INTERMEDIATE EXAMINATION SET 2

MODEL ANSWERS TERM – JUNE 2023

PAPER - 10

CORPORATE ACCOUNTING AND AUDITING

Time Allowed: 3 Hours **Full Marks: 100**

The figures in the margin on the right side indicate full marks.

Where considered necessary, suitable assumptions may be made and clearly indicated in the answer.

SECTION - A : (Corporate Accounting)

Answer Question No. 1 and any three from Question No. 2, 3, 4 and 5.

1. (a)

(i)	b
(ii)	d
(iii)	c
(iv)	b
(v)	d
(vi)	b

(b)

1.	False
2.	False
3.	True
4.	False

(c)

(i)	reinsure
(ii)	Diluted
(iii)	Bonus
(iv)	Current Assets

2. (a) **Statement showing computation of maximum number of equity shares Buy Back and maximum price for Buy-Back**

(i) According to Outstanding Equity Shares Test, maximum number buy-back of equity shares

= (25% of paid-up Equity Share Capital) / Face value per equity share

= 25% of 1,20,000/ 10 = 30,000 shares

(ii) According to Buy-back Resource Test, maximum amount that has to be paid for buy-back

= 25% of (Paid up capital + Free Reserves and Securities Premium)

= 25% of ₹(12,00,000 + 18,00,000 + 6,00,000) = ₹9,00,000

So, Maximum buy-back price per equity share = ₹ 9,00,000/30,000 shares = ₹30 per share

Now, it has to be verified that after the buy-back of shares, the post buy-back debt-equity ratio test will not exceed 2:1.

Ascertainment of Post Buyback Debt-Equity Ratio

Here, Debt = 14% Debentures + Creditors = ₹ (25,00,000 + 11,00,000) = ₹36,00,000

Post buy-back Equity:

- Post buy-back Share Capital = Existing Share Capital - Face value of shares buy-back
  = [12,00,000 - (30,000 x ₹10)] = ₹9,00,000
- Post buy-back Free Reserves & Securities Premium
  = Existing Free Reserves & Securities Premium - Amount utilised for buy-back
  = [(18,00,000 + 6,00,000) - 9,00,000] = ₹15,00,000

  Post buy-back Equity = ₹9,00,000 + ₹15,00,000 = ₹24,00,000

  Post buy-back Debt-equity ratio = Total Debt / Equity

  = ₹36,00,000/ ₹24,00,000 = 1.5, which happens to be less than 2:1

  So, the above condition of maintaining Debt-Equity ratio gets satisfied.

Hence, Q Ltd. may be suggested to buy-back 30,000 shares @ ₹30 each (i.e., at ₹ 20 premium per share).

(b) Debentures may be of the following types:

a. Redeemable vs. Irredeemable Debentures

Redeemable Debentures are debentures that are repayable by a company at the end of the pre-specified time period. Irredeemable debentures are not repayable during the life-time of the company.

b. Secured vs. Unsecured Debentures

Secured Debentures are those debentures which create a charge on the assets of the company. These are also called Mortgage Debentures. Unsecured debentures are issued without the support of a collateral security. These are also called Naked Debentures.

c. Convertible vs. Non-convertible Debentures

Debentures which are convertible into other securities viz. equity shares, preference shares or new debentures after a specified period are referred to as Convertible Debentures. They may fully convertible or partly convertible. On the other hand, Debentures which are not convertible into any other security are referred to as Non-convertible Debentures.

3. (a) **Cash Flow Statement**

For the year ended 31.03.2022

Particulars	₹	₹	₹
1. Cash flow from operating activities			
Net profit		10,00,000	
Add: Adjustment for non-cash expenses			
Depreciation on assets	2,50,000		
Discount on issue of debentures	15,000		
Interest on debentures	1,75,000	4,40,000	
	10,000	14,40,000	
Less: Profit on sale of investment (1,60,000-1,50,000	30,000		
Interest received on investment		40,000	
		14,00,000	
Operating profit before adjustment for w.c changes		5,000	
Add: Decrease in B/R [25,000-20,000)		2,650	
Increase in sundry creditors (85,650-83,000)		3,400	
Increase in o/s expenses (40,900-37,500)		14,11,050	
		59,000	
Less: Increase in stock (6,59,000-6,00,000)		2,550	
Increase in sundry debtors (1,06,550-1,04,000)		2,500	
Decrease in B/P (22,500-20,000)		13,47,000	
Less: Income tax paid		4,80,000	
Net cash from operating activities			8,67,000
2. Cash flow from investing activities			
Sale of investment		1,60,000	
Interest received on investment		30,000	1,90,000
3. Cash flow from financing activities			
Issue of shares at premium		3,00,000	
Redemption of preference shares at 5% premium		(7,87,500)	
Preference dividend paid		(75,000)	
Interest on debenture paid		(1,75,000)	
Equity dividend paid (2,50,000+1,50,000)		(4,00,000)	(11,37,500)
(1+2+3)			(80,500)
Add: Opening cash and cash equivalent			98,150
Closing cash and cash equivalent			17,650

Workings:

(1) Purchase of land against shares has not been shown in the C/F Statement as it does not amount to any inflow or outflow of cash.

(b) **(i)** In the context of an Electricity Company, interest on working capital is a component of Tariff and a part of capacity charges. The working capital shall cover cost of fuel stock, advance payment towards such cost, cost towards secondary fuel oil stock, maintenance spares, receivables and operation and maintenance expenses including water charges and security expenses, for one month. Rate of interest on working capital shall be on normative basis.

(ii) Statement of Interest on Working Capital (₹ in lakhs)

Sr. No.	Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
1	2	3	4	5	6	7
1	Cost of Coal/Lignite	2,000	2,000	2,000	2,000	2,000
2	Cost of Main Secondary Fuel Oil	200	200	300	300	300
3	Fuel Cost	Nil	Nil	Nil	Nil	Nil
4	Liquid Fuel Stock	Nil	Nil	Nil	Nil	Nil
5	O & M Expenses	250	250	350	350	350
6	Maintenance Spares	100	100	100	100	100
7	Receivables	1,800	1,800	1,800	1,800	1,800
8	Total Working Capital	4,350	4,350	4,550	4,550	4,550
9	Rate of Interest	12%	12%	12%	12%	12%
10	Interest on Working Capital	522	522	546	546	546

4. (a)

Beta Ltd.

Balance Sheet as on 31st March, 2022

Particulars	Note No.	As on 31.3.22
EQUITY AND LIABILITIES		
Shareholders' funds :		
(a) Share capital	1	2,00,000
(b) Reserves and surplus	2	1,18,600
Non-current liabilities		Nil
Current liabilities :		
(a) Trade payables		49,000
(b) Other current liabilities	3	3,400
(c) Short-term provisions	4	50,400
Total		4,21,400

ASSETS		
Non-current assets :		
(a) PPE	5	79,900
(b) Intangible assets		9,120
Current assets :		
(a) Inventories		1,76,000
(b) Trade receivables	6	63,980
(c) Cash and cash equivalents	7	92,400
Total		4,21,400

Foot Note: Contingent Liability for Proposed Dividend = ₹ 12,000

Statement of Profit and Loss
For the year ended 31st March, 2022

Particulars	Note No.	31.3.22
Revenue from operations	8	6,80,000
Other income	9	6,000
Total revenue (A)		6,86,000
Expenses: Purchases of stock-in-trade	10	4,70,000
Changes in inventories of stock-in-trade	11	(26,000)
Employee benefits expense	12	76,800
Depreciation and amortisation expenses	13	12,580
Other expenses	14	26,620
Total expenses (B)		5,60,000
Profit before tax (A ~B)		1,26,000
Less : Provision for taxation @ 40%		50,400
Profit after tax		75,600

Notes to Accounts:

Particulars	₹	₹
1. Share Capital		
Authorized: 40000 equity shares of ₹ 10 each		4,00,000
Issued, Subscribed and Paid up: 20000 equity shares of ₹ 10 each		2,00,000
2. General Reserve: as on 1.4.21	31,000	
Add: transfer during the year	4,000	35,000
Profit and loss: as on 1.4.21	30,000	
Add: profit during the year	75,600	
	1,05,600	
Less: Dividend paid	18,000	
Transfer to General reserve	4,000	83,600
		1,18,600

3. Other Current Liabilities		
Outstanding Rent		1,800
Outstanding Salaries		1,600
		3,400
4. Short term Provisions		
Provision for taxation		50,400
5. PPE: Plant and machinery	58,000	
Less: Depreciation	8,700	49,300
Furniture	34,000	
Less: Depreciation	3,400	30,600
		79,900
Intangible Assets: Patent	9,600	
Less. amortisation	480	9,120
6. Trade receivables:		
Trade receivable		65,000
Less: Provision for doubtful debts		1,020
		63,980
7. Cash and cash equivalents : Cash at bank		92,400
8. Revenue from operations : Sales		6,80,000
9. Other income: Discount received		6,000
10. Purchases of stock-in-trade: Gross purchases Less: Returns (4,90,000-20,000)		4,70,000
11. Changes in inventories of stock-in-trade: Opening – Closing (1,50,000-1,76,000)		(26,000)
12. Employee benefits expense :		
Salary add: outstanding (60,000+1,800)	61,800	
Contribution to PF	10,000	
Staff welfare exp.	5,000	
		76,800
13. Depreciation and amortisation expenses :		
Depreciation : Plant and machinery @ 15%	8,700	
Furniture @ 10%	3,400	
Amortisation: Patents @ 5%	480	12,580
14. Other expenses:		
Rent and rates including outstanding: ₹ (8,000 + 1,600)		9,600
Freight and carriage		1,900
Stationary		3,800
Repairs		4,000
Insurance		6,000
Miscellaneous expenses		300
Provision for doubtful debts		1,020
		26,620

Working Notes:

1) Dividend for the year: 15% on ₹ 2,00,000	30,000	
Less : Interim dividend paid	18,000	
Proposed dividend		12,000

(b) As per the General Instructions for Preparation of Balance Sheet provided in the context of Part I of Division I of Schedule III of the Companies Act, 2013, An asset shall be classified as current when it satisfies any of the following criteria:

(1) it is expected to be realised in, or is intended for sale or consumption in, the company's normal operating cycle;

(2) it is held primarily for the purpose of being traded;

(3) it is expected to be realised within twelve months after the reporting date; or

(4) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

All other assets shall be classified as non-current.

Accordingly, the status of the trade receivable will be as follows:

Case	Credit period	Operating cycle	Remaining period	Classification on 31.03.2022	Rule
(i)	14 months	12 months	11 months	CA	Rule 3
(ii)	16 months	12 months	13 months	NCA	Rule 3
(iii)	16 months	14 months	13 months	NCA	Rule 3
(iv)	16 months	18 months	13 months	CA	Rule 1

5. (a) (i) Profit for the year = ₹48,00,000

Weighted average number of shares = 10,00,000

Basic EPS = 48,00,000/10,00,000 = ₹4.80

No. of shares under option = 2,00,000

No. of shares that would have been issued at fair value = 2,00,000x15/20 = 1,50,000

Weighted average number of shares = 10,00,000+(2,00,000 – 1,50,000) = 10,50,000

Adjusted earnings = ₹48,00,000

Diluted EPS = 48,00,000/10,50,000 = ₹4.57

(ii) Calculation of actual return on plan assets

Particulars	₹	₹
Change in plan assets (8,55,000 – 6,00,000)		2,55,000
Adjustments:		
Employer's contribution	2,10,000	
Less: Benefit paid	1,50,000	60,000
Actual return on plan assets		1,95,000

(b) There are several principles governing insurance business, the important of which are discussed below.

a. **Principle of indemnity:** Insurance is a contract of indemnity. In a contract of indemnity, only those who suffer loss are compensated to the extent of actual loss suffered by them.

b. **Insurable interest:** One can undertake insurance only if he/she has an insurable interest.

c. **Principle of uberrimae fidei**: In a contract of insurance, there is an implied condition that each party must disclose every material fact known to him. This is because all contracts of insurance are contracts of uberrimea fidei, i.e., contracts of utmost good faith.

d. **Principle of Proximate Cause:** This principle applies when the loss is the result of two or more causes. The insurance company will find the nearest cause of loss to the property and if the property is found to be insured against such cause, the insured will get the compensation.

e. **Principle of Subrogation:** As per this principle, after the insured, has been compensated for the incurred loss to him on the subject matter that was insured, the rights of the ownership of that property goes to the insurer.

f. **Principle of Contribution:** It states that the insured cannot make a profit by claiming the loss of one subject matter from different policies or companies.

g. **Principle of Loss Minimization:** This principle says that as an owner, it is obligatory on the part of the insurer to take necessary steps to minimize the loss to the insured property.

SECTION - B : (Auditing)

Answer Question No. 6 and any three from Question No. 7, 8, 9 and 10.

6. (a)

(i)	c
(ii)	a
(iii)	c
(iv)	a
(v)	b
(vi)	b

(b)

1.	False
2.	True
3.	False
4.	True

(c)

(i)	177 (7)
(ii)	143 (12)
(iii)	objective
(iv)	530

7. (a)

S. No.	Points of Distinction	Statutory Audit	Non-statutory Audit
1.	Legal compulsion	It is compulsory.	It is voluntary.
2.	Scope	The relevant statute or law determines the scope of work.	The employer or partners determine the scope of work.
3.	Qualification of auditor	The academic or professional qualification is prescribed for the auditor.	The auditor need not possess any academic or professional qualifications.
4.	Powers, rights and duties of an auditor	The statute dictates the powers, rights and duties of an auditor.	The agreement between an auditor and firm decides these matters.

5.	Independence	The auditor has independence in status and in mental attitude.	The auditor does not enjoy such independence.
6.	Auditor's liability	The auditor is liable for negligence under the Common Law and for misfeasance under the relevant statute governing the audit.	The auditor is liable for negligence only under the Common Law.
7.	Publication of audit report	The audit report is published for the public.	The audit report is made known to the employers or partners.

(b) The following techniques are generally used for evaluation of internal control system:

a. **Narrative Record:** It is a complete and exhaustive description of the system. It is appropriate in circumstances where a formal control system is lacking, like in the case of small businesses. Gaps in the control system are difficult to identify using a narrative record.

b. **Check List:** The Internal Control Checklist is a tool to help evaluate and strengthen internal controls, promote effective and efficient business practices, and improve compliance in a department or functional unit. The checklist is not meant to be absolute but informative when reviewing controls in a given area. In fact, checklist is a series of instructions and/or questions which the auditor or the audit staff must follow and answer. When he completes the instructions, he initials the space against the instruction. Answers to the checklist instructions are usually 'Yes', 'No' or 'Not Applicable'.

c. **Flow Chart:** It is a pictorial representation of the internal control system depicting its various elements such as operations, processes and controls, which help in giving a concise and comprehensive view of the organization's working to the auditor. A complete flow chart would depict the process of raising documents, personnel involved in doing so, the flow of documents through various departments, maintenance of records, flow of goods and consideration, and dealing with results.

d. **Internal Control Questionnaire:** This is the most widely used method for collecting information regarding the internal control system and involves asking questions to various people at different levels in the organization. The questionnaire is in a pre-designed format to ensure collection of complete and all relevant information. The questions are formed in a manner that would facilitate obtaining full information through answers in 'Yes' or 'No', whereby the answer 'Yes' is satisfactory, whereas the answers 'No' appear to indicate a weakness. However, questionnaire may receive descriptive responses also.

8. (a) (i) As per Section 141(3)(g), a person or a partner of a firm shall not be eligible for appointment as the auditor of a company if –

(i) Such person is in full time employment elsewhere; or

(ii) 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 capital less than ₹100 crore.

In the given case, P is in whole-time employment elsewhere, thus excluded for calculation of the limit for the firm. If Q and R do not hold any audits in their personal capacity/as partners of other firms, the total number of company audits to be accepted by PQR & Co. is 40. Since audit of dormant companies are excluded from the limit, the firm holds (40-1) = 39 eligible audit assignments. Thus, acceptance of audit of XYZ Ltd. will accordingly be within specified limits.

(ii) In the given case, after retirement of Mr. M, the firm shall hold audit of 33 companies of which 15 will be public companies. The ceiling as per requirement of the Council of ICAI will be 40 audit assignments (20 x 2 = 40 audits). The firm also accepts the audit of one private company with paid up share capital of more than 100 crores, and seven one person companies. Here, the assignments of one person companies are excluded from the ceiling as per Section 141(3)(g). Hence the total audit assignments = 33 + 1 = 34. Thus, the ceiling is not violated and hence the above assignments can be accepted.

(b) As per Section 148(3) of the Companies Act 2013, cost audit shall be conducted by a Cost Accountant who shall be appointed by the Board. No person appointed under Section 139 as an auditor of the company shall be appointed for conducting the audit of cost records. The auditor so appointed shall comply with the cost auditing standards.

Rule 6 of the Companies (Cost Records and Audit) Rules 2014 –

1) The category of companies specified in rule 3 and the thresholds limits laid down in rule 4, shall within one hundred and eighty days of the commencement of every financial year, appoint a cost auditor.

2) Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the

Central Government within a period of 30 days of the Board meeting in which such appointment is made or within a period of 180 days of the commencement of the financial year, whichever is earlier, through electronic mode, in Form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

3) Every cost auditor appointed as such shall continue in such capacity till the expiry of 180 days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

9. **(a)** The audit procedure to be applied to conduct audit of the issue of debentures include the following:

- The auditor should verify that the prospectus had been duly filed with the registrar before the date of allotment of debentures.
- He should check the amount collected in the cash book with the counterfoils of receipts issued to the applicants and also cross check the amount into the application and allotment book.
- He should examine the debenture trust deed and note the conditions contained therein as to issue and repayment.
- If the debentures are covered by a mortgage of a charge, it should be verified that the charge has been correctly recorded in the register of mortgage and charges and it has also been registered with the registrar of the companies.
- Compliance with SEBI guidelines should also be ensured.
- Where debentures have been issued as fully paid up to vendors as a part of the purchase consideration, the contract in this regard should be checked.

(b) The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

An audit report with a disclaimer of opinion must include the 'Basis for Disclaimer'.

Situations leading to reporting with a disclaimer of opinion are:

(i) Auditor was prevented by the management from (a) observing the counting of physical inventory and (b) performing other procedures such as requesting external confirmation of debtors and creditors, and bank account balances.

(ii) Non-receipt of branch audit reports from a significant number of branches.

10. (a) The auditor is supposed to consider the following general points in conducting the audit of local self-government:

a) Ensure that his appointment is in line with the respective regulation of the local body and approved by the appropriate authority.

b) Obtain a detail understanding of the rules and regulations that governs the operations, especially the financial control and accounting of the organisation.

c) Consult the relevant documents, minutes and resolutions of various meetings of different committees.

d) With regards to various government schemes which are implemented through local bodies, check the utilization of grant, appropriate authorization being maintained throughout and adequacy of accounting.

e) Apply in depth investigation in areas with potential fraud such as revenue collection, various waiver schemes, use of casual labour etc.

f) Whenever there is a provision of funds, ensure that the expenditure is incurred from the provision and the same has been authorized by the competent authority.

g) Ensure that where huge financial expenditure is involved, the schemes are running economically and is expected to generate the targeted outcome.

(b) Audit risk can broadly be classified into – Risk of Material Restatement and Detection Risk.

A. Risk of Material Misstatement

It may be defined as the risk that the financial statements are materially misstated prior to the audit exercise either due to any unintentional error or any organised fraud. This risk may exist either at the overall financial statement level (i.e., possibility that material misstatement relates pervasively to the financial statements as a whole) or at assertion level (i.e., possibility that material misstatement may exist while classifying the transactions, calculating the balances or disclosing some material information).

The risk of material misstatement at the assertion level has two components as follows:

(a) Inherent Risk: This refers to the possibility of material misstatement due to complex transactions or even due to organised fraud. Accordingly, this risk may be higher for some classes of transactions, account balances and disclosures.

(b) **Control Risk:** This refers to the possibility of material misstatement due to ineffective design, implementation and maintenance of internal control system. Thus, a sound internal control system significantly reduces this risk.

B. Detection Risk

This refers to the possibility that the audit procedures applied by the auditor to reduce the audit risk to an acceptably low level will not be able to detect a misstatement which, either individually or in aggregate, may be material.