Solved

Scanner

# Appendix

## CS Executive Programme Module - II (New Syllabus)

(**Solution of December - 2014)**

**Paper - 5: Company Accounts and Auditing Practice**

**Chapter- 1: Share Capital**

**2014 - Dec [2A] (Or)** (i)

**Statement showing liability of underwriter's**

| Particulars | Marigold 35% | Lotus 25% | Tulip 30% | Lily 10% |
|---|---|---|---|---|
| Gross Liability | 35,000 | 25,000 | 30,000 | 10,000 |
| *Less*: Marked application | 20,000 | 15,000 | 22,000 | 8,000 |
| | 15,000 | 10,000 | 8,000 | 2,000 |
| *Less*: Unmarked application (W.N.1) 15,000 in Gross liability ratio 7:5:6:2 | 5,250 | 3,750 | 4,500 | 1,500 |
| Net Liability | 9,750 | 6,250 | 3,500 | 500 |

**Working Note:**

**Calculation of Unmarked application**

| | |
|---|---|
| Total application | 80,000 |
| *Less*: Marked application (20,000+15,000+22,000+,8000) | (65,000) |
| | 15,000 |

## Chapter- 2: Debentures

**2014 - Dec [2]** (c)

**Journal Entry**

| Particulars | | Dr. (₹) | Cr. (₹) |
|---|---|---|---|
| Bank A/c | Dr. | 9,50,000 | |
| Loss on Issue of Debentures A/c | Dr. | 1,50,000 | |
| To 12% Debentures A/c | | | 10,00,000 |
| To Premium on Redemption of Deb. A/c | | | 1,00,000 |
| (Allotment of 10,000 12% debentures of ₹ 100 each issued at a discount of 5% and redeemable at a premium of 10% after 5 years as per Board's Resolution dated.....) | | | |

**Note:** Total loss on issue of debentures has been arrived at as follows:
Loss on issue of debentures = Discount on issue + Premium on redemption
= ₹ (50,000 + 1,00,000) = ₹ 1,50,000
This total loss of ₹ 1,50,000 has to be written off over a period of 5 years.
Therefore, every year 1/5 of ₹ 1,50,000 = ₹ 30,000 have to be written off.

Dr. Cr.

| Date | Particulars | ₹ | Date | Particulars | ₹ |
|---|---|---|---|---|---|
| 1st Year (at the beginning) | To 12% Debentures A/c | 50,000 | 1st Year (at the end) | By Profit and Loss A/c | 30,000 |
| | To Premium on Redemption A/c | 1,00,000 | | By Balance c/d | 1,20,000 |
| | | 1,50,000 | | | 1,50,000 |
| 2nd Year (at the beginning) | To Balance b/d | 1,20,000 | 2nd Year (at the end) | BY Profit and Loss A/c | 30,000 |
| | | | | By Balance c/d | 90,000 |
| | | 1,20,000 | | | 1,20,000 |
| 3rd Year (at the beginning | To Balance b/d | 90,000 | 3rd Year (at the end) | By Profit and Loss A/c | 30,000 |
| | | | | By Balance c/d | 60,000 |
| | | 90,000 | | | 90,000 |

| | | | | | |
|---|---|---|---|---|---|
| 4th Year (at the beginning) | To Balance b/d | 60,000 | 4th Year (at the end) | By Profit and Loss A/c | 30,000 |
| | | | | By Balance c/d | 30,000 |
| | | 60,000 | | | 60,000 |
| 5th Year (at the beginning) | To Balance b/d | 30,000 | 5th Year (at the end) | By Profit and Loss A/c | 30,000 |
| | | 30,000 | | | 30,000 |

## Chapter- 3: Final Accounts of Companies

**2014 - Dec [1]** (a)

According to Section 198(2), credit shall be given for the bounties and subsidies received from any Government or any public authority constituted or authorised in this behalf, by any Government, unless and except in so far as the Central Government otherwise directs.

**According to Section 198(3), credit shall not be given for the following sums, namely:**

(a) profits, by way of premium on shares or debentures of the company, which are issued or sold by the company;
(b) profits on sales by the company of forfeited shares;
(c) profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof;
(d) profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets:
Provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written down value;
(e) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

**According to Section 198(4), the following sums shall be deducted, namely:**

(a) all the usual working charges;
(b) directors' remuneration;

(c) bonus or commission paid or payable to any member of the company's staff, or to any engineer, technician or person employed or engaged by the company, whether on a whole-time or on a part-time basis;
(d) any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits;
(e) any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf;
(f) interest on debentures issued by the company;
(g) interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets;
(h) interest on unsecured loans and advances.

**2014 - Dec [1]** (c)

Preliminary expenses should not include the following expenses which are incurred before commencement of business:

(i) Cost of preparation of the feasibility report.
(ii) Cost of preparation of the project report.
(iii) Cost of conducting market survey or any other survey necessary for the business of the company.
(iv) Consultancy fees payable for engineering services in connection with the business.

Generally, a limit is prescribed in the Articles or Prospectus or the Statement in lieu of Prospectus upto which any amount would be spent on preliminary expenses. But sanction of the shareholders is necessary if the amount spent on preliminary expenses exceeds the said limit. The accounting for preliminary expenses will be as follows:

Preliminary Expenses A/c Dr. with the amount of expenditure
To Cash or Bank A/c

Strictly speaking preliminary expenses are of capital nature and as such should be shown on the assets side of the Balance Sheet under the heading "Miscellaneous Expenditure".

Although, there is no legal compulsion to write off the amount of preliminary expenses, it is prudent to write it off as soon as possible since, it is unrepresented by assets. Preliminary expenses being of capital nature, may be written off against capital profits.

**2014 - Dec [2A] (Or)** (ii)

The profit or loss of the business, thus acquired, the period from the date of purchase till the date of incorporation is called Profit or Loss Prior to Incorporation. Unless the agreement with the vendors provides otherwise, such a profit or loss belongs to the company. But profit or loss prior to incorporation should not be regarded as trading profit or loss of the company since the company cannot earn profit or incur loss before it

comes into existence. In fact, such profit or loss increases or decreases the net assets acquired by the company on its formation and comes to it not as revenue but as capital. Thus, profit or loss prior to incorporation is of capital nature and as such it is necessary to ascertain such profit or loss as accurately as possible.

The profit or loss prior to incorporation should be treated in the books of accounts in the following manner:

(i) **Profit prior to incorporation:** Such a profit, being of capital nature, cannot be credited to the Profit and Loss Account and thus it cannot ordinarily be used for the purpose of payment of dividend. Hence, such a profit should be credited to Capital Reserve Account which can be utilised in writing off capital losses like preliminary expenses, discount on issue of shares or debentures or in writing down the value of fixed assets including goodwill. Until it is fully utilized, Capital Reserve Account has to be shown in the liabilities side of the Balance Sheet under the heading "Reserve and Surplus".

(ii) **Loss prior to incorporation:** Such a loss, being of capital nature, should be debited to a separate account called "Loss Prior to Incorporation Account" which can be written off against other capital profits of the company. It can also be written off against the profit revenue profit of the company.

**2014 - Dec [3]** (b)

**Working Note 1:**

**Calculation of Profit for the purpose of Managerial Remuneration**

| | | | |
|---|---|---|---|
| N.P. | | | 20,00,000 |
| + | Depreciation | 4,00,000 | |
| + | Preliminary expenses | 1,00,000 | |
| + | Provision for tax | 31,00,000 | |
| + | Bonus | 1,50,000 | |
| + | Provision for Doubtful debt | 90,000 | |
| + | Scientific Research expenditure (It is treated as capital expenditure) | 2,00,000 | |
| + | Managing Director Remuneration | 3,00,000 | 43,40,000 |
| *Less*: | Depreciation allowable | 3,50,000 | |
| *Less*: | Bonus liability as per Bonus Act, 1965 | 1,80,000 | |
| *Less*: | Capital Profit on sale of fixed assets (Sale price-cost price) (1,10,000 + 1,55,000 - 2,00,000) | 65,000 | (5,95,000) |
| | **Profit** | | **57,45,000** |

**Calculation of Managerial Remuneration**

5% of Profit i.e. 5% of 57,45,000 = ₹ 2,87,250

**Chapter- 4: Corporate Restructuring**

**2014 - Dec [1]** (d)

The following are the distinguishing features of 'pooling of interest method' and 'purchase method' of accounting for amalgamations:

| | Pooling of Interest Method | Purchase Method |
|---|---|---|
| (i) | This method is applicable for amalgamations which are in the nature of merger. | This method is applicable for amalgamations which are in the nature of purchase. |
| (ii) | Assets, liabilities, reserves and profit and loss account of the transferor company are all incorporated through journal in the financial statements of transferee company. Hence, there is a wholesome and total aggregation of financial figures. | There is only a partial aggregation, as only assets and liabilities are combined with that of assets and liabilities of the transferee company. Reserves and profit and loss account are not incorporated. Hence, there is partial aggregation of financial figures. |
| (iii) | No goodwill or capital reserve account is to come about as a result of difference between the consideration paid and the net assets taken over by the transferee company. The difference is to be adjusted in general reserve or other reserves. | The difference of consideration paid and the net assets taken over by the transferee company is either goodwill or capital reserve. |
| (iv) | No account called amalgamation adjustment account is to be brought into books, as all the reserves are taken into the books of the transferee company. | The transferee company has to carry forward any statutory reserve for legal compliance by debiting amalgamation adjustment account and crediting statutory reserve account. The amalgamation adjustment account will be shown on the assets side of balance sheet of the transferee company under the head Miscellaneous Expenditure. |

**2014 - Dec [2A] (Or)** (iii)

The meaning of the term 'Corporate Restructuring' is quite wide and varied. Depending upon the requirements of a company, it is possible to restructure its business, financial and organizational transactions in different forms. Restructuring is a method of changing the organizational structure in order to achieve the strategic goals of the organization or to sharpen the focus on achieving them. The essentials of Corporate Restructuring are efficient and competitive business operations by increasing the market share, brand power and synergies.

**WHY CORPORATE STRUCTURING EXERCISE IS CARRIED OUT ?**

**The various needs for undertaking a Corporate Restructuring exercise are as follows:**

(i) to focus on core strengths, operational synergy and efficient allocation of managerial capabilities and infrastructure.

(ii) consolidation and economies of scale by expansion and diversion to exploit extended domestic and global markets.

(iii) revival and rehabilitation of a sick unit by adjusting losses of the sick unit with profits of a healthy company.

(iv) acquiring constant supply of raw materials and access to scientific research and technological developments.

(v) capital restructuring by appropriate mix of loan and equity funds to reduce the cost of servicing and improve return on capital employed.

(vi) Improve corporate performance to bring it at par with competitors by adopting the radical changes brought out by information technology.

**2014 - Dec [3]** (c)

**(Journal Entries in the book of Thin Ltd.)**

| | Particulars | | Dr. (₹) | Cr. (₹) |
|---|---|---|---|---|
| (i) | Business Purchase A/c | Dr. | 25,00,000 | |
| | To Ganesh A/c | | | 25,00,000 |
| | (Being consideration due) | | | |
| (ii) | Freehold Premises A/c | Dr. | 10,00,000 | |
| | Plant and Machinery A/c | Dr. | 8,00,000 | |
| | Inventories A/c | Dr. | 2,00,000 | |
| | Trade Receivable A/c | Dr. | 2,75,000 | |
| | Bank A/c | Dr. | 7,50,000 | |
| | Goodwill A/c | Dr. | 3,00,000 | |
| | To Provision for bad debt A/c | | | 2,50,000 |
| | To Trade payable A/c | | | 5,00,000 |
| | To Bills payable A/c | | | 3,00,000 |
| | To Business Purchase A/c | | | 25,00,000 |
| | (Being Assets and liability taken over ) | | | |

| | | | | |
|---|---|---|---|---|
| (iii) | Ganesh A/c | Dr. | 25,00,000 | |
| | To Equity share capital A/c | | | 20,00,000 |
| | To Bank A/c | | | 5,00,000 |
| | (Being allotment of 2,00,000 equity shares @₹ 10 each & Balance in cash) | | | |

**Balance Sheet of Thin Ltd. as at**

| | | | |
|---|---|---|---|
| **I.** | **Equity & Liabilities** | | |
| | **Shareholder fund:** | | |
| | Share Capital (10,00,000 @ 10) | | 1,00,00,000 |
| | Equity Share (2,00,000 @ 10) | | 20,00,000 |
| | Current Liabilities: | | |
| | Bills payable | 3,00,000 | |
| | Trade payable | 5,00,000 | 8,00,000 |
| | | | 28,00,000 |
| **II.** | **Assets** | | |
| | **Non current assets** | | |
| | **Fixed assets** | | |
| | (i) **Tangible assets** | | |
| | Freehold premises | 10,00,000 | |
| | Plant & Machinery | 8,00,000 | 18,00,000 |
| | (ii) **Intangible assets** | | |
| | Goodwill | | 3,00,000 |
| | **Current assets** | | |
| | Stock | | 2,00,000 |
| | Trade receivable | 2,75,000 | |
| | *Less*: Provision for bad debts | 25,000 | 2,50,000 |
| | Cash and cash equivalents | | 2,50,000 |
| | | | 28,00,000 |

**Chapter- 5: Consolidation of Accounts**

**2014 - Dec [2]** (b)

**PRE-ACQUISITION LOSSES OF SUBSIDIARY COMPANY**

Accumulated losses of the subsidiary company upto the date of acquisition of shares by the holding company are called pre-acquisition losses. Both the holding company and the minority shareholders must share such losses in proportion to their respective holdings. The minority shareholders' share of such losses should be deducted from the amount of Minority Interest. But the holding company's share of such losses should be treated as capital loss and debited to Goodwill Account. While preparing the Consolidated Balance Sheet, this Goodwill Account should be shown as an asset.

**2014 - Dec [4]** (b)

**Consolidated Balance Sheet of H Ltd. and its S Ltd. as on 31st March, 2014.**

| | | | | |
|---|---|---|---|---|
| **I.** | **Equity and Liabilities** | | | |
| | **Shareholder Fund:** | | | |
| | Share Capital | | | 15,00,000 |
| | **Reserve and Surplus:** | | | |
| | General Reserve | 6,00,000 | | |
| | *Add*: Revenue Reserve | 1,20,000 | 7,20,000 | |
| | Profit and Loss A/c | 3,00,000 | | |
| | *Add*: Revenue Profit | 13,800 | 3,13,800 | 10,33,800 |
| | **Non Current Liabilities** | | | |
| | Minority Interest | | | 1,44,450 |
| | **Current Liabilities** | | | |
| | Trade Payable (4,50,000+1,50,000) | | | 6,00,000 |
| | | | | 32,78,250 |
| **II.** | **Assets** | | | |
| | **Non Current assets** | | | |
| | **Fixed assets** | | | |
| | (i) Machinery (9,00,000+ 2,70,000) = 11,70,000 | | | |

| | | | | | |
|---|---|---|---|---|---|
| | *Add*: Revaluation Profit = | 1,50,000 | | | |
| | *Less*: Dep. on Revaluation Profit | (15,000) | 13,05,000 | | |
| (ii) | Furniture (1,50,000+ 51,000) | | 2,01,000 | | |
| | *Less*: Revaluation Loss | | (15,000) | | |
| | *Add*: Depreciation on Rev. Loss: | | 2,250 | 1,88,250 | 14,93,250 |
| (iii) | Goodwill | | | | 36,000 |
| (iv) | Other assets (13,20,000+ 4,29,000) | | | | 17,49,000 |
| | | | | | 32,78,250 |

**Working Note No. 1**

Time Ratio: Fully Post

Note: As in this question date regarding acquisition of share is not given, therefore, we assume it is beginning of the year.

**Working Note No. 2**

Minority: Holding

20% : 80% = 1 : 4

**Working Note No. 3**

**Profit & Loss A/c of S Ltd.**

| | | | |
|---|---|---|---|
| To Transfer to General Reserve | | By balance b/d | 45,000 |
| (2,25,000 - 75,000) | 1,50,000 | By Profit during Year | 1,80,000 |
| To balance c/d | 75,000 | | |

**Working Note No. 4**

**Machinery:**

| | |
|---|---|
| Book value | 3,00,000 |
| *Less*: Revalued | (4,50,000) |
| Revaluation Profit | 1,50,000 |

**Calculation of Rate of Depreciation:**

$$\frac{\text{Book value} - \text{B/s value}}{\text{Book value}} \times 100$$

$$\frac{3,00,000 - 2,70,000}{3,00,000} \times 100 = 10\%$$

**Depreciation on Revaluation Profit:**

1,50,000 × 10% = 15,000

**Furniture:**

| | |
|---|---|
| Book value | 60,000 |
| *Less*: Revalued | (45,000) |
| Revaluation loss : | 15,000 |

**Depreciation:**

$$\frac{\text{Book value} - \text{B/s value}}{\text{Book value}} \times 100$$

$$= \frac{60{,}000 - 51{,}000}{60{,}000} \times 100 = 15\%$$

**Depreciation on Revaluation Loss:**

15,000× 15% = 2,250

**Working Note No. 5**

**Allocation Table**

| | Total | Minority Interest | Capital Profit | Holding Co. Share Revenue Profit | Holding Co. Share Revenue Reserve |
|---|---|---|---|---|---|
| (A) **Pre-acquisition Profit** | | | | | |
| Opening bal. of Gen. Res. | 75,000 | | | | |
| Opening bal. of P&L A/c | 45,000 | | | | |
| *Add*: Revaluation Profit | 1,50,000 | | | | |
| *Less*: Revaluation Loss | (15,000) | | | | |
| | 2,55,000 | 51,000 | 2,04,000 | - | - |
| (B) **Post acquisition Profit** | | | | | |
| Transfer to Gen. Reserve | 1,50,000 | 30,000 | - | - | 1,20,000 |
| Profit during year | 1,80,000 | | | | |
| *Less*: Transfer to G.R. (1,50,000) | 30,000 | 6,000 | - | 24,000 | - |
| *Add*: Dep. on Revaluation loss | 2,250 | 450 | - | 1,800 | - |
| *Less*: Dep. on Revaluation Profit | (15,000) | (3,000) | - | (12,000) | - |
| (A+B) | | 84,450 | 2,04,000 | 13,800 | 1,20,000 |

**Working Note No. 6**
**Calculation of Minority Interest:**

| | |
|---|---|
| Share Capital (3,00,000 × 20%) | 60,000 |
| *Add*: Undistributable Profit (W.N. 5) | 84,450 |
| | 1,44,450 |

**Working Note No. 7**
**Calculation of cost of control:**

| | |
|---|---|
| Investment | 4,80,000 |
| *Less*: Face value of share (3,00,000×80%) | (2,40,000) |
| *Less*: Capital profit as per Allocation table (W.N.5) | (2,04,000) |
| Goodwill | 36,000 |

**Chapter- 6: Valuation of Shares and Intangible Assets**
**2014 - Dec [1]** (b)
**Recognition of an Expense on Intangible Asset**
Expenditure on an intangible item should be recognized as an expense when it is incurred unless:
(a) it forms part of the cost of an intangible asset that meets the recognition criteria;
(b) the item is acquired in an amalgamation in the nature of purchase and cannot be recognized as an intangible asset.

If this is the case, this expenditure (included in the cost of acquisition) should form part of the amount attributed to goodwill (capital reserve) at the date of acquisition.
In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, expenditure on research is always recognised as an expense when it is incurred. Examples of other expenditure that is recognised as an expense when it is incurred include:
(a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of fixed asset. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity;
(b) expenditure on training activities;
(c) expenditure on advertising and promotional activities; and
(d) expenditure on relocating or re-organising part or all of an enterprise.

**2014 - Dec [4]** (a)

**Valuation of shares**

(i) **Intrinsic value method**

| **Assets:** | |
|---|---|
| Land and Building | 90,000 |
| Plant and Machinery | 45,000 |
| Goodwill | 60,000 |
| Trade marks | 7,500 |
| Stock | 18,000 |
| Trade Receivable (33,000 - 3,000) | 30,000 |
| Cash at Bank | 19,000 |
| | 2,69,500 |
| *Less*: Liabilities | |
| Trade payable | 36,250 |
| Workman Saving A/c | 11,250 |
| Net asset | 2,22,000 |

**Intrinsic value of Share** $= \frac{\text{Net assets}}{\text{No. of shares}}$

$= \frac{2,22,000}{7,500} =$ ₹ **29.60**

(ii) **Yield value method**

| | |
|---|---|
| Total Profit of last 3 years - | 1,03,500 |
| *Less*: Bad debt | (3,000) |
| | 1,00,500 |

Average Profit $= \frac{1,00,500}{3}$ = 33,500

*Less*: Transfer to Reserve
(25% of 33,500) = 8,375

Profit available for dividend = 25,125

Rate of dividend $= \frac{25,125}{75,000} \times 100$ = 33.5%

$$\textbf{Yield value of share} = \frac{\text{Rate of dividend}}{\text{Normal Rate of dividend}} \times \text{Paid up value of each share}$$

$$= \frac{33.5}{10} \times 10 = ₹\ \mathbf{33.5}$$

**Chapter- 7: Liquidation of Company**

**2014 - Dec [2]** (a)

**ORDER OF PAYMENT**

The amount received from the assets not specifically pledged & the amounts contributed by the contributories must be distributed by the liquidator in the following order:

1. Expenses of winding up including the liquidators remuneration
2. Creditors secured by the floating charge on the assets of the company
3. Preferential creditors
4. Unsecured creditors
5. The surplus, if any, amongst the contributories (i.e. preference shareholders & equity shareholders) according to their respective rights & interests.

**2014 - Dec [3]** (a)

**Note:** Mr. A ceased to be member for more than one year from date of liquidation of company.

Therefore, he is not liable as a contributory.

**Statement showing calculation of liability of B list contributories**

| Date | Creditors outstanding on date ceasing to be member | Incremental creditor outstanding | B 12000 Shares | C 15000 Shares | D 8000 Shares | E 5000 Shares | Amount to be paid to creditor |
|---|---|---|---|---|---|---|---|
| 15-06-12 | 50,000 | 50,000 | 15,000 | 18,750 | 10,000 | 6,250 | 50,000 |
| 18-10-12 | 92,000 | 42,000 | - | 22,500 | 12,000 | 7,500 | 42,000 |
| 24-12-12 | 1,05,000 | 13,000 | - | - | 8,000 | 5,000 | 3,250 |
| 12-02-13 | 1,10,000 | 5,000 | - | - | - | 5,000 | NIL |
| Maximum amount payable to creditor (A) | | | 15,000 | 41,250 | 30,000 | 23,750 | |
| Amount of calls in arrear @ ₹ 3 (B) | | | 36,000 | 45,000 | 24,000 | 15,000 | |
| Amount to be paid (A) or (B) WEL | | | 15,000 | 41,250 | 24,000 | 15,000 | |
| Therefore, Total Amount paid to creditors = ₹95,250 | | | | | | | |

**Note:**

Incremental creditor of ₹ 13,000 on 24-12-12 will get only ₹ 2,000 from D & ₹ 1,250 from E.

**Chapter- 8: Corporate Financial Reporting**

**2014 - Dec [2]** (d)

**The Advantages of preparation of value added statements are:**

1. Reporting of value added statements shows improvement in the attitude of the employees towards their employing companies because value added statements shows a broader view of the companies objectives and responsibilities.
2. Value added statement of a company gives indication about the worthful contribution of the company towards the national income because it links the companies financial accounts with national income.
3. Value added statement makes it easier for the company to provide productivity bonus to its employees on the basis of VA/ payroll ratio.
4. The preparation of value added statement is based on some basic concepts - such as going concern, consistency, matching concept and substance over form which are also equally accepted in the income statement and position statement.
5. Trends in value added based ratio (VA/ payroll, taxation / VA, VA/ sales etc.) are helpful in comparison of companies with other companies & with international companies.
6. It also evaluates the ranking & size of any company using sales or capital employed figure as a basis of company's ranking can cause distortion because sales may be inflated by the company to show better ranking and size.

**Chapter- 9: Accounting Standards**

**2014 - Dec [1]** (e)

**AS-9 – Revenue Recognition**

This standard deals with the basis for recognition of revenue in the statement of profit and loss of an enterprise. It lays down the conditions to recognise revenue by sale of goods, rendering of services, resources yielding interest, royalties and dividends. Revenue should be recognised for sale of goods or services only when the collection is reasonably assured and (i) the property in goods is transferred from seller to buyer (ii) there is no uncertainty regarding the amount of consideration that will be realised from sale of goods. In the case of services rendered either completed service contract method or proportionate service contract method may be adopted for revenue recognition. In the case of revenue by way of interest, the credit is taken on a time proportion basis taking into account the amount outstanding and the rate applicable. In the case of royalties, revenue is recognised on approval basis in accordance with the terms of the relevant agreement. The revenue is recognised for dividend once the right to receive dividend is established.

**2014 - Dec [2]** (e)

**AS-18 – Related Party Disclosures**

This standard is applied in reporting related party relationships and transactions between a reporting enterprise and its related parties. Related partly disclosure requirements do not apply in circumstances where providing such disclosure would conflict with the reporting enterprise's duties of confidentiality as specifically required in terms of a statute or by any regulator.

If there have been transactions between related parties, during the existence of a related party relationship the reporting enterprise should disclose:

(i) the name of the transacting related party;

(ii) a description of the relationship between the parties;

(iii) description of the nature of the transactions;

(iv) volume of transactions either as an amount or as an appropriate proportion;

(v) any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) the amounts written off or written back in the period in respect of debts due from or to related parties. Items of a similar nature may be disclosed in aggregate by type of related party.

**Chapter- 10: Auditing Concepts**

**2014 - Dec [6A] (Or)** (ii)

**Procedure of issuing auditing standards**

1. The Auditing and Assurance Standards Board identifies the areas where auditing standards need to be formulated and the priority in regard to their selection.
2. In the preparation of the auditing standards, the Board is normally, assisted by study groups comprising of a cross section of members of the Institute.
3. On the basis of the work of the study groups, an Exposure Draft of the proposed auditing standard is prepared by the Board and issued for comments of the members.
4. After taking into the comments received, the draft of the proposed auditing standard is finalized by the Board and submitted to the Council of the Institute.
5. The Council considers the final draft of the proposed auditing standard and, if necessary, modifies the same in consultation with the Board. The auditing standard is then issued under the authority of the Council.

   While formulating the auditing standards, the Board also takes into consideration the applicable laws, customs, usages and business environment in the country.

**Chapter- 11: Types of Company Audit**

**2014 - Dec [5]** (a)

**Eligibility and Qualifications of Auditor**

Section 141(1)&(2) of the Companies Act, 2013 prescribed the following eligibility and qualifications of auditor which are as under:

(i) Only a Chartered Accountant (individual) or a firm where majority of partners practicing in India are Chartered Accountants can be appointed as auditor.

(ii) Where a firm including a Limited Liability Partnership (LLP) is appointed as an auditor of a company, only the partners who are Chartered Accountants shall be authorized to act and sign on behalf of the firm.

**Disqualifications of Auditor**

Section 141(3) of the Companies Act, 2013 read with Rule 10 prescribed the following persons shall not be eligible for appointment as an auditor or a company, namely:

- A body corporate, except LLP;
- An officer or employee of the company;
- Any partner/employee of officer or employee of company;
- A person who himself or his relative/partner is holding any security or interest in the company or any company which is its holding, subsidiary, associate;
- A person whose relative is holding security or interest not exceeding ₹ 1 lakh face value in companies as mentioned above. Provided that this condition be also applicable in the case of a company not having share capital or other securities, wherever relevant. Provided further that in the event of acquiring any security or interest by a relative, above the threshold limit i.e. ₹ 1 lakh, the corrective action to maintain the limits (₹ 1 lakh) shall be taken by the auditor within 60 days of such acquisition or interest;
- A person who or whose relative or partner is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 5 lakhs shall not be eligible for appointment;
- A person who or whose relative or partner has given a guarantee or provided any security in connection with the indebtedness of any third person to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 1 lakh shall not be eligible for appointment;
- A person or a firm who, whether directly or indirectly, has “business relationship” with the company or its subsidiary or its holding or associate company.

**2014 - Dec [5]** (b)

**Mandatory Rotation of Auditors**

Under the Section 139(2), the system of rotation of auditors has been introduced for the auditors of listed companies and other class of companies.

The other class of companies (specified companies) shall mean the following classes of companies excluding one person companies and small companies as prescribed under Rule 5 of the Companies (Audit and Auditors) Rules.

(a) all unlisted public companies having paid up share capital of rupees ten crores or more;

(b) all private limited companies having paid up share capital of rupees twenty crores or more;

(c) all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

The provisions for rotation of auditors under sub-sections 2, 3 and 4 of Section 139 are given below:

- If the auditor is an individual, he cannot be auditor of such a company for more than 5 consecutive years.
- If an audit firm/LLP is auditor of the company, it cannot be auditor of such a company for more than two terms of 5 consecutive years (i.e. 10 years).
- If an individual auditor who has completed his one term of 5 years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of his term.
- In an audit firm/LLP which has completed its one term of 10 years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of its term.
- It may be noted that any firm/LLP which has one or more partners, who are also partners in the outgoing audit firm/LLP cannot be appointed as auditors during this 5 years period.

**2014 - Dec [5]** (c)

**AUDITOR NOT TO RENDER CERTAIN SERVICES (PROHIBITED SERVICES)-Section 144**

An auditor shall provide to the company only such other services as are approved by the Board of Directors/ the Audit Committee, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely:

(a) accounting and book keeping services;

(b) internal audit;

(c) design and implementation of any financial information system;

(d) actuarial services;
(e) investment advisory services;
(f) investment banking services;
(g) rendering of outsourced financial services;
(h) management services; and
(i) any other kind of services as may be prescribed.

**2014 - Dec [6A] (Or)** (iii)

**CAG's Role in functioning of financial committees of Parliament**

The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committee. His reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his reports. He scrutinizes the notes which the Ministries submit to the Committees and helps the Committees to check the correctness submit to the Committees and helps the Committees to check the correctness of facts and figures in their draft reports.

The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations. The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature.

In respect of those cases in Audit Reports, which could not be discussed in detail by the Committees, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature. This ensures that the audit Reports are not taken lightly by the Government, even if the entire report is not deliberated upon by the Committee.

**Chapter- 13: Internal Control**

**2014 - Dec [6]** (b)

**INTERNAL CHECK**

Internal check is best regarded as indicating checks on the day-to-day transactions which operate continuously as a part of the routine systems whereby work of one person is proved independently or is complementary to the work of another, the object being the prevention of or early detection of errors and frauds.

The main objective of internal check is prevention of errors and frauds and/or detection of errors and frauds at the earliest. Internal check is a continuous process and is part of the day-to-day routine. It relates to all the transactions that take place every day. Internal check is achieved by complementary allocation of duties and by independent verification of the work of one person by another.

**DIFFERENCE BETWEEN INTERNAL CHECK AND INTERNAL AUDIT**

**Way of checking:** In internal check system work is automatically checked whereas in internal audit system work is checked specially.

**Cost involvement:** In internal check system checking is done when the work is being done. Mistake can be checked at an early stage in internal check system.

**Thrust of system:** Thrust of internal check system is to prevent the errors and whereas the thrust of internal audit system is to detect the errors and frauds.

**Time of checking:** In internal check system checking is done when the work is being done whereas in internal audit system work is checked after it is done. Mistakes can be checked at an early stage in internal check system.

**Chapter- 14: Review of Internal Control**

**2014 - Dec [6]** (c)

**Management Information Systems Review Objectives**

1. To determine whether review procedures are necessary to achieve stated objectives.
2. To determine whether MIS policies or practices, processes, objectives and internal controls are adequate.
3. To evaluate whether MIS applications provide users with timely, accurate, consistent, complete and relevant information.
4. To assess the types and level of risk associated with MIS and the quality of controls over those risks.
5. To determine whether MIS applications and enhancements to existing systems adequately support corporate goals.
6. To determine whether MIS is being developed in compliance with an approved corporate MIS policy or practice statement.
7. To determine whether management is committed to providing the resources needed to develop the required MIS.
8. To determine if officers are operating according to established guidelines.
9. To evaluate the scope and adequacy of audit activities.
10. To initiate corrective action when policies or practices, processes, objectives or internal controls are deficient.
11. To determine if any additional work is needed to fulfill the examination strategy of the institution.

**Chapter- 15: Audit Engagement and Documentation**

**2014 - Dec [6]** (a)

**The need for Working papers**

The need for Working papers listed as follows:

(a) They aid in the planning and performance of the audit.
(b) They aid in the supervision and review of the audit work and to review the quality of work performed, in accordance with AAS-17 “Quality Control for Audit Work”.

(c) They provide evidence of the audit work performed to support the auditor's opinion.
(d) They document clearly and logically the schedule, results of test, etc.
(e) The working papers should evidence compliance with technical standards.
(f) They document that Internal control has been appropriately studied and evaluated.
(g) They document that the evidence obtained and procedures performed afford a reasonable basis for an opinion.
(h) They retain a record of matters of continuing significance to future audits of the entity.
(i) They enable an experienced auditor to conduct quality control reviews in accordance with Statement on Peer Review issued by the Institute of Chartered Accountants of India.
(j) The process of preparing sufficient audit documentation contributes to the quality of an audit.
(k) They fulfil the need to document oral discussions of significant matters and communicate to those charged with governance, as discussed in AAS-27, Communication of Audit Matters with those Charged with Governance.

**2014 - Dec [6A] (Or)** (i)

**Verification of assets involves the following steps:**

1. Enquiry into the value placed on assets.
2. Examination of the ownership and title deeds of assets.
3. Physical inspection of the tangible assets.
4. Confirmations regarding the charge on assets.
5. Ensuring that the assets are disclosed, classified and presented in accordance with recognized accounting policies and legal requirements.

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**FOR NOTES**

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