example of a business strategy is cost leadership for products in a certain domain. Business Strategy determines goals to determine Operational and Organizational Business Processes to implement Business Processes.

2. (i) Boxes in E-R Diagram: Boxes are commonly used to represent entities. An entity may be a 'physical object' such as a house or a car, an 'event' such as a house sale or a car service, or a 'concept' such as a customer transaction or order. The entity is represented by a rectangle and labeled with a singular noun.

Diamonds in E-R Diagram: Diamonds are normally used to represent relationships. A relationship is an association that exists between two entities. For example, a Class is taught by Instructor. The relationships on an ER Diagram are represented by lines drawn between the entities involved in the association.

(ii) Sales Process: Sales covers all the business processes relating to fulfilling customer requests for goods or services. It involves transactional flow of data from the initial point of documenting a customer order to the final point of collecting the cash. The process involves the activities - Customer Order, Recording, Pick release, Shipping, Invoice, Receipt and Reconciliation.

P2P - Procure to Pay (Purchase to Pay or P2P): This cycle covers all the business processes relating to obtaining raw materials required for production of a product or for providing a service. It involves the transactional flow of data form the point of placing an order with a vendor to the point of payment to the vendor. Typical life cycle of P2P involves Purchase recognition, Request for quote, Quotation, Purchase order, Receipts and Payments.

(iii) Random Access Memory (RAM): This memory is volatile in nature which means Information is lost as soon as power is turned off. This is Read Write memory.

Read Only Memory (ROM): This is non-volatile in nature (contents remain even in absence of power). Usually, these are used to store small amount of information for quick reference by CPU. Information can be read not modified. Generally used by manufacturers to store data & programs like translators that is used repeatedly.

(iv) Memory Management: Memory Management features of Operating System allow controlling how memory is accessed and maximize available memory & storage. Operating systems also provides Virtual Memory by carving an area of hard disk to supplement the functional memory capacity of RAM. In this way, it augments memory by creating a virtual RAM.

Task Management: Task Management feature of Operating system helps in allocating resources to make optimum utilization of resources. This facilitates a user to work with more than one application at a time i.e. multitasking and also allows more than one user to use the system i.e. timesharing.

(v) Fat / Thick Client: A **fat client** or **thick client** is a client that performs the bulk of any data processing operations itself, and does not necessarily rely on the server. Unlike thin clients, thick clients do not rely on a central processing server because the processing is done locally on the user system, and the server is accessed primarily for storage purposes. For that reason, thick clients often are not well-suited for public environments. To maintain a thick client, IT needs to maintain all systems for software deployment and upgrades, rather than just maintaining the applications on the server. For example – Personal Computer.

Thin Client: Thin clients use the resources of the host computer. A thin client generally only presents processed data provided by an application server, which performs the bulk of any required data processing. A thin client machine is going to communicate with a central processing server, meaning there is little hardware and software installed on the user's machine. A device using web application (such as Office Web Apps) is a thin client.

(vi) Session Layer of OSI Model: This layer sets up, coordinates, and terminates conversations, exchanges, and dialogs between the applications at each end. It deals with session and connection coordination. It provides for full-duplex, half-duplex, or simplex operation, and establishes check pointing, adjournment, termination, and restart procedures. The OSI model made this layer responsible for "graceful close" of sessions also.

Transport Layer of OSI Model: This layer ensures reliable and transparent transfer of data between user processes, assembles and disassembles message packets, and provides error recovery and flow control. Multiplexing and encryption are undertaken at this layer level. This means that the Transport Layer can keep track of the segments and retransmit those that fail.

(vii) Knowledge-Level Systems: These systems support discovery, processing and storage of knowledge and data workers. These further control the flow of paper work and enable group working. The users of these systems include knowledge and data workers who are selected, recruited and trained in a special manner than the non-knowledge workers. The knowledge resides in the heads of knowledge workers and these are the most precious resource an organization possesses.

Operational-Level Systems: These systems support operational managers tracking elementary activities that can include tracking customer orders, invoice tracking, etc. Operational-level systems ensure that business procedures are followed. The users include Operational Managers or supervisors that are responsible for the daily management of the line workers who produce the product or offer the service.

(viii) General-purpose planning languages: These allow users to perform many routine tasks, for example; retrieving various data from a database or performing statistical analyses. The languages in most electronic spreadsheets are good examples of general-purpose planning languages. These languages enable user to tackle abroad range of budgeting, forecasting, and other worksheet-oriented problems.

Special-purpose planning languages: These are more limited in what they can do, but they usually do certain jobs better than the general-purpose planning languages. Some statistical languages, such as Statistical Analysis System (SAS) and Statistical Package for the Social Science (SPSS) are examples of special purpose planning languages.

(ix) Batch Processing: It is defined as a processing of large set of data in a specific way, automatically, without needing any user intervention. The data is first collected, during a work day, for example, and then batch-processed, so all the collected data is processed in one go. This could happen at the end of the work day, for example, when computing capacities are not needed for other tasks. It is possible to perform repetitive tasks on large number of pieces of data rapidly without needing the user to monitor it. Batched jobs can take a long time to process. Batch processing is used in producing bills, stock control, producing monthly credit card statements, etc.

Online Processing: Data is processed immediately while it is entered, the user usually only has to wait a short time for a response. (Example: games, word processing, booking systems). Interactive or online processing requires a user to supply an input. Interactive or online processing enables the user to input data and get the results of the processing of that data immediately.

(x) Attendance Systems: Many attendance automation systems are available in the market that help entity to automate the process of attendance tracking and report generation. It has features such as supervisor login access, holiday pay settings, labour distribution, employee scheduling and rounding, employee view time card, overtime settings, battery-backed employee database and optional door/gate access control.

Vehicle Tracking System: A lot of applications have been developed that allow entity to track their goods while in transit. Few applications are high end, allowing owner of goods to check the temperature of cold stored goods while in transit. It has features such as GPS based location, GPRS connection based real-time online data-logging and reporting, route accuracy on the fly while device is moving, real-time vehicle tracking, geo-fencing, SMS and e-mail notifications, over-the-air location query support, on-board memory to store location inputs during times when GPRS is not available or cellular coverage is absent.

3. (i) Extranets: Extranets are network links that use Internet technologies to interconnect the Intranet of a business with the Intranets of its customers, suppliers, or other business partners. Companies can use Extranets to perform following functions:

- Establish direct private network links between themselves, or create private secure Internet links between them called virtual private networks.
- Use the unsecured Internet as the extranet link between its intranet and consumers and others, but rely on encryption of sensitive data and its own firewall systems to provide adequate security.

(ii) Mobile Commerce: M-commerce (mobile commerce) is the buying and selling of goods and services through wireless handheld devices such as cellular telephone and personal digital assistants (PDAs). Also, known as next-generation e-commerce, m-commerce enables users to access the Internet without needing to find a place to plug in. Thus, m-commerce is all about the explosion of applications and services that are accessible from Internet-enabled mobile devices.

(iii) Data Sharing in Grid Computing: For small grids, the sharing of data can be easy, using existing networked file systems, databases, or standard data transfer protocols. As a grid grows and the users become dependent on any of the data storage repositories, the administrator should consider procedures to maintain backup copies and replicas to improve performance. All the resource management concerns apply to data on the grid.

(iv) Benefits of Business Process Automation (BPA) are as follows:

- **Saving on costs:** Automation leads to saving in time and labor costs.
- **Staying ahead in competition:** Today, in order to survive, businesses need to adopt automation.
- **Fast service to customers:** This was not the initial reason for adoption of BPA but gradually business managers realized that automation could help them to serve their customers faster and better.

(v) **Android:** Android is a Linux-based operating system designed primarily for touch screen mobile devices such as smart phones and tablet computers. Android was built to enable developers to create compelling mobile applications that take full advantage of all a handset has to offer. Android powers devices from some of the best handset and tablet manufacturers in the world, like Samsung, HTC, Motorola, Sony, Asus and more. Android devices come in all shapes and sizes, with vibrant high-resolution displays and cameras, giving the flexibility to choose the one that's just right for a user. Android is an open source and the permissive licensing allows the software to be freely modified and distributed by device manufacturers, wireless carriers and enthusiast developers.

(vi) **Packet Switching in Switched Networks:** It is a sophisticated means of maximizing transmission capacity of networks. **Packet switching** refers to protocols in which messages are broken up into small transmission units called packets, before they are sent. Each packet is transmitted individually across the net. The packets may even follow different routes to the destination. Since there is no fixed path, different packets can follow different path and thus they may reach to destination out of order.

(vii) **Decentralized Computing:** Decentralized computing is the allocation of resources, both hardware and software, to each individual workstation, or office location. In contrast, centralized computing exists when most functions are carried out, or obtained from a remote centralized location. A collection of decentralized computers systems are components of a larger computer network, held together by local stations of equal importance and capability. These systems can run independently of each other. Decentralized systems enable file sharing and all computers can share peripherals such as printers and scanners as well as modems, allowing all the computers in the network to connect to the internet.

(viii) **Data Resource Management Controls:** Many organizations now recognize that data is a critical resource that must be managed properly and therefore, accordingly, centralized planning and control are implemented. For data to be managed better; users must be able to share data, data must be available to users when it is needed, in the location where it is needed, and in the form in which it is needed. Further it must be possible to modify data easily and the integrity of the data be preserved. If data repository system is used properly, it can enhance data and application system reliability. It must be controlled carefully, however, because the consequences are serious if the data definition is compromised or destroyed. Careful control should be exercised over the roles by appointing senior, trustworthy persons, separating duties to the extent possible and maintaining and monitoring logs of the data administrator's and database administrator's activities.

(ix) **File Management System:** With increasing inventory of office files and records, many office automation systems are developed that allow office records to be kept in soft copy and easy tracking of the same. It has features such as web access, search, Microsoft office integration, records management software, electronic forms (e-forms), calendar, document version control, document scanning and imaging, check documents out/ check documents in, document "tagging" or metadata capture, virtual folders and document linking.

(x) **Certificate Authority:** It is critical to ensure the highest levels of security in a grid because the grid is designed to execute code and not just share data. Thus, viruses, Trojan horses, and other attacks cane affect the grid system. The Certificate Authority is one of the most important aspects of maintaining strong grid security. An organization may choose to use an external Certificate Authority or operate one itself. The primary responsibilities of a Certificate Authority are as follows:

- Positively identifying entities requesting certificates;
- Issuing, removing, and archiving certificates;
- Protecting the Certificate Authority server;
- Maintaining a namespace of unique names for certificate owners;
- Serving signed certificates to those needing to authenticate entities; and
- Logging activity.

4. **BPM Life Cycle (BPM-L Cycle):** An Enterprise Resource Planning (ERP) application divides BPM into the following phases:

(i) **Analysis phase:** This involves analysis of the current environment and current processes, identification of needs and definition of requirements.

(ii) **Design phase:** This involves evaluation of potential solutions to meet the identified needs, business process designing and business process modeling.

(iii) **Implementation phase:** This involves project preparation, blue printing, realization, final preparation, go live and support.

(iv) **Run and Monitor phase:** This involves business process execution or deployment and business process monitoring.

(v) **Optimize:** Iterate for continuous improvement.

5. Control is defined as policies, procedures, practices and organization structure that are designed to provide reasonable assurance that business objectives are achieved and undesired events are prevented or detected and corrected.

Major control objectives are given as follows:

- **Authorization -** ensures that all transactions are approved by responsible personnel in accordance with their specific or general authority before the transaction is recorded.
- **Completeness -** ensures that no valid transactions have been omitted from the accounting records.
- **Accuracy -** ensures that all valid transactions are accurate, consistent with the originating transaction data and information is recorded in a timely manner.
- **Validity -** ensures that all recorded transactions fairly represent the economic events that occurred are lawful in nature, and have been executed in accordance with management's general authorization.
- **Physical Safeguards and Security -** ensures that access to physical assets and information systems are controlled and properly restricted to authorized personnel.
- **Error Handling -** ensures that errors detected at any stage of processing receive prompt corrective action and are reported to the appropriate level of management.
- **Segregation of Duties -** ensures that duties are assigned to individuals in a manner that ensures that no one individual can control both the recording function and the procedures relative to processing a transaction.

6. Transmission Media in telecommunication networks connects the message source with the message receiver by means of **Guided Media** and **Unguided Media**.

- ♦ **Guided Media/Bound Media:** Guided Transmission Media uses a "cabling" system that guides the data signals along a specific path. Some of the common examples of guided media are Twisted Pair, Coaxial cable and Fiber optics.
  - **Twisted-Pair Wire:** Twisted-pair is ordinary telephone wire, consisting of copper wire twisted into pairs. It is the most widely used media for telecommunications and is used for both voice and data transmissions. It is used extensively in home and office telephone systems and many LANs and WANs.
  - **Coaxial Cable:** This telecommunications media consists of copper or aluminium wire wrapped with spacers to insulate and protect it. Coaxial cables can carry a large volume of data and allows high-speed data transmission used in high-service metropolitan areas for cable TV systems, and for short-distance connection of computers and peripheral devices. It is used extensively in office buildings and other work sites for local area networks.

- **Fiber Optics:** This media consists of one or more hair-thin filaments of glass fiber wrapped in a protective jacket. Signals are converted to light form and fired by laser in bursts. Optical fibres can carry digital as well as analog signals and provides increased speed and greater carrying capacity than coaxial cable and twisted-pair lines.

♦ **Unguided Media/Unbound Media:** Unguided Transmission Media consists of a means for the data signals to travel but nothing to guide them along a specific path. The data signals are not bound to a cabling media. Some of the common examples of unguided media are Terrestrial Microwave, Radio waves, Micro Waves, Infrared Waves and Communications Satellites.

- **Terrestrial Microwave:** Terrestrial microwave media uses the atmosphere as the medium through which to transmit signals, and is used extensively for high-volume as well as long-distance communication of both data and voice in the form of electromagnetic waves.
- **Radio Waves:** Radio waves are an invisible form of electromagnetic radiation that varies in wavelength from around a millimeter to 100,000 km, making it one of the widest ranges in the electromagnetic spectrum. Radio waves are most commonly used transmission media in the wireless Local Area Networks.
- **Micro Waves:** Microwaves are radio waves with wavelengths ranging from as long as one meter to as short as one millimeter, or equivalently, with frequencies between 300 MHz (0.3 GHz) and 300 GHz. These are used for communication, radar systems, radio astronomy, navigation and spectroscopy.
- **Infrared Waves:** Infrared light is used in industrial, scientific, and medical applications. Night-vision devices using infrared illumination allow people or animals to be observed without the observer being detected.
- **Communication Satellites:** Communication satellites use the atmosphere (microwave radio waves) as the medium through which to transmit signals. A satellite is some solar-powered electronic device that receives, amplifies, and retransmits signals; the satellite acts as a relay station between satellite transmissions stations on the ground (earth stations). They are used extensively for high-volume as well as long-distance communication of both data and voice.

7. Major ways to make payments electronically are as follows:

(i) **Credit Cards:** In a credit card transaction, the steps involved are authorization, batching, clearing and funding. The consumer presents preliminary proof of his ability to pay by presenting his credit card number to the merchant. The merchant can verify this with the bank, and create a purchase slip for the consumer to endorse. The merchant then uses this purchase slip to collect funds from the bank, and, on the next billing cycle, the consumer receives a statement from the bank with a record of the transaction.

(ii) **Electronic Cheque:** Credit card payments are popular for commerce on the Internet. However, FSTC and CyberCash are two systems that let consumers use electronic cheques to pay Web merchants directly. Financial Services Technology Corporation (FSTC) is a consortium of banks and clearing houses that has designed an electronic cheque that is initiated electronically, and uses a digital signature for signing and endorsing. By CyberCash, electronic cheque functions as a message to the sender's bank to transfer funds, and, like a paper cheque, the message is given initially to the receiver who, in turn, endorses the cheque and presents it to the bank to obtain funds.

(iii) **Smart Cards:** Smart cards are any pocket sized card with embedded integrated circuits. Smart cards can provide identification authentications, data storage and application processing. Smart cards may serve as a credit or ATM cards, Fuel cards, mobile phone SIMs, access-control cards, public transport or public phone payment cards etc. on the card. Contact cards, Contactless cards and Combi/Hybrid Cards are the three types of Smart Cards.

(iv) **Electronic Purses:** Electronic Purse Card is very similar to a pre-paid card. Bank issues a stored value card to its customer, the customer can then transfer value from his/her account to the card at an ATM, a personal computer, or a specially equipped telephone. While making purchases, customers pass their cards through a vendor's Point of Sale terminal. Validation is done through a Personal Identification Number (PIN Number). Once the transaction is complete, funds are deducted directly from the cards and transferred to the vendor's terminal. When the value on a card is spent, consumers can load additional funds from their accounts to the card.

8. **Output Controls:** Output controls ensure that the data delivered to users will be presented, formatted and delivered in a consistent and secured manner. Whatever the type of output, it should be ensured that the confidentiality and integrity of the output is maintained and that the output is consistent. Output controls have to be enforced both in a batch-processing environment as well as in an online environment.

- **Storage and Logging of Sensitive and Critical Forms:** Pre-printed stationery should be stored securely to prevent unauthorized destruction or removal and usage. Only authorized persons should be allowed access to stationery supplies such as security forms, negotiable instruments etc.
- **Logging of Output Program Executions:** When programs, used for output of data, are executed, they should be logged and monitored.
- **Controls over Printing:** It should be ensured that unauthorized disclosure of information printed is prevented.
- **Report Distribution and Collection Controls:** Distribution of reports should be made in a secure way to avoid unauthorized disclosure of data. A log should be maintained as to what reports were generated and to whom it was distributed.
- **Retention Controls:** Retention controls consider the duration for which outputs should be retained before being destroyed. Consideration should be given to the type of medium on which the output is stored.
- **Existence/Recovery Controls:** These controls are needed to recover output in the event that it is lost or destroyed. If the output is written to a spool of files or report files and has been kept, then recovery is easy and straight-forward.

9. The three tiers in Three-tier architecture are as follows:

- **Presentation Tier:** This tier occupies the top level, communicates with other tiers and displays information related to services available on a website.
- **Application Tier:** Also, called the Middle tier, Logic tier, Business Logic or Logic tier; this tier controls application functionality by performing detailed processing.
- **Database Tier:** This tier houses the database servers where information is stored and retrieved. Data in this tier is kept independent of application servers or business logic.

10. List of activities that are executed by Operating systems include the following:

- ♦ **Performing hardware functions:** Application programs to perform tasks must obtain input from keyboards, retrieve data from disk & display output on monitors. Achieving all this is facilitated by operating system that acts as an intermediary between the application program and the hardware.
- ♦ **User Interfaces:** An important function of any operating system is to provide user interface. DOS has a Command based User Interface (UI) i.e. text commands were given to computer to execute any command, whereas Windows has Graphic User Interface (GUI) which uses icons & menus.

- **Hardware Independence:** Every computer could have different specifications and configurations of hardware. Operating system provides Application Program Interfaces (API) which can be used by application developers to create application software, thus obviating the need to understand the inner workings of OS and hardware. Thus, OS gives us hardware independence.
- **Memory Management:** Memory Management features of Operating System control how memory is accessed and maximizes available memory & storage. Operating systems also provides Virtual Memory by carving an area of hard disk to supplement the functional memory capacity of RAM.
- **Task Management:** Task Management feature of Operating system helps in allocating resources to make optimum utilization of resources. This facilitates a user to work with more than one application at a time i.e. multitasking and allows more than one user to use the system i.e. timesharing.
- **Networking Capability:** Operating systems can provide systems with features & capabilities to help connect computer networks. Like Linux & Windows 8 give us an excellent capability to connect to internet.
- **Logical Access Security:** Operating systems provide logical security by establishing a procedure for identification & authentication using a User ID and Password. It can log the user access thereby providing security control.
- **File Management:** The Operating System keeps a track of where each file is stored and who can access it, based on which it provides the file retrieval.

11. **Mobile Computing:** Mobile Computing is the use of portable computing devices (such as laptop and handheld computers) in conjunction with mobile communication technologies to enable users to access the Internet and data on their home or work computers from anywhere in the world. Mobile computing is enabled by use of mobile devices (portable and hand held computing devices) such as PDA, laptops, mobile phones, MP3 players, digital cameras, tablet PC and Palmtops on a wireless network.

    Mobile computing involves **Mobile Communication**, **Mobile Hardware** and **Mobile Software**; which are discussed as follows:

    - **Mobile Communication:** Mobile Communication refers to the infrastructure put in place to ensure that seamless and reliable communication goes on. These would include devices such as Protocols, Services, Bandwidth and Portals necessary to facilitate and support the stated services. The data format is also defined at this stage. The signals are carried over the air to intended devices that are capable of receiving and sending similar kind of signals. It will incorporate all aspects of wireless communication.

- **Mobile Hardware:** Mobile Hardware includes mobile devices or device components that receive or access the service of mobility. They would range from Portable laptops, Smart phones, Tablet PC's to Personal Digital Assistants. These devices will have receptors that can send and receiving signals. These devices are configured to operate in full- duplex, whereby they can send and receive signals at the same time.
- **Mobile Software:** Mobile Software is the actual program that runs on the mobile hardware. It deals with the characteristics and requirements of mobile applications. This is the engine of that mobile device. In other terms, it is the operating system of that appliance. It is the essential component that makes the mobile device operates.

12. Risks involved in e-Commerce are as follows:

- **Problem of anonymity:** There is need to identify and authenticate users in the virtual global market where anyone can sell to or buy from anyone, anything from anywhere.
- **Repudiation of contract:** There is possibility that the electronic transaction in the form of contract, sale order or purchase by the trading partner or customer may be denied.
- **Lack of authenticity of transactions:** The electronic documents that are produced in the course of an e-Commerce transaction may not be authentic and reliable.
- **Data Loss, Theft or Duplication:** The data transmitted over the Internet may be lost, duplicated, tampered with or replayed.
- **Attack from hackers:** Web servers used for e-Commerce may be vulnerable to hackers.
- **Denial of Service:** Service to customers may be denied due to non-availability of system as it may be affected by viruses, e-mail bombs and floods.
- **Non-recognition of electronic transactions:** e-Commerce transactions as electronic records and digital signatures may not be recognized as evidence in courts of law.
- **Lack of audit trails:** Audit trails in e-Commerce system may be lacking and the logs may be incomplete, too voluminous or easily tampered with.
- **Problem of piracy:** Intellectual property may not be adequately protected when such property is transacted through e-Commerce.

13. Some examples of Office Automation Systems are as follows:

Application	Description
Word Processing	Use of a computer to perform automatically many of the tasks necessary to prepare typed or printed documents.
Electronic mail	Use of a computer network that allows users to send, store and retrieve messages using terminals and storage devices.
Voice Mail	Requires computers with an ability to store audio messages digitally and convert them back upon retrieval.
Electronic Calendaring	Use of a networked computer to store and retrieve a manager's appointment calendar. Allows other managers' calendars to be accessed and facilitates scheduling.
Video Conferencing	Use of television equipment to link geographically dispersed conference participants.
Desktop Video Conferencing	Video and audio equipment are attached to each workstation in the network enabling the two-way communication of picture and way communication of picture and sound.
FAX	Uses special equipment that can read a document at one end of a communication channel and make a copy at the other end.
Imaging	Uses Optical Character Recognition (OCR) to convert data on paper to a digital format for storage in a secondary storage device.
Desktop Publishing	Uses a computer to prepare output that is very close in quality to that produced by a typesetter.

14. To use Grid Computing, a user's perspective is as follows:

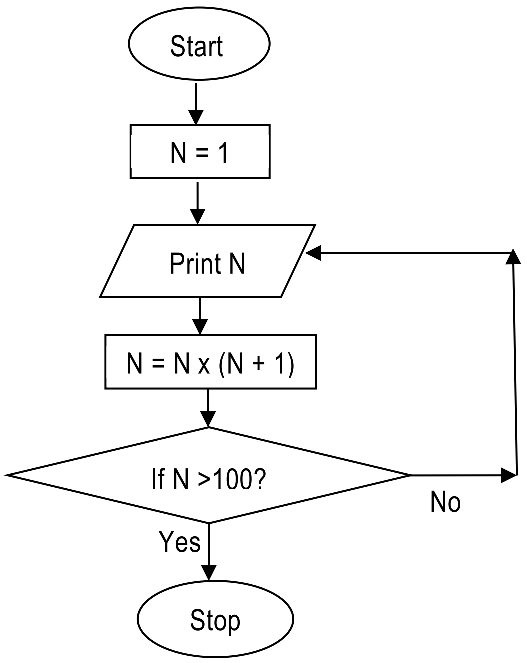
- **Enrolling and installing Grid Software:** A user may first have to enroll his machine as a donor on the grid and install the provided grid software on his own machine that may require authentication for security purposes. The user positively establishes his identity with a Certificate Authority who must take steps to assure that the user is in fact who he claims to be. Once the user and/or machine are authenticated, the grid software is provided to the user for installing on his machine for the purposes of using the grid as well as donating to the grid.

- **Logging onto the grid:** Most grid systems require the user to log on to a system using an ID that is enrolled in the grid. Once logged on, the user can query the grid and submit jobs. Some grid implementations permit some query functions if the user is not logged into the grid or even if the user is not enrolled in the grid.
- **Queries and submitting jobs:** The user will usually perform some queries to check to see how busy the grid is, to see how his submitted jobs are progressing, and to look for resources on the grid. Grid systems usually provide command-line tools as well as graphical user interfaces (GUIs) for queries. Job submission usually consists of three parts, even if there is only one command required.
    - First, some input data and possibly the executable program or execution script file are sent to the machine to execute the job.
    - Second, the job is executed on the grid machine. The grid software running on the donating machine executes the program in a process on the user's behalf.
    - Third, the results of the job are sent back to the submitter.
- **Data configuration:** The data accessed by the grid jobs may simply be staged in and out by the grid system. However, depending on its size and the number of jobs, this can potentially add up to a large amount of data traffic. For example, if there will be a very large number of sub-jobs running on most of the grid systems for an application that will be repeatedly run, the data they use may be copied to each machine and reside until the next time the application runs. This is preferable to using a networked file system to share this data, because in such a file system, the data would be effectively moved from a central location every time the application is run. This type of analysis is necessary for large jobs to better utilize the grid and not create unnecessary bottlenecks.
- **Monitoring progress and recovery:** The user can query the grid system to see how his application and its sub-jobs are progressing. When the number of sub-jobs becomes large, it becomes too difficult to list them all in a graphical window. Instead, there may simply be one large bar graph showing some averaged progress metric. It becomes more difficult for the user to tell if any particular sub-job is not running properly. A grid system, in conjunction with its job scheduler, often provides some degree of recovery for sub-jobs that fail. A job may fail due to a Programming error, Hardware or power failure, Communications interruption, and Excessive slowness due to infinite loop or some other form of contention.
- **Reserving resources:** To improve the quality of a service, the user may arrange to reserve a set of resources in advance for his exclusive or high-priority use. Such a reservation system can also be used in conjunction with planned hardware or software maintenance events, when the affected resource might not be available for grid use.

15. **(a)** Let us define the variable first:

N: Number

The desired flowchart is as follows:



(b) The output for the above program is as follows:

1

2

6

42

(c) The output of the above program in case N is initialized as 0 will be -

0, 0, 0, 0, 0 …………………………… (infinite loop)

SECTION – B: STRATEGIC MANAGEMENT

Correct/Incorrect with reasoning

1. State with reasons which of the following statements are correct/incorrect:
   - (a) The first step of strategy formulation in strategic management model is to undertake internal analysis.
   - (b) Vertical diversification integrates firms forward or backward in the product chain.
   - (c) Growth share matrix is popularly used for resource allocation.
   - (d) The term PESTLE is used to describe a framework for analysis of macro environmental factors.
   - (e) Key success factors are constant for all industries.
   - (f) Benchmarking is a process of one-time improvement in search for competitive advantage.
   - (g) In hourglass structure, more personnel are required at middle levels for effective functioning.
   - (h) Production strategy implements, supports and drives higher strategies.
   - (i) Changes in strategy may lead to changes in organizational structure.
   - (j) Strategic management is not needed in not-for-profit organisations.

Differences between the two concepts

2. Distinguish between the following:
   - (a) Forward integration and backward integration.
   - (b) DMAIC and DMADV methodology of six sigma.
   - (c) Transformational leadership style and Transactional leadership style.
   - (d) Logistic management and Supply chain management.

Short notes

3. Write short notes on the following:
   - (a) Characteristics of a Global Company.
   - (b) Importance of Strategic Management.
   - (c) Strategic groups.
   - (d) Need for Turnaround Strategy.

Brief answers

4. Briefly answer the following questions:

   (a) What does the concept of 'question marks' in the context of BCG Growth-share matrix signify? What strategic options are open to a business firm which has some 'question marks' in the portfolio of its businesses?

   (b) Determining an appropriate mix of debt and equity in a firm's capital structure can be vital to successful strategy implementation'. Discuss.

   (c) 'A network structure is suited to unstable environment.' Elaborate.

Descriptive answers

Chapter 1-Business Environment

5. What do you mean by micro environment of business? Explain its elements.

6. What are the strategic responses of an organization to its environment? Explain.

Chapter 2-Business Policy and Strategic Management

7. How strategic decisions differ in nature from other routine decisions taken in day-today working of an organization? Explain.

8. 'Organizations sustain superior performance over a long period of time, in spite of the rapid changes taking place continually in its competitive environment if they implement strategic management successfully.' Discuss.

Chapter 3-Strategic Analysis

9. A pharmaceutical company wants to grow its business. Draw Ansoff's Product Market Growth Matrix to advise them of the available options.

10. Explain the significance of SWOT analysis.

Chapter 4-Strategic Planning

11. Explain briefly following areas on which the strategic planners concentrate to achieve the long term prosperity:

    (i) Profitability

    (ii) Competitive position

    (iii) Employee development

    (iv) Public responsibility

12. Michael Porter has suggested three generic strategies. Explain them with examples.

Chapter 5-Formulation of Functional Strategy

13. What are the objectives that must be kept in mind while designing a pricing strategy of a new product?

14. Discuss the broad areas in which Functional Strategies of a business organization is carried out.

Chapter 6-Strategic Implementation and Control

15. Describe the concept of corporate culture. Elaborate the problems that business houses are facing while changing their culture to remain adaptive with the globally changing scenario.
16. ABC Ltd. plans to introduce changes in its structure, technology and people. Explain how Kurt Lewin's change process can help this firm.

Chapter 7-Reaching Strategic Edge

17. Define Business Process Re-engineering. Briefly outline the steps therein.
18. Explain in brief, how E-commerce environment has affected the business?

SUGGESTED ANSWERS / HINTS

1 (a) **Incorrect:** Identifying an organisation's existing vision, mission, objectives, and strategies is the starting point for any strategic management process because an organisation's existing situation and condition may preclude certain strategies and may even dictate a particular course of action. Determining vision and mission provides long-term direction, delineate what kind of enterprise the company is trying to become and infuse the organisation with a sense of purposeful action.

(b) **Correct:** In vertically integrated diversification, firms opt to engage in businesses that are related to the existing business of the firm. It moves forward or backward in the chain and enters specific product with the intention of making them part of new businesses for the firm.

(c) **Correct**: Growth share matrix also known for its cow and dog metaphors is popularly used for resource allocation in a diversified company. Primarily it categorises organisations/products on the basis two factors consisting of the growth opportunities and the market share enjoyed.

(d) **Correct:** The term PESTLE is used to describe a framework for analysis of macro environmental factors. PESTLE analysis involves identifying the political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy.

(e) **Incorrect:** Key success factors vary from industry to industry and even from time to time within the same industry as driving forces and competitive conditions change. Rarely an industry has more than three or four key success factors at any one time. And even among these three or four, one or two usually outrank the others in importance. Managers, therefore, have to resist the temptation to include factors that have only minor importance. To compile a list of every factor that matters even a little bit defeats the purpose of concentrating management attention on the factors truly critical to long-term competitive success.

(f) **Incorrect:** Benchmarking is a process of continuous improvement in search for competitive advantage. Firms can use benchmarking process to achieve improvement in diverse range of management function like maintenance operations, assessment of total manufacturing costs, product development, product distribution, customer services, plant utilisation levels and human resource management.

(g) **Incorrect:** Hourglass organization structure consists of three layers with constricted middle layer. The structure has a short and narrow middle-management level. Information technology links the top and bottom levels in the organization taking away many tasks that are performed by the middle level managers. A shrunken middle layer coordinates diverse lower level activities.

(h) **Correct:** For effective implementation of higher level strategies, strategists need to provide direction to functional managers, including production, regarding the plans and policies to be adopted. Production strategy provides a path for transmitting corporate and business level strategy to the production systems and makes it operational. It may relate to production planning, operational system, control and research & development.

(i) **Correct:** Changes in strategy may require changes in structure as the structure dictates how resources will be allocated. Structure should be designed to facilitate the strategic pursuit of a firm and, therefore, should follow strategy. Without a strategy or reasons for being, companies find it difficult to design an effective structure.

(j) **Incorrect** – Strategic management applies equally to profit as well as not-for-profit organizations. Though not-for-profit organizations are not working for the profit, they have to have purpose, vision and mission. They also work within the environmental forces and need to manage strategically to stay afloat to accomplish their objectives. For the purpose of continuity and meeting their goals, they also need to have and manage funds and other resources just like any other for-profit-organization.

2. **(a)** Forward and backward integration forms part of vertically integrated diversification. In vertically integrated diversification, firms opt to engage in businesses that are vertically related to the existing business of the firm. The firm remains vertically within the same process. While diversifying, firms opt to engage in businesses that are linked forward or backward in the chain and enters specific product/process steps with the intention of making them into new businesses for the firm.

Backward integration is a step towards creation of effective supply by entering business of input providers. Strategy employed to expand profits and gain greater control over production of a product whereby a company will purchase or build a business that will increase its own supply capability or lower its cost of production. On the other hand, forward integration is moving forward in the value chain and entering business lines that use existing products. Forward integration will also take place where organisations enter into businesses of distribution channels.

(b) For implementing six sigma, there are two separate key methodologies for existing and new processes. They are known as DMAIC and DMADV.

DMAIC is an acronym for five different steps used in six sigma - Define, Measure, Analyze Improve, and Control. DMAIC methodology is directed towards improvement of existing product, process or service.

- Define: To begin with six sigma experts define the process improvement goals that are consistent with the strategy of the organization and customer demands. They discuss different issues with the senior managers so as to define what needs to done.
- Measure: The existing processes are measured to facilitate future comparison. Six sigma experts collect process data by mapping and measuring relevant processes.
- Analyze: Verify cause-and-effect relationship between the factors in the processes. Experts need to identify the relationship between the factors. They have to make a comprehensive analysis to identify hidden or not so obvious factor.
- Improve: On the basis of the analysis experts make a detailed plan to improve.
- Control: Initial trial or pilots are run to establish process capability and transition to production. Afterwards continuously measure the process to ensure that variances are identified and corrected before they result in defects.

DMADV is an acronym for Define, Measure, Analyze, Design, and Verify. DMADV is a strategy for designing new products, processes and services.

- Define: As in case of DMAIC six sigma experts have to formally define goals of the design activity that are consistent with strategy of the organization and the demands of the customer.
- Measure: Next identify the factors that are critical to quality (CTQs). Measure factors such as product capabilities and production process capability. Also assess the risks involved.
- Analyze: Develop and design alternatives. Create high-level design and evaluate to select the best design.
- Design: Develop details of design and optimise it. Verify designs may require using techniques such as simulations.

- Verify: Verify designs through simulations or pilot runs. Verified and implemented processes are handed over to the process owners.

However, in spite of different orientation in two methodologies, conceptually there is overlapping between the DMAIC and DMADV as both are essentially having similar objectives.

(c) Difference between transformational and transactional leadership

1. Transformational leadership style uses charisma and enthusiasm to inspire people to exert them for the good of organization. Transactional leadership style uses the authority of its offices to exchange rewards such as pay, status, etc.
2. Transformational leadership style may be appropriate in turbulent environment, in industries at the very start or end of their cycles, poorly performing organisations, when there is a need to inspire a company to embrace major changes. Transactional leadership style can be appropriate in settled environment, in growing or mature industries and in organisations that are performing well.
3. Transformational leaders inspire employees by offering the excitement, vision, intellectual stimulation and personal satisfaction. Transactional leaders prefer a more formalized approach to motivation, setting clear goals with explicit rewards or penalties for achievement and non-achievement. Transactional leaders focus mainly to build on existing culture and enhance current practices.

(d) Supply chain management is an extension of logistic management. However, there are differences between the two. Logistical activities typically include management of inbound and outbound goods, transportation, warehousing, handling of material, fulfillment of orders, inventory management and supply/demand planning. Although these activities also form part of supply chain management, the latter is much broader. Logistic management can be termed as one of its part that is related to planning, implementing, and controlling the movement and storage of goods, services and related information between the point of origin and the point of consumption.

Supply chain management is an integrating function of all the major business activities and business processes within and across organisations. Supply Chain Management is a systems view of the linkages in the chain consisting of different channel partners – suppliers, intermediaries, third-party service providers and customers. Different elements in the chain work together in a collaborative and coordinated manner. Often it is used as a tool of business transformation and involves delivering the right product at the right time to the right place and at the right price.

3. (a) In simple economic terms, globalization refers to the process of integration of world into one huge market. At the company level, globalization means two things: (a) the company commits itself heavily with several manufacturing locations around the world and offers products in several diversified industries and (b) it also means ability to compete in domestic markets with foreign competitors.

The global company views the world as one market minimizing the importance of national boundaries. A global company has three attributes:

(i) It is a conglomerate of multiple units located in different parts of the globe but all linked with common ownership.

(ii) Multiple units draw a common pool of resources such as money, credit, patents, trade name, etc.

(iii) The units respond to common strategy.

(b) **Importance of Strategic Management:** Strategic Management is very important for the survival and growth of business organizations in dynamic business environment. Other major benefits of strategic management are as follows:

- It helps organizations to be more proactive rather than reactive in dealing with its future. It facilitates the organisations to work within vagaries of environment and remains adaptable with the turbulence or uncertain future. Therefore, they are able to control their own destiny in a better way.
- It provides better guidance to entire organization on the crucial point – what it is trying to do. Also provides framework for all major business decisions of an enterprise such a decision on businesses, products, markets, organization structures, etc.
- It facilitates to prepare the organization to face the future and act as pathfinder to various business opportunities. Organizations are able to identify the available opportunities and identify ways and means as how to reach them.
- It serves as a corporate defence mechanism against mistakes and pitfalls. It helps organizations to avoid costly mistakes in product market choices or investments.
- Over a period of time, strategic management helps organizations to evolve certain core competencies and competitive advantages that assist in the fight for survival and growth.

(c) Strategic groups are clusters of competitors that share similar strategies and therefore compete more directly with one another than with other firms in the same industry. Strong economic compulsions often constrain these firms from switching one competitive posture to another. An industry contains only one strategic group when all firms essentially have identical strategies and have comparable market positions. At the other extreme, there are as many strategic groups as there are competitors when each rival pursues a distinctively different competitive approach and occupies a substantially different competitive position in the market place.

(d) Turnaround is needed when an enterprise's performance deteriorates to a point that it needs a radical change of direction in strategy, and possibly in structure and culture as well. It is a highly targeted effort to return an organization to profitability and increase positive cash flows to a sufficient level. It is used when both threats and weaknesses adversely affect the health of an organization so much that its basic survival is difficult.

The overall goal of turnaround strategy is to return an underperforming or distressed company to normalcy in terms of acceptable levels of profitability, solvency, liquidity and cash flow. To achieve its objectives, turnaround strategy must reverse causes of distress, resolve the financial crisis, achieve a rapid improvement in financial performance, regain stakeholder support, and overcome internal constraints and unfavourable industry characteristics.

4. (a) The BCG growth-share matrix is the simplest way to portray a corporation's portfolio of investments. Using the matrix, organisations can identify four different types of products or Strategic Business Units. *Question Marks,* sometimes called problem children or wildcats, are low market share businesses in high-growth markets.

They require a lot of cash to hold their share. They need heavy investments with low potential to generate cash. Question marks if left unattended are capable of becoming cash traps. Since growth rate is high, increasing it should be relatively easier.

It is for business organisations to turn those businesses into stars and then to cash cows when the growth rate reduces. *Thus the strategic option that they must strive to achieve is to build.* Here the objective is to increase market share, even by forgoing short-term earnings in favour of building a strong future with large market share.

(b) Successful strategy implementation often requires additional capital. Besides net profit from operations and the sale of assets, two basic sources of capital for an organization are debt and equity. Fixed debt obligations generally must be met, regardless of financial or operating performance. This does not mean that equity issuances are always better than debt for raising capital. If ordinary stock is issued to finance strategy implementation; ownership and control of the enterprise gets diluted. This can be a serious concern in today's business environment of hostile takeovers, mergers, and acquisitions.

The major factors regarding which strategies have to be made by a financial manager are: capital structure; procurement of capital and working capital borrowings; reserves and surplus as sources of funds; and relationship with lenders, banks and financial institutions. Strategies related to the sources of funds are important since they determine how financial resources will be made available for the implementation of strategies. Organizations have a range of alternatives regarding the sources of funds. While one company may rely on external borrowings, another may follow a policy of internal financing.

(c) Network structure is a newer and somewhat more radical organizational design. The network structure could be termed a "non-structure" as it virtually eliminates in-house business functions and outsource many of them. An organisation organized in this manner is often called a virtual organization because it is composed of a series of project groups or collaborations linked by constantly changing non-hierarchical, cobweb-like networks. The network structure becomes most useful when the environment of a firm is unstable and is expected to remain so. Under such conditions, there is usually a strong need for innovation and quick response. Instead of having salaried employees, it may contract with people for a specific project or length of time. Long-term contracts with suppliers and distributors replace services that the company could provide for itself.

5. The environment of business can be categorised into two broad categories micro-environment and macro-environment. Micro-environment is related to small area or immediate periphery of an organization. Micro-environment influences an organization regularly and directly. Developments in the micro environment have direct impact on the working of organizations. Micro environment includes the company itself, its suppliers, marketing intermediaries, customer markets and competitors. The elements of micro environment are specific to the said business and affects its working on short term basis.

- **Consumers / Customers:** Customers who may or may not be consumers are the people who pay money to acquire organisational products and services. Consumer is the one who ultimately consumes or uses the product or services. The marketer has to closely monitor and analyse the changes in the consumer tastes and preferences and their buying habits. Consumer occupies the central position in the market.
- **Competitors:** Competitors are the other business entities that compete for resources as well as markets. A study of the competitive scenario is essential for the marketer, particularly threats from competition.
- **Organization:** Individuals occupying different positions or working in different capacities in organizations consists of individuals who come from outside. They have different and varied interests. An organization has several non-specific elements in form of individuals and groups that may affect its activities. Owners, board of directors and employees form part of organisation.
- **Market:** The market is larger than customers. The market is to be studied in terms of its actual and potential size, its growth prospect and also its attractiveness. The marketer should study the trends and development and the key success factors of the market.
- **Suppliers:** Suppliers form an important component of the micro environment. The suppliers provide raw materials, equipment, services and so on. Suppliers with their own bargaining power affect the cost structure of the industry. They constitute a major force, which shapes competition in the industry.

- **Market Intermediaries:** Intermediaries bridge the gap between the organisations and customers. They are in form of stockist, wholesalers and retailers. They exert considerable influence on the business organizations. In many cases the consumers are not aware of the manufacturer of the products they buy. They buy product from the local retailers or big departmental stores.

6. A business organization and its many environments have in numerous interrelationship. It is difficult to determine exactly what the business organisation should do in response to a particular situation in the environment. Strategically, the business organisations should make efforts to exploit the opportunities and avoid the threats.

In this context, following are the possible strategic responses of an organisation to its business environment:

(i) **Least resistance:** Some organisations just manage to survive by way of coping with their changing external environments. They are simple goal-maintaining units. They are very passive in their behaviour and are solely guided by the signals of the external environment. They are not ambitious but are content with taking simple paths of least resistance in their goal-seeking and resource transforming behaviour.

(ii) **Proceed with caution:** At the next level, are the organisations that take an intelligent interest to adapt with the changing external environment. They seek to monitor the changes in that environment, analyse their impact on their own goals and activities and translate their assessment in terms of specific strategies for survival, stability and strength. This is a sophisticated strategy than to wait for changes to occur and then take corrective-adaptive action.

(iii) **Dynamic response:** At a still higher sophisticated level, are those organisations that regard the external environmental forces as partially manageable and controllable by their actions. Their feedback systems are highly dynamic and powerful. They not merely recognise and ward off threats; they convert threats into opportunities. They are highly conscious and confident of their own strengths and the weaknesses of their external environmental 'adversaries'. They generate a contingent set of alternative courses of action to be picked up in tune with the changing environment.

7. Strategic decisions are different in nature than all other decisions which are taken at various levels of the organization during day-to-day working of the organizations. The major dimensions of strategic decisions are given below:

- Strategic issues require top-management decisions.
- Strategic issues involve the allocation of large amounts of company resources.
- Strategic issues are likely to have a significant impact on the long term prosperity of the firm.
- Strategic issues are future oriented.
- Strategic issues usually have major multifunctional or multi-business consequences.
- Strategic issues necessitate consideration of factors in the firm's external environment.

8. Business organizations function within dynamic environment. The environment may vary from being conducive to hostile. Whatever be the conditions, implementation of strategic management is very important for the survival and growth of business organizations. Strategy implementation helps in improving the competence with which it is executed and helps organizations to sustain superior performance in following manner:

- Strategic management helps organizations to be more proactive rather than reactive in dealing with its future.
- It provides better guidance to entire organization on the crucial point – what it is trying to do.
- It facilitates to prepare the organization to face the future. Organizations are able to identify the available opportunities and identify ways and means as how to reach them.
- It serves as a corporate defense mechanism against mistakes and pitfalls.
- Over a period of time strategic management helps organization to evolve certain core competencies and competitive advantages.

9. The Ansoff's product market growth matrix (proposed by Igor Ansoff) is a useful tool that helps businesses decide their product and market growth strategy. With the use of this matrix a business can get a fair idea about how its growth depends upon it markets in new or existing products in both new and existing markets.

The Ansoff's product market growth matrix is as follows:

	Existing Products	**New Products**
Existing Markets	Market Penetration	Product Development
New Markets	Market Development	Diversification

Based on the matrix, A may segregate its different products. Being in pharmaceuticals, development of new products is result of extensive research and involves huge costs. There are also social dimensions that may influence the decision of the company. It can adopt penetration, product development, market development or diversification simultaneously for its different products.

Market penetration refers to a growth strategy where the business focuses on selling existing products into existing markets. It is achieved by making more sales to present customers without changing products in any major way. Market development refers to a growth strategy where the business seeks to sell its existing products into new markets. It is a strategy for company growth by identifying and developing new markets for current company products. Product development is refers to a growth strategy where business aims to introduce new products into existing markets. It is a strategy for company growth by offering modified or new products to current markets. Diversification refers to a growth strategy where a business markets new products in new markets. It is a strategy by starting up or acquiring businesses outside the company's current products and markets.

As market conditions change overtime, a company may shift product-market growth strategies. For example, when its present market is fully saturated a company may have no choice other than to pursue new market.

10. An important component of strategic thinking requires the generation of a series of strategic alternatives, or choices of future strategies to pursue, given the company's internal strengths and weaknesses and its external opportunities and threats. The comparison of strengths, weaknesses, opportunities, and threats is normally referred to as SWOT analysis. SWOT analysis helps managers to craft business model that will allow a company to gain a competitive advantage. Key reasons for SWOT analyses are:

- It provides a logical framework for systematic identification of issues having bearing on the business situation, generation of alternative strategies and the choice of a strategy.
- It presents a comparative account of both external and internal environment in a structured form where it is possible to compare external opportunities and threats with internal strengths and weaknesses.
- It guides the strategist in strategy identification. It guides the strategist to think of overall position of the organization that helps to identify the major purpose of the strategy under focus.

11. Following are the areas on which the strategic planners concentrate to achieve the long term prosperity:

(i) **Profitability:** The ability of an organization to operate in the long run depends on achieving an adequate level of profits. These profits usually expressed in terms of earnings per share or return on equity.

(ii) **Competitive position:** The method of knowing the organization's success is based on the relative dominance of an organization in the market place. Organizations commonly establish an objective in terms of competitive position, using total sales or market place as measures of their competitive position.

(iii) **Employee development:** Providing employee value education and training leads to increased compensation and job security. Providing such opportunities often increases productivity and decreases turnover.

(iv) **Public responsibility:** Managers recognize their responsibilities towards their customers and to society at large. Many organizations work not only to develop reputations for fairly priced products and services but also to establish themselves as responsible corporate citizens.

12. The basic purpose of following a generic strategy is to gain competitive advantage so as to ensure long-time survival and growth. According to Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. These bases form different generic strategies as follows:

- **Cost leadership** emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive. It frequently results from productivity increases and aggressive pursuit of cost reduction throughout the development, production, marketing, and distribution processes. It allows a firm to earn higher profits than its competitors. For example, car manufacturers Maruti and Hyundai work on reducing their costs to sell their cars in popular segment at attractive prices.
- **Differentiation** is a strategy aimed at producing products and services considered unique industry wide and directed at consumers who are relatively price-insensitive. It concerns with distinguishing a product/service from that of its competitors through unique design features, technological leadership, unique uses of products and attributes like quality, environmental impact and customer service. For example, Apple brings out mobile phone with distinct features.
- **Focus** means producing products and services that fulfil the specific needs of small groups of consumers. It involves selecting or focusing a market or customer segment in which to operate. For example, Nestle KitKat targeting on teenagers and young adults or Johnson and Johnson having host of products such as cream, shampoo, brushes for infants and young babies.

13. For a new product pricing strategies for entering a market needs to be designed. In pricing a really new product at least three objectives must be kept in mind.

i. Making the product acceptable to the customers.

ii. Producing a reasonable margin over cost.

iii. Achieving a market that helps in developing market share.

For a new product an organization may either choose to skim or penetrate the market. In skimming prices are set at a very high level. The product is directed to those buyers who are relatively price insensitive but sensitive to the novelty of the new product. For example call rates of mobile telephony were set very high initially. Even the incoming calls were charged. Since the initial off take of the product is low, high price, in a way, helps in rationing of supply in favour of those who can afford it.

In penetration pricing firm keeps a temptingly low price for a new product which itself is selling point. A very large number of the potential customers may be able to afford and willing to try the product.

14. Once higher level corporate and business strategies are developed, management need to formulate and implement strategies for each functional area. Functional strategies provide details to business strategy & governs as to how key activities of the business are to be managed. Functional area strategy include marketing, financial, production and human resource management are based on the functional capabilities of an organisation.

i. **Marketing:** Marketing is considered to be activities related to identifying the needs of customers and taking such actions to satisfy them in return of some consideration.

ii. **Finance:** Financial strategies are related to several finance and accounting concepts considered to be central to strategy implementation.

iii. **Production:** The strategy for production is related to the production system, operational planning and control, and research and development.

iv. **Logistics:** Logistics integrates the flow of supplies into, through and out of an organization to achieve a level of service to ensure availability of right materials at right place, at right time in right quality and at right cost.

v. **Research and Development:** R&D strategy is designed to match external opportunities to internal strengths to achieve organisational objectives.

vi. **Human Resource Development:** Human resource strategy is designed to develop employees, provide them suitable opportunities and proper working conditions so as to ensure their optimal contribution.

15. The phenomenon which often distinguishes good organizations from bad ones could be summed up as 'corporate culture'. Corporate culture refers to a company's values, beliefs, business principles, traditions, and ways of operating and internal work environment. Every corporation has a culture that exerts powerful influences on the behaviour of managers. Culture affects not only the way managers behave within an organization but also the decisions they make about the organization's relationships with its environment and its strategy.

Changing a company's culture to align it with strategy is among the toughest management tasks-easier to talk about than do. Changing culture and making it to remain adaptive with the globally changing scenario is very difficult because of the heavy anchor of deeply held values and habits. It takes concerted management action over a sustained period of time to replace an unhealthy culture with a healthy culture or to root out certain unwanted cultural obstacles and instil ones that are more strategy-supportive.

The following needs to be done to change the culture for making it to remain adaptive with globally changing scenario:

1. To diagnose which facets of the present culture are strategy supportive and which are not.
2. Managers have to talk openly and forthrightly to all concerned about those aspects of the culture that have to be changed.
3. Talk has to be followed swiftly by visible, aggressive actions to modify the culture-actions that everyone will understand are intended to establish a new culture more in tune with the strategy.
4. The culture-changing actions include revising policies and procedures in ways that will help drive cultural change, altering incentive compensation (to reward the desired cultural behaviour), praising and recognizing people who display the new cultural traits, recruiting and hiring new managers and employees who have the desired

cultural values and can serve as role models for the desired cultural behaviour, replacing key executives who are strongly associated with the old culture, and taking every opportunity to communicate to employees the basis for cultural change and its benefits to all concerned.

16. The changes in the environmental forces often require businesses to make modifications in their existing strategies and bring out new strategies. Strategic change is a complex process and it involves a corporate strategy focused on new markets, products, services and new ways of doing business.

To make the change lasting, Kurt Lewin proposed three phases of the change process for moving the organization from the present to the future. These stages are unfreezing, changing and refreezing.

(a) **Unfreezing the situation:** The process of unfreezing simply makes the individuals or organizations aware of the necessity for change and prepares them for such a change. Lewin proposes that the changes should not come as a surprise to the members of the organization. Sudden and unannounced change would be socially destructive and morale lowering. The management must pave the way for the change by first "unfreezing the situation", so that members would be willing and ready to accept the change.

Unfreezing is the process of breaking down the old attitudes and behaviours, customs and traditions so that they start with a clean slate. This can be achieved by making announcements, holding meetings and promoting the ideas throughout the organization.

(b) **Changing to New situation:** Once the unfreezing process has been completed and the members of the organization recognise the need for change and have been fully prepared to accept such change, their behaviour patterns need to be redefined. H.C. Kellman has proposed three methods for reassigning new patterns of behaviour. These are compliance, identification and internalisation.

- **Compliance:** It is achieved by strictly enforcing the reward and punishment strategy for good or bad behaviour. Fear of punishment, actual punishment or actual reward seems to change behaviour for the better.
- **Identification:** Identification occurs when members are psychologically impressed upon to identify themselves with some given role models whose behaviour they would like to adopt and try to become like them.
- **Internalization:** Internalization involves some internal changing of the individual's thought processes in order to adjust to a new environment. They have given freedom to learn and adopt new behaviour in order to succeed in the new set of circumstances.

(c) **Refreezing:** Refreezing occurs when the new behaviour becomes a normal way of life. The new behaviour must replace the former behaviour completely for successful and permanent change to take place. In order for the new behaviour to become permanent, it must be continuously reinforced so that this newly acquired behaviour does not diminish or extinguish.

Change process is not a one time application but a continuous process due to dynamism and ever changing environment. The process of unfreezing, changing and refreezing is a cyclical one and remains continuously in action.

17. Business Process Reengineering (BPR) is an approach to unusual improvement in operating effectiveness through the redesigning of critical business processes and supporting business systems. It is revolutionary redesign of key business processes that involves examination of the basic process itself. It looks at the minute details of the process, such as why the work is done, who does it, where is it done and when it is done. BPR refers to the analysis and redesign of workflows and processes both within the organization and between the organization and the external entities like suppliers, distributors, and service providers.

The orientation of redesigning efforts is basically radical. In other words, it is a total deconstruction and rethinking of business process in its entirety, unconstrained by its existing structure and pattern. Its objective is to obtain quantum jump in process performance in terms of time, cost, output, quality, and responsiveness to customers. BPR is a revolutionary redesigning of key business processes.

BPR involves the following steps:

1. **Determining objectives and framework:** Objectives are the desired end results of the redesign process which the management and organization attempts to achieve. This will provide the required focus, direction, and motivation for the redesign process. It helps in building a comprehensive foundation for the reengineering process.
2. **Identify customers and determine their needs*:*** The designers have to understand customers - their profile, their steps in acquiring, using and disposing a product. The purpose is to redesign business process that clearly provides added value to the customer.
3. **Study the existing process:** The existing processes will provide an important base for the redesigners. The purpose is to gain an understanding of the 'what', and 'why' of the targeted process. However, some companies go through the reengineering process with clean perspective without laying emphasis on the past processes.
4. **Formulate a redesign process plan:** The information gained through the earlier steps is translated into an ideal redesign process. Formulation of redesign plan is the real crux of the reengineering efforts. Customer focussed redesign concepts are identified and formulated. In this step alternative processes are considered and the best is selected.

5. **Implement the redesign:** It is easier to formulate new process than to implement them. Implementation of the redesigned process and application of other knowledge gained from the previous steps is key to achieve dramatic improvements. It is the joint responsibility of the designers and management to operationalise the new process.

18. Growing use of the Internet by businesses and consumers reshapes the economic landscape and alters traditional industry boundaries. The following features stand out:

- The Internet makes it feasible for companies everywhere to compete in global markets.
- Competition in an industry is greatly intensified by the new e-commerce strategic initiatives of existing rivals and by the entry of new, enterprising e-commerce rivals.
- Entry barriers into the e-commerce world are relatively low.
- Online buyers gain bargaining power because they confront far fewer obstacles to comparing the products, prices, and shipping times of rival vendors.
- The Internet makes it feasible for companies to reach beyond their borders to find the best suppliers and, further, to collaborate closely with them to achieve efficiency gains and cost savings.
- Internet and PC technologies are advancing rapidly, often in uncertain and unexpected directions.
- The internet results in much faster diffusion of new technology and new idea across the world.
- The e-commerce environment demands that companies move swiftly.
- E-commerce technology opens up a host of opportunities for reconfiguring industry and company value chains.
- The Internet can be an economical means of delivering customer service.
- The needed e-commerce resource in short supply is human talent-in the form of both technological expertise and managerial know-how.