

REVISION TEST PAPERS

INTERMEDIATE (IPC) COURSE

(UNDER OLD SCHEME)

GROUP – II

NOVEMBER, 2020



BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

(Set up by an Act of Parliament)

New Delhi

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Edition : September, 2020

Website : www.icai.org

E-mail : bosnoida@icai.in

Department/Committee : Board of Studies

Price : ₹ 90/-

ISBN No. :

Published by : The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi- 110 002, India.

Typeset and designed at Board of Studies.

Printed by :

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REVISION TEST PAPER, NOVEMBER, 2020 – OBJECTIVE & APPROACH

(Students are advised to go through the following paragraphs carefully to derive maximum benefit out of this RTP)

I Objective of Revision Test Paper

Revision Test Papers are one among the many educational inputs provided by the Board of Studies (BOS) to its students. Popularly referred to as RTP by the students, it is one of the very old publications of the BOS whose significance and relevance from the examination perspective has stood the test of time.

RTPs provide glimpses of not only the desirable ways in which examination questions are to be answered but also of the professional quality and standard of the answers expected of students in the examination. Further, aspirants can assess their level of preparation for the examination by answering various questions given in the RTP and can also update themselves with the latest developments in the various subjects relevant from the examination point of view.

The primary objectives of the RTP are:

- To help students get an insight of their preparedness for the forthcoming examination;
- To provide an opportunity for a student to find all the latest developments relevant for the forthcoming examination at one place;
- To supplement earlier studies;
- To enhance the confidence level of the students adequately; and
- To leverage the preparation of the students by giving guidance on how to approach the examinations.

RTPs contain the following:

- (i) Planning and preparing for examination
- (ii) Subject-wise guidance – An overview
- (iii) Updates applicable for a particular exam in the relevant subjects
- (iv) Topic-wise questions and detailed answers thereof in respect of each paper
- (v) Relevant publications/announcement applicable for the particular examination

Students must bear in mind that the RTP contains a variety of questions based on different sections of the syllabi and thus a comprehensive study of the entire syllabus is a pre-requisite before answering the questions of the RTP. In other words, in order to derive maximum benefit out of the RTPs, it is advised that before proceeding to solve the

questions given in the RTP, students ought to have thoroughly read the Study Materials, solved the questions given in the Practice Manual and gone through the Suggested Answers of the earlier examinations. It is important to remember that there can be large number of other complex questions which are not covered in the RTP. In fact, questions contained herein are only illustrative in nature.

The topics on which the questions are set herein have been carefully selected and meticulous attention has been paid in framing different types of questions. Detailed answers are provided to enable the students to do a self-assessment and have a focused approach for effective preparation.

Students are welcome to send their suggestions for fine tuning the RTP to the Director, Board of Studies, The Institute of Chartered Accountants of India, A-29, Sector-62, Noida 201 309 (Uttar Pradesh). RTP is also available on the Institute's website www.icai.org under the BOS knowledge portal in students section for downloading.

II. Planning and preparing for examination

Ideally, when you receive the RTP, you should have completed the entire syllabus of all the subjects at least once. RTP is an effective tool to revise and refresh your concepts and knowledge gained through the first round of study of the whole course. When the RTP reaches your hand, your study plan should have been completed as under:

❖ *Study Materials*

You must have finished reading the relevant Study Materials of all the subjects. Make sure you go through the Study Material as they cover the syllabus comprehensively.

❖ *Other Educational Inputs*

In case of papers on Taxation, you must have carefully perused the Supplementary Study paper containing the latest amendments made through the relevant Finance Act and notifications and circulars issued from time to time which are applicable for the forthcoming examinations.

❖ *Practice Manuals*

Practice Manuals are an excellent medium of understanding the practical aspects of the various provisions learnt through the Study Materials. Solving the Practice Manual at least once before proceeding to the RTP will ensure that you have a grasp of the application and computational aspect of the syllabus as well.

❖ *Suggested Answers*

Giving an honest attempt to solve the previous attempts suggested answers on your own, will give you a flavour of the pattern of question paper and type of questions which are being asked in the examination.

After completing the above process, you should go through the Updates provided in the RTP and then proceed to solve the questions given in the RTP on your own. RTPs are provided to you to check your preparation standards and hence it must be solved on your own in a time-bound manner.

The stratagem and the fine points requiring careful consideration in respect of preparation for the CA examinations are explained in comprehensive details in BOS' publication "How to face CA Examinations? A Matrix of Winning Strategies". The publication may be referred to when you start preparing for a subject.

Examination tips

How well a student fares in the examination depends upon the level and depth of his preparation. However, there are certain important points which can help a student better his performance in the examination. These useful tips are given below:

- Reach the examination hall well in time.
- As soon as you get the question paper, read it carefully and thoroughly. You are given separate 15 minutes for reading the question paper.
- Plan your time so that appropriate time is awarded for each question. Keep sometime for checking the paper as well.
- First impression is the last impression. The question which you can answer in the best manner should be attempted first.
- Always attempt to do all questions. Therefore, it is important that you must finish each question within allocated time.
- Read the question carefully more than once before starting the answer to understand very clearly as to what is required.
- Answer all parts of a question one after the other; do not answer different parts of the same question at different places.
- Write in a neat and legible hand-writing.
- Always be concise and write to the point and do not try to fill pages unnecessarily.
- There must be logical expression of the answer.
- In case a question is not clear, you may state your assumptions and then answer the question.
- Check your answers carefully and underline important points before leaving the examination hall.

III. Subject-wise Guidance – An Overview**PAPER 5: ADVANCED ACCOUNTING**

The Revisionary Test Paper (RTP) of Advanced Accounting is divided into two parts viz Part I - Relevant Announcements, Amendments and Notifications for November, 2020 examination and Part II –Questions and Answers.

It may be noted that the July, 2015* edition of the Study Material and April, 2016 edition of Practice Manual is relevant for November, 2020 Examination. However, Chapters 2, 4, 5 and 6 of the Intermediate Paper 5 Advanced Accounting Study Material have been revised in line with the Companies (Accounting Standards) Amendment Rules, Banking and IRDA Regulations. These revised chapters have been uploaded on the BoS Knowledge Portal of the Institute's website. It is advised to ignore the chapters given in July, 2015 Edition (or prior Edition) of the Study Material and to refer the updated chapters uploaded on the BoS Knowledge Portal of the Institute's website.

Part I of the Revisionary Test Paper consists of the 'Relevant Amendments and Notifications - applicable and not applicable' for November, 2020 examination. The purpose of this information in the RTP is to apprise the students with the latest developments applicable for November, 2020 examination. The brief summary of the same has been given as under:

A. Applicable for November, 2020 examination:

- I. Amendments in Schedule III (Division I) to the Companies Act, 2013
- II. Amendment in AS 11 "The Effects of Changes in Foreign Exchange Rates"
- III. Amendments made by MCA in the Companies (Accounting Standards) Rules, 2006
- IV. Companies (Share Capital and Debentures) Amendment Rules, 2019 – reg. Debenture Redemption Reserve
- V. Provisions of the Companies Act related with Liquidation of Companies
- VI. Maintenance of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR)
- VII. Enhanced borrowing facility provided to the banks to meet their liquidity shortages till September 30, 2020
- VIII. Sale of Securities held in Held to Maturity (HTM) Category
- VIII. Relevant Updated Provisions of the Insurance Act.

*Chapters 2, 4, 5 and 6 of the Intermediate Paper 5 Advanced Accounting Study Material have been revised and the revised chapters have been uploaded on the BoS Knowledge Portal of the Institute's website.

B. Not applicable for November, 2020 examination:

Ind ASs issued by the Ministry of Corporate Affairs.

Part II of the Revisionary Test Paper consists of twenty questions together with their answers. First fourteen questions are based on different topics discussed in the study material. Last 6 questions of this RTP are based on Accounting Standards. For easy reference the topic / accounting standard number on which the question is based has been quoted at the top of each question. The details of topics, on which questions in the RTP are based, are as under:

Question No.	Topic
1	Dissolution of partnership firm
2	Limited Liability Partnerships
3	Accounting for ESOPs
4	Buy Back of Securities
5	Redemption of Debentures
6	Underwriting of Shares
7	Amalgamation of companies
8	Internal Reconstruction of a Company
9	Liquidation of a Company
10	Financial Statements of Insurance Companies
11	Financial Statements of Banking Companies
12	Departmental Accounts
13	Branch Accounting
14	Framework for preparation and presentation of Financial Statements
15 to 20	Accounting Standards

Answers to the questions have been given in detail along with the working notes for easy understanding and comprehending the steps in solving the problems. The answers to the questions have been presented in the manner which is expected from the students in the examination. The students are expected to solve the questions under examination conditions and then compare their solutions with the solutions given in the Revisionary Test Paper and further strategize their preparation for scoring more marks in the examination.

PAPER – 6: AUDITING AND ASSURANCE

RTP is a tool to refresh your knowledge which you have acquired while doing your conceptual study from Study Material, Practice Manual and other modes of knowledge like student journal, bare acts etc.

The Revisionary Test Paper (RTP) of Auditing and Assurance for November, 2020 carries twenty two descriptive questions along with Integrated Case Scenarios followed by MCQs and five standalone MCQs along with their answers. These questions have been taken from the entire syllabus which is divided into nine chapters along with engagement and quality control standards, etc. discussed in the study material.

The various Chapters/topics as mentioned above are Standards on Auditing, Nature of Auditing, Basic Concepts in Auditing, Preparation for an Audit, Internal Control, Vouching, Verification of Assets and Liabilities, Company Audit and Special Audits. The chapter's name is also clearly indicated before each question. The questions in the RTP have been arranged in the same sequence as prescribed in the study material to facilitate easy revision by the students. An attempt has been made to cover the syllabus comprehensively.

This RTP of Auditing and Assurance has been divided into two parts viz Part I – Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority relevant for November, 2020 examination and Part II – Questions and Answers.

The relevant notified sections of the Companies Act, 2013 and other legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authorities up to 30th April, 2020 are applicable for November, 2020 Examination. The questions have been answered in this RTP keeping in view latest amendments as per above mentioned dates.

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT**Section – A: Information Technology**

The Revision Test Paper on Information Technology is a supplementary tool that provides comprehensive view of the entire syllabus which is divided into five chapters. It is based on the study material that is already provided to the students. The chapter-wise questions and answers are provided so that students could test their preparation level for the examination.

The RTP for November 2020 examination contains total 15 questions out of which first 5 questions numbered 1 to 5 are Multiple Choice Questions (MCQ) based on Integrated Case Scenario covering all the chapters. Each MCQ has four options out of which only one option is correct.

Remaining 10 Descriptive questions numbered 6 to 15 are provided chapter-wise with 2 questions from each chapter. These questions have been selected from various topics keeping in view the complete and uniform coverage of the syllabus from all the chapters. Full answer to each descriptive question is specified so that students would be benefited without searching the answers from various sources.

The questions provide an insight to the students to evaluate their understanding on the fundamental concepts of Business Process Management & IT; Information Systems and IT Fundamentals; Telecommunication and Networks; Business Information Systems and Business Process Automation through Application software.

Section – B: Strategic Management

The Revision Test Paper in the subject of Strategic Management for the November, 2020 examination contains twenty questions. The questions have been selected from all the sections/chapters uniformly to cover whole syllabus. Questions are based on different skill levels, i.e., “Comprehension & Knowledge” as well as “Analysis & Application”.

The questions included are of different categories – multiple choice questions based on case scenario, application based and simple multiple choice questions, distinguish between, short notes, descriptive and questions based on practical scenarios. The first question contains multiple choice questions based on case scenario are subdivided into five different parts. Questions from two to six are mixed of application based and simple multiple choice questions. All multiple choice questions are given with four alternatives and the student has to opt the correct option. Subsequently, fourteen different questions have been included to cover all the seven chapters of the syllabus. Chapter names have been mentioned before questions. A descriptive question based on practical scenario has been included from each section. Another descriptive question has also been included from each section of the syllabus.

The students should take up this Revision test paper as a tool to check their preparedness in the subject. Mere reading of Revision Test Paper will not be helpful. To properly self-assess the preparation in the subject, students must attempt the questions on their own. Compare your answers with the suggested answers and hints given to assess the level of preparation and identify areas where more focus is required. Then you may work on these areas to improve the quality of answers that you write.

Work hard and perform well in the examination!

PAPER – 5: ADVANCED ACCOUNTING

PART – I: ANNOUNCEMENTS STATING APPLICABILITY & NON-APPLICABILITY For November, 2020 EXAMINATION

A. Applicable for November, 2020 Examination

I. Amendments in Schedule III (Division I) to the Companies Act, 2013

In exercise of the powers conferred by sub-section (1) of section 467 of the Companies Act, 2013), the Central Government made the following amendments in Division I of the Schedule III with effect from the date of publication of this notification in the Official Gazette:

- (A) under the heading “II Assets”, under sub-heading “Non-current assets”, for the words “Fixed assets”, the words “Property, Plant and Equipment” shall be substituted;
- (B) in the “Notes”, under the heading “General Instructions for preparation of Balance Sheet”, in paragraph 6,-
 - (I) under the heading “B. Reserves and Surplus”, in item (i), in sub- item (c), the word “Reserve” shall be omitted;
 - (II) in clause W., for the words “fixed assets”, the words “Property, Plant and Equipment” shall be substituted.

II. Amendment in AS 11 “The Effects of Changes in Foreign Exchange Rates”

In exercise of the powers conferred by clause (a) of sub-section (1) of section 642 of the Companies Act, 1956, the Central Government, in consultation with National Advisory Committee on Accounting Standards, hereby made the amendment in the Companies (Accounting Standards) Rules, 2006, in the "ANNEXURE", under the heading "ACCOUNTING STANDARDS" under "AS 11 on The Effects of Changes in Foreign Exchange Rates", for the paragraph 32, the following paragraph shall be substituted, namely :-

"32. An enterprise may dispose of its interest in a non-integral foreign operation through sale, liquidation, repayment of share capital, or abandonment of all, or part of, that operation. The payment of a dividend forms part of a disposal only when it constitutes a return of the investment. Remittance from a non-integral foreign operation by way of repatriation of accumulated profits does not form part of a disposal unless it constitutes return of the investment. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss. A write-down of the carrying amount of a non-integral foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised at the time of a write-down".

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

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 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	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 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.	Footnote has been modified.

		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.		
	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 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.	No liability for proposed dividends must be created now. Such proposed dividends are to be 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 Amalgamation 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	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	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

		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.	of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.	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 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	Now discounting of provision for decommissioning, restoration and similar liabilities should be done as per the pre-tax discount rate as mentioned therein.

			the statement of profit and loss.	
	73		<u>Transitional Provisions</u> 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 corresponding effect to the related item of property, plant and equipment.

IV. Companies (Share Capital and Debentures) Amendment Rules, 2019 – reg. Debenture Redemption Reserve

In exercise of the powers conferred by sub-sections (1) and (2) of section 469 of the Companies Act, 2013 (18 of 2013), the Central Government made the Companies (Share Capital and Debentures) Amendment Rules, 2019 dated 16th August, 2019 to amend the Companies (Share Capital and Debentures) Rules, 2014. As per the Companies (Share Capital and Debentures) Amendment Rules, under principal rules, in rule 18, for sub-rule (7), the following sub-rule shall be substituted, namely: -

“(7) The company shall comply with the requirements with regard to Debenture Redemption Reserve (DRR) and investment or deposit of sum in respect of debentures maturing during the year ending on the 31st day of March of next year, in accordance with the conditions given below:-

- (a) Debenture Redemption Reserve shall be created out of profits of the company available for payment of dividend;
- (b) the limits with respect to adequacy of Debenture Redemption Reserve and investment or deposits, as the case may be, shall be as under;-
 - (i) Debenture Redemption Reserve is not required for debentures issued by All India Financial Institutions regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures;
 - (ii) For other Financial Institutions within the meaning of clause (72) of section 2 of the Companies Act, 2013, Debenture Redemption Reserve shall be as

applicable to Non –Banking Finance Companies registered with Reserve Bank of India.

- (iii) For listed companies (other than All India Financial Institutions and Banking Companies as specified in sub-clause (i)), Debenture Redemption Reserve is not required in the following cases - (A) in case of public issue of debentures – A. for NBFCs registered with Reserve Bank of India under section 45-IA of the RBI Act, 1934 and for Housing Finance Companies registered with National Housing Bank; B. for other listed companies; (B) in case of privately placed debentures, for companies specified in sub-items A and B.
- (iv) for unlisted companies, (other than All India Financial Institutions and Banking Companies as specified in sub-clause (i)) -
 - (A) for NBFCs registered with RBI under section 45-IA of the Reserve Bank of India Act, 1934 and for Housing Finance Companies registered with National Housing Bank, Debenture Redemption Reserve is not required in case of privately placed debentures.
 - (B) for other unlisted companies, the adequacy of Debenture Redemption Reserve shall be ten percent. of the value of the outstanding debentures;
- (v) In case a company is covered in item (A) or item (B) of sub-clause (iii) of clause (b) or item (B) of sub-clause (iv) of clause (b), it shall on or before the 30th day of April in each year, in respect of debentures issued by a company covered in item (A) or item (B) of sub clause (iii) of clause (b) or item (B) of sub-clause (iv) of clause (b), invest or deposit, as the case may be, a sum which shall not be less than fifteen per cent., of the amount of its debentures maturing during the year, ending on the 31st day of March of the next year in any one or more methods of investments or deposits as provided in sub-clause (vi):

Provided that the amount remaining invested or deposited, as the case may be, shall not at any time fall below fifteen percent. of the amount of the debentures maturing during the year ending on 31st day of March of that year.
- (vi) for the purpose of sub-clause (v), the methods of deposits or investments, as the case may be, are as follows:— (A) in deposits with any scheduled bank, free from any charge or lien; (B) in unencumbered securities of the Central Government or any State Government; (C) in unencumbered securities mentioned in sub-clause (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882; (D) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian

Trusts Act, 1882:

Provided that the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above.

- (c) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule.
- (d) the amount credited to Debenture Redemption Reserve shall not be utilized by the company except for the purpose of redemption of debentures."

NOTE: Unit 3 of Chapter 4 on Redemption of Debentures of Intermediate Paper 5 Advanced Accounting Study Material has been revised. The revised unit has been uploaded on the BoS Knowledge Portal of the Institute's website. It is advised to ignore the unit given in July, 2015 Edition (or prior Edition) of the Study Material and to refer the updated unit uploaded on the BoS Knowledge Portal of the Institute's website at the below mentioned link: <https://resource.cdn.icai.org/54231bos43539cp4-u3.pdf>

V. Provisions of the Companies Act 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 can be made by the company, any contributory or contributories, the registrar, any person authorized by Central Govt. in that behalf or in 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*].:

- (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.

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

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;
- (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 or 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.

VI Maintenance of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR)**Statutory Liquidity Ratio (SLR)**

In exercise of the powers conferred by sub-section (2A) of Section 24 read with Section 51 and Section 56 of the Banking Regulation Act, 1949 (10 of 1949) and in supersession of the notifications DBR.No.Ret.BC.14/12.02.001/2016-17 dated October 13, 2016 BR.NDBR.No.Ret.BC.91/12.02.001/2017-18 dated October 04, 2017, the Reserve Bank hereby specifies that with effect from the dates given below, every Scheduled Commercial Bank (including RRBs), Local Area Bank, Small Finance Bank, Payments Bank, Primary (urban) co-operative bank and State and central co-operative banks shall continue to maintain in India assets (referred to as 'SLR assets') the value of which shall not, at the close of business on any day, be less than:

- (i) 19.25 per cent from January 5, 2019
- (ii) 19.00 per cent from April 13, 2019

- (iii) 18.75 per cent from July 6, 2019
- (iv) 18.50 per cent from October 12, 2019
- (v) 18.25 per cent from January 4, 2020
- (vi) 18.00 per cent from April 11, 2020

of their total net demand and time liabilities in India as on the last Friday of the second preceding fortnight, valued in accordance with the method of valuation specified by the Reserve Bank from time to time.

Cash Reserve Ratio (CRR)

As per RBI Circular no. DOR.No.Ret.BC.50/12.01.001/2019-20 dated March 27, 2020, the Reserve Bank of India hereby notifies that the average Cash Reserve Ratio (CRR) required to be maintained by every Bank shall be 3.00* per cent of its net demand and time liabilities from the fortnight beginning March 28, 2020 for a period of one year, ending on March 26, 2021.

**Earlier it was 4%.*

VII Enhanced borrowing facility provided to the banks to meet their liquidity shortages till September 30, 2020

As per RBI Circular no. RBI/2019-20/259DOR.No.Ret.BC.77/12.02.001/2019-20 (applicable for All Scheduled Banks (excluding Regional Rural Banks) dated June 26, 2020 and Statement of Developmental and Regulatory Policies dated March 27, 2020, the borrowing limit of scheduled banks under the Marginal Standing Facility (MSF scheme), by dipping into the prescribed SLR, was increased from 2 per cent to 3 per cent of their Net Demand and Time Liabilities (NDTL) outstanding at the end of the second preceding fortnight with immediate effect. This relaxation was earlier available up to June 30, 2020. It has now been decided to extend this enhanced limit till September 30, 2020.

VIII Sale of Securities held in Held to Maturity (HTM) Category

Accounting treatment

Investments by Primary (Urban) Co-operative Banks (UCBs) if securities acquired by banks with the intention to hold them up to maturity will be classified under HTM category. As per Circular no. RBI/2018-19/205 DCBR.BPD. (PCB) Cir.No.10/16.20.000/2018-19 dated 10th June, 2019, it is reiterated that UCBs are not expected to resort to sale of securities held in HTM category. However, if due to liquidity stress, UCBs are required to sell securities from HTM portfolio, they may do so with the permission of their Board of Directors and rationale for such sale may be clearly recorded. Profit on sale of investments from HTM category shall first be taken to the Profit and Loss account and, thereafter, the amount of such profit shall be appropriated to 'Capital Reserve' from the net profit for the year after statutory

appropriations. Loss on sale shall be recognized in the Profit and Loss account in the year of sale.

Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks

As per Circular no. RBI/2018-19/204 DBR.No.BP.BC.46/21.04.141/2018-19 dated 10th June, 2019 (referring to RBI circular DBR No BP.BC.6/21.04.141/2015-16 dated July 1, 2015 advising banks that if the value of sales and transfer of securities to / from HTM category exceeds 5 per cent of the book value of investments held in HTM category at the beginning of the year) banks should disclose the market value of the investments held in the HTM category and indicate the excess of book value over market value for which provision is not made. Apart from transactions that are already exempted from inclusion in the 5 per cent cap, it has been decided that repurchase of State Development Loans (SDLs) by the concerned state government shall also be exempted.

IX Relevant Provisions of the Insurance Act

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		

B. Not applicable for November, 2020 ExaminationNon-Applicability of Ind AS for November, 2020 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, 2020 Examination.

PART – II : QUESTIONS AND ANSWERS**QUESTIONS****Dissolution of partnership firm**

1. Amit, Sumit and Kumar are partners sharing profit and losses in the ratio 2:2:1. The partners decided to dissolve the partnership on 31st March, 2020 when their Balance Sheet was as under:

Liabilities	Amount	Assets	Amount
Capital Accounts:		Land & Building	1,35,000
Amit	55,200	Plant & Machinery	45,000
Sumit	55,200	Furniture	25,500
General Reserve	61,500	Investments	15,000
Kumar's Loan A/c	15,000	Book Debts	60,000
Loan from D	1,20,000	Less: Prov. for bad debts (6,000)	54,000

Trade Creditors	30,000	Stock	36,000
Bills Payable	12,000	Bank	13,500
Outstanding Salary	7,500	Capital Withdrawn:	
		Kumar	<u>32,400</u>
Total	3,56,400	Total	3,56,400

The following information is given to you:

- (i) Realisation expenses amounted to ₹ 18,000 out of which ₹ 3,000 was borne by Amit.
- (ii) A creditor agreed to takeover furniture of book value ₹ 12,000 at ₹ 10,800. The rest of the creditors were paid off at a discount of 6.25%.
- (iii) The other assets realized as follows:
 - Furniture - Remaining taken over by Kumar at 90% of book value
 - Stock - Realised 120% of book value
 - Book Debts - ₹ 12,000 of debts proved bad, remaining were fully realized
 - Land & Building - Realised ₹ 1,65,000
 - Investments - Taken over by Amit at 15% discount
- (iv) For half of his loan, D accepted Plant & Machinery and ₹ 7,500 cash. The remaining amount was paid at a discount of 10%.
- (v) Bills payable were due on an average basis of one month after 31st March, 2020, but they were paid immediately on 31st March @ 6% discount "per annum".

Prepare the Realization Account, Bank Account and Partners Capital Accounts in columnar form in the books of Partnership firm.

Limited Liability Partnerships

2. (a) Explain the provisions related with liability of Limited Liability Partnership (LLP) and its partners as per LLP Act, 2008.
- (b) What are circumstances when LLP can be wound up by the Tribunal. Explain in brief.

Accounting for ESOPs

3. Kaushal Ltd. has its share capital divided into equity shares of ₹ 10 each. On 1.1.2020 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 till the month of March, 2020. The employees exercised their options for 3,600 shares only and the remaining options lapsed. Show Journal entries (with narration) as would appear in the books of the company till the month of March, 2020 relating to ESOPs as the company closes its books on 31st March every year.

Buy Back of Securities

4. Pratham Ltd. (a non-listed company) has the following Capital structure as on 31st March, 2020:

Particulars	₹	₹
Equity Share Capital (shares of ₹ 10 each fully paid)		30,00,000
Reserves & Surplus		
General Reserve	32,50,000	
Security Premium Account	6,00,000	
Profit & Loss Account	4,30,000	
Revaluation Reserve	<u>6,20,000</u>	49,00,000
Loan Funds		42,00,000

You are required to compute by Debt Equity Ratio Test, the maximum number of shares that can be bought back in the light of above information, when the offer price for buy back is ₹ 30 per share.

Redemption of Debentures

5. XYZ Ltd. has issued 1,000, 12% convertible debentures of ₹ 100 each redeemable after a period of five years. According to the terms & conditions of the issue, these debentures were redeemable at a premium of 5%. The debenture holders also had the option at the time of redemption to convert 20% of their holdings into equity shares of ₹ 10 each at a price of ₹ 20 per share and balance in cash. Debenture holders amounting ₹ 20,000 opted to get their debentures converted into equity shares as per terms of the issue. You are required to calculate the number of shares issued and cash paid for redemption of ₹ 20,000 debenture holders.

Underwriting of Shares

6. A joint stock company resolved to issue 10 lakh equity shares of ₹ 10 each at a premium of ₹ 1 per share. One lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications.

The issue was underwritten by X, Y and Z for a commission @2% of the issue price, 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively. Their firm underwriting was as follows :

X 30,000 shares, Y 20,000 shares and Z 10,000 shares. The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public.

Marked applications were as follows:

X 1,19,500 shares, Y 57,500 shares and Z 10,500 shares.

Unmarked applications totaled 7,00,000 shares.

Accounts with the underwriters were promptly settled.

You are required to prepare a statement calculating underwriters' liability (in shares) for shares other than shares underwritten firm.

Amalgamation of Companies

7. X Ltd. and Y Ltd. give the following information of assets, equity and liabilities as on 31st March, 2018:

	X Ltd. (₹)	Y Ltd. (₹)
<u>Equity and Liabilities</u>		
Equity Shares of ₹ 10 each	30,00,000	9,00,000
9% Preference Shares of ₹ 100 each	3,00,000	-
10% Preference Shares of ₹ 100 each	-	3,00,000
General Reserve	2,10,000	2,10,000
Retirement Gratuity Fund (long term)	1,50,000	60,000
Trade Payables	3,90,000	2,40,000
<u>Assets</u>		
Goodwill	1,50,000	75,000
Land & Buildings	9,00,000	3,00,000
Plant & Machinery	15,00,000	4,50,000
Inventories	7,50,000	5,25,000
Trade Receivables	6,00,000	3,00,000
Cash and Bank	1,50,000	60,000

X Ltd. absorbs Y Ltd. on the following terms:

- (i) 10% Preference Shareholders are to be paid at 10% premium by issue of 9% Preference Shares of X Ltd.
- (ii) Goodwill of Y Ltd. on absorption is to be computed based on two times of average profits of preceding three financial years (2016-17 : ₹ 90,000; 2015-16 : ₹ 78,000 and 2014-15: ₹ 72,000). The profits of 2014 -15 included credit of an insurance claim of ₹ 25,000 (fire occurred in 2013-14 and loss by fire ₹ 30,000 was booked in Profit and Loss Account of that year). In the year 2015 -16, there was an embezzlement of cash by an employee amounting to ₹ 10,000.
- (iii) Land & Buildings are valued at ₹ 5,00,000 and the Plant & Machinery at ₹ 4,00,000.

- (iv) Inventories are to be taken over at 10% less value and Provision for Doubtful Debts is to be created @ 2.5%.
- (v) There was an unrecorded current asset in the books of Y Ltd. whose fair value amounted to ₹ 15,000 and such asset was also taken over by X Ltd.
- (vi) The trade payables of Y Ltd. included ₹ 20,000 payable to X Ltd.
- (vii) Equity Shareholders of Y Ltd. will be issued Equity Shares @ 5% premium.

You are required to:

- (i) Prepare Realisation A/c in the books of Y Ltd.
- (ii) Show journal entries in the books of X Ltd.
- (iii) Prepare the Balance Sheet of X Ltd. after absorption as at 31st March, 2018.

Internal Reconstruction of a Company

8. The following information pertains to Z Limited as on 31st March, 2019:

	Amount in ₹
<u>Share Capital:</u>	
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
<u>Reserves and Surplus:</u>	
Profit and Loss Account	(14,60,000)
<u>Non-Current Liabilities:</u>	
10% Secured Debentures	16,00,000
<u>Current Liabilities:</u>	
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
<u>Non-Current Assets:</u>	
<u>(a) Property, plant and equipment:</u>	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000

<u>(b) Intangible Assets:</u>	
Goodwill	11,00,000
Patents	5,00,000
<u>Current Assets:</u>	
Trade Investments	5,00,000
Trade Receivables	5,00,000
Inventory	10,00,000

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 of Goodwill, Patents, Loss in Profit and Loss account to be written off. Also prepare Bank Account and Reconstruction A/c.

Liquidation of Company

9. M. Ltd. resolved on 31st December 2019 that the company be wound up voluntarily. The following was the trial balance extracted from its books as on that date:

	₹	₹
	Dr.	Cr.
Fixed assets	2,00,000	
Inventory	1,20,000	
Book debts	2,40,000	
Cash in hand	40,000	
Profit and loss A/c (Dr. balance)	3,00,000	
1,000, 6% Preference Shares of ₹ 100 each, fully paid		1,00,000
2,000 Equity shares of ₹ 100 each, fully paid		2,00,000
2,000 Equity shares of ₹ 100 each ₹ 75 paid up		1,50,000
Loan from bank (on security of stock)		1,00,000
Trade Payables		<u>3,50,000</u>
	<u>9,00,000</u>	<u>9,00,000</u>

The assets realized the following amounts (after all costs of realization and liquidator's commission amounting to ₹ 5,000 paid out of cash in hand).

	₹
Fixed assets	1,68,000
Inventory	1,10,000
Trade Receivables	2,30,000

Calls on partly paid shares were made but the amounts due on 200 shares were found to be irrecoverable.

You are required to prepare Liquidator's Final Statement of Receipts and Payments.

Financial Statements of Insurance Companies

10. From the following balances extracted from the books of REAL General Insurance Company Ltd. as on 31st March, 2020, you are required to prepare Revenue Accounts in respect of Fire and Marine Insurance Business for the year ended 31st March, 2020.

Particulars	Fire ₹	Marine ₹
Outstanding Claim as on 1 st April, 2019	28,000	7,000
Claims Paid	1,00,000	80,000
Reserved for unexpired Risk as on 1 st April 2019	2,00,000	1,40,000
Premium Received	4,50,000	3,30,000
Agent's Commission paid	40,000	20,000
Expenses of management paid	60,000	45,000
Re Insurance Premium paid	25,000	15,000

The following additional points are also to be taken into consideration:

- (1) Claims outstanding as on 31st March 2020 were as follows:
 - (a) Fire Insurance - ₹ 10,000
 - (b) Marine Insurance - ₹ 15,000
- (2) Premium outstanding as on 31st March, 2020 were as follows:
 - (a) Fire Insurance - ₹ 30,000
 - (b) Marine Insurance - ₹ 20,000
- (3) Reserve for unexpired risk to be maintained at 50% and 100% of net premiums in respect of Fire & Marine Insurance respectively.
- (4) Expenses of management due on 31st March, 2020 were ₹ 10,000 for Fire Insurance and ₹ 5,000 in respect of Marine Insurance.

Financial Statements of Banking Companies

- 11 (a) State with reason whether the following cash credit accounts are NPA or not:

	Case-1	Case-2
Sanctioned limit	60,00,000	45,00,000
Drawing power	56,00,000	42,00,000
Amount outstanding continuously 01-01-19 to 31-03-19	48,00,000	30,00,000
Total interest debited for the above period	3,84,000	2,40,000
Total credits for the above period	Nil	3,20,000

- (b) The following is an extract from the trial balance of Novel Bank Limited as on 31st March 2019:

Rebate on bills discounted as on 1st April 2018	₹ 78,566 (Cr. bal)
Discount Received	₹ 1,60,572 (Cr. bal)

An analysis of bills discounted is as follows:

Amount ₹	Due Date
2,90,000	01 June 2019
8,75,000	08 June 2019
5,65,000	21 June 2019
8,12,000	01 July 2019
6,50,000	05 July 2019

Find out the amount of discount to be credited to Profit and Loss Account for the year ending on 31st March, 2019 and pass the necessary journal entries. The rate of discount shall be taken at 10% per annum.

Departmental Accounts

12. Department X sells goods to Department Y at a profit of 50% on cost and to Department Z at 20% on cost. Department Y sells goods to Department X and Z at a profit of 25% and 15% respectively on sales. Department Z charges 30% profit on cost to Department X and 40% profit on sale to Y.

Stocks lying at different departments at the end of the year are as under:

	Dept. X	Dept. Y	Dept. Z
	₹	₹	₹
Transfer from Department X		75,000	48,000
Transfer from Department Y	50,000		82,000
Transfer from Department Z	52,000	56,000	

Calculate the unrealized profit of each department and also total unrealized profit.

Accounting for Branches

13. M & S Co. of Lucknow has an integral foreign branch in Canberra, Australia. At the end of 31st March 2020, the following ledger balances have been extracted from the books of the Lucknow office and the Canberra branch.

	Lucknow office (₹ In thousand)		Canberra Branch (Aust. Dollars in thousand)	
	Dr.	Cr.	Dr.	Cr.
Capital		1,500		
Reserves & Surplus		1,500		
Land	500			
Buildings (Cost)	1,000			
Buildings - Accumulated Dep.		200		
Plant and Machinery (Cost)	2,500		200	
Plant and Machinery - Accumulated Dep.		600		130
Debtors/Creditors	280	200	60	30
Stock as on 1- 4-2019	100		20	
Branch Stock Reserve		4		
Cash & Bank Balances	10		10	
Purchases/Sales	240	520	20	123
Goods sent to Branch		100	5	
Managing Partner's Salary	30			
Wages and Salaries	75		45	
Rent			12	
Office Expenses	25		18	
Commission Receipts		256		100
Branch/HO Current Account	120			7
	4,880	4,880	390	390

You are required to convert the Branch Trial Balance given above into rupees by using the following exchange rates:

Opening rate	1 A \$ = ₹ 50
Closing rate	1 A \$ = ₹ 53
Average rate	1 A \$ = ₹ 51.00
for Fixed Assets	1 A \$ = ₹ 46.00

Framework for Preparation and Presentation of Financial Statements

14. With regard to financial statements name any four

- (i) Users
- (ii) Qualitative characteristics
- (iii) Elements.

Accounting Standards**AS 4 Contingencies and Events occurring after the Balance Sheet Date**

15. A fire, on 2nd April, 2020, completely destroyed a manufacturing plant of Omega Ltd. whose financial year ended on 31st March, 2020, the financial statements were approved by their approving authority on 15th June, 2020. It was expected that the loss of ₹ 10 million would be fully covered by the insurance company. How will you disclose it in the financial statements of Omega Ltd. for the year ended 31st March, 2020.

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

16. The Accountant of Virush Limited has sought your opinion, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2020. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard:

- (i) Till the previous year the machinery 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.
- (ii) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.

AS 12 Accounting for Government Grants

17. How would you treat the following in the accounts in accordance with AS 12 'Government Grants'?

- (i) ₹ 35 Lakhs received from the Local Authority for providing Medical facilities to the employees.
- (ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area.

AS 16 Borrowing Costs

18. (a) Vital Limited borrowed an amount of ₹150 crores on 1.4.2019 for construction of boiler plant @ 10% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Vital Ltd. capitalized ₹ 19.50 crores for the accounting period ending on 31.3.2020. Due to surplus fund

out of ₹150 crores, an income of ₹ 1.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

- (b) When capitalization of borrowing cost should cease as per Accounting Standard 16? Explain in brief.

AS 19 Leases

19. (a) Viral Ltd. sold machinery having WDV of ₹ 40 lakhs to Saral Ltd. for ₹ 50 lakhs and the same machinery was leased back by Saral Ltd. to Viral Ltd. The lease back is in nature of operating lease. You are required to explain the treatment in the given cases –
- Fair value is ₹ 45 lakhs and sale price is ₹ 38 lakhs.
 - Fair value is ₹ 40 lakhs and sale price is ₹ 50 lakhs.
 - Fair value is ₹ 46 lakhs and sale price is ₹ 50 lakhs

AS 20 Earnings Per Share

- (b) A-One Limited supplied the following information. You are required to compute the earnings per share as per AS 20:

Net profit attributable to equity shareholders	Year 2017-18: ₹ 1,00,00,000
	Year 2018-19 : ₹ 1,50,00,000

Number of shares outstanding prior to

Right Issue	50,00,000 shares
Right Issue	One new share for each four outstanding shares i.e., 12,50,000 shares
	Right Issue Price - ₹ 96
	Last date of exercising rights - 30-06-2018
Fair value of one equity share immediately prior to exercise of rights on 30-06-2018	₹ 101

AS 26 Intangible Assets

20. (a) X Ltd. carried on business of manufacturing of Bakery products. The company has two trademarks "Sun" and "Surya". One month before, the company comes to know through one of the marketing managers that both trademarks have allegedly been infringed by other competitors engaged in the same field. After investigation, legal department of the company informed that it had weak case on trademark "Sun" and strong case in regard to trademark "Surya". X Ltd. incurred additional legal fees to stop infringement on both trademarks. Both trademarks have a remaining legal life of 10 years. How should X Ltd. account for these legal costs incurred relating to the two trademarks?

AS 29 Provisions, Contingent Liabilities and Contingent Assets

- (b) (i) How will you distinguish contingent assets with Contingent Liabilities. Explain in brief.
- (ii) Alpha Ltd. has entered into a sale contract of ₹ 7 crores with Gamma Ltd. during 2018-19 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 2019-20 financial year. In case of failure of Alpha Ltd. to deliver within the schedule, a compensation of ₹2 crores is to be paid to Gamma Ltd. Alpha Ltd. planned to manufacture the goods during the last month of 2018-19 financial year. As on balance sheet date (31.3.2019), the goods were not manufactured and it was unlikely that Alpha Ltd. will be in a position to meet the contractual obligation. You are required to advise Alpha Ltd. on requirement of provision for contingency in the financial statements for the year ended 31st March, 2019, in line with provisions of AS 29?

SUGGESTED ANSWERS/HINTS**1. Realization Account**

	₹		₹
To Land and Building	1,35,000	By Provision for bad debts	6,000
To Plant and Machinery	45,000	By Loan from D	1,20,000
To Furniture	25,500	By Trade creditors	30,000
To Investments	15,000	By Bills payable	12,000
To Book debts	60,000	By Outstanding salary	7,500
To Stock	36,000	By Kumar - Furniture taken over (13,500 x .9)	12,150
To Bank (Realization expenses)	15,000	By Bank A/c-	
To Amit- Realization expenses	3,000	Stock Realized	43,200
To Bank A/c -		Land & Building	1,65,000
Bill payable	11,940	Debtors	<u>48,000</u>
D's Loan	7,500		2,56,200
		By Amit (Investment taken over)	12,750

	D's Loan	54,000		
	Creditors	18,000		
	Salary	7,500		
To	Profit trs/f to partners' capital Accounts			
	Amit	9,264		
	Sumit	9,264		
	Kumar	<u>4,632</u>		
		<u>23,160</u>		
		4,56,600		<u>4,56,600</u>

Bank Account

		₹			₹
To	Balance b/d	13,500	By	Realization A/c (payment of liabilities: 11,940 + 7,500 + 54,000 + 15,000 + 18,000 + 7,500)	1,13,940
To	Realization A/c (assets realized)	2,56,200	By	Amit	79,314
To	Kumar	<u>12,618</u>	By	Sumit	<u>89,064</u>
		2,82,318			2,82,318

Partners' Capital Accounts

		Amit	Sumit	Kumar		Amit	Sumit	Kumar
		₹	₹	₹		₹	₹	₹
To	Balance b/d			32,400	By	Balance b/d	55,200	55,200
					By	Kumar's Loan		15,000
To	Realization A/c (Investment taken over)	12,750			By	General Reserve	24,600	24,600
To	Realization A/c (Furniture taken over)			12,150	By	Realisation A/c (expense)	3,000	
To	Bank A/c	79,314	89,064		By	Realization A/c (profit)	9,264	9,264
					By	Bank A/c		12,618
		<u>92,064</u>	<u>89,064</u>	<u>44,550</u>		<u>92,064</u>	<u>89,064</u>	<u>44,550</u>

Working Notes:**1. Payment for Bills Payable**

Particulars	Amount (₹)
Bills Payable as per Balance Sheet	12,000
Less: Discount for early payment {12,000 x 6% x (1/12)}	<u>60</u>
Amount Paid in Cash	11,940

2. Payment to D's Loan

Particulars	Amount (₹)
D's Loan as per Balance Sheet	<u>120,000.00</u>
50% of Loan adjusted as below:	
Plant & Machinery accepted at Book Value (₹ 45,000) and ₹ 7,500 in cash.	7,500
Balance 50% of Loan adjusted as below:	
In cash after allowing discount of 10% i.e. ₹ 60,000 – ₹ 6,000 = ₹ 54,000.	54,000

3. Payment to Trade Creditors

Particulars	Amount (₹)
Trade Creditors as per Balance Sheet	30,000
Less: Furniture of Book Value ₹ 12,000 accepted at value ₹ 10,800	<u>10,800</u>
	19,200
Less: Discount @ 6.25%	<u>1,200</u>
Amount paid in Cash	18,000

4. Furniture taken over by Kumar

Particulars	Amount
Furniture as per Balance Sheet	25,500
Less: Furniture of Book Value ₹ 12,000 accepted by trade creditors	<u>12,000</u>
	13,500
Less: 10% of Book Value	<u>1,350</u>
Value of Furniture taken over by Kumar	12,150

2. (a) Under section 27 (3) of the LLP Act, 2008 an obligation of an LLP arising out of a contract or otherwise, shall be solely the obligation of the LLP. The limitations of liability of an LLP and its partners are as follows:
- ◆ The Liabilities of an LLP shall be met out of the properties of the LLP;
 - ◆ A partner is not personally liable, directly or indirectly (for an obligation of an LLP arising out of a contract or otherwise), solely by reason of being a partner in the LLP;
 - ◆ An LLP is not bound by anything done by a partner in dealing with a person, if:
 - The partner does not have the authority to act on behalf of the LLP in doing a particular act; and
 - The other person knows that the partner has no authority or does not know or believe him to be a partner in the LLP
 - ◆ The liability of the LLP and the partners perpetrating fraudulent dealings shall be unlimited for all or any of the debts or other liabilities of the LLP.
- (b) Under section 64 of the LLP Act, 2008, an LLP may be wound up by the Tribunal:
- If the LLP decides that it should be wound up by the Tribunal;
 - If for a period of more than six months, the number of partners of the LLP is reduced below two;
 - If the LLP is unable to pay its debts;
 - If the LLP has acted against the interests of the integrity and sovereignty of India, the security of the state or public order;
 - If the LLP has defaulted in the filing of the Statement of Account and Solvency with the Registrar for five consecutive financial years;

3. **Journal Entries in the books of Kaushal Ltd.**

			₹	₹
1.3.2020	Bank A/c	Dr.	1,08,000	
to	Employee compensation expense A/c	Dr.	72,000	
31.3.2020	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)			

31.3.2020	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 Note:

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.

4. Debt Equity Ratio Test

	Particulars	₹
a)	Loan funds	42,00,000
(b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (₹ in crores)	21,00,000
(c)	Present equity shareholders fund (₹ in crores)	72,80,000
(d)	Future equity shareholder fund (₹ in crores) (See Note 2)	59,85,000 (72,80,000-12,95,000)
(e)	Maximum permitted buy back of Equity (₹ in crores) [(d) – (b)] (See Note 2)	38,85,000 (by simultaneous equation)
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) (See Note 2)	1,29,500 (by simultaneous equation)

Working Note:

1. Shareholders' funds

Particulars	₹
Paid up capital	30,00,000
Free reserves (32,50,000 + 6,00,000 + 4,30,000)	<u>42,80,000</u>
	<u>72,80,000</u>

2. As per section 68 of the Companies Act, 2013, amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y'.

Equation 1 : (Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained = Maximum permissible buy-back of equity.

$$(72,80,000 - x) - 21,00,000 = y \quad (1)$$

$$\text{Since } 51,80,000 - x = y$$

$$\text{Equation 2: } \left(\frac{\text{Maximum buy-back}}{\text{Offer price for buy-back}} \times \text{Nominal Value} \right)$$

= Nominal value of the shares bought –back to be transferred to CRR

$$= \left(\frac{y}{30} \times 10 \right) = x$$

$$3x = y \quad (2)$$

$$x = ₹ 12,95,000 \text{ crores and } y = ₹ 38,85,000 \text{ crores}$$

5.

	Number of debentures
Debenture holders opted for conversion (20,000 /100)	<u>200</u>
Option for conversion	20%
Number of debentures to be converted (20% of 200)	40

Redemption value of 40 debentures at a premium of 5%

$$[40 \times (100+5)] \quad ₹ 4,200$$

Equity shares of ₹ 10 each issued on conversion

$$[₹ 4,200 / ₹ 20] \quad 210 \text{ shares}$$

Calculation of cash to be paid : ₹

Number of debentures 200

Less: number of debentures to be converted into equity shares (40)

160

Redemption value of 160 debentures (160 × ₹ 105) ie. ₹ 16,800.

6. **Statement showing underwriters' liability for shares other than shares underwritten firm**

	X	Y	Z	Total
Gross liability (Issued shares – purchased by promoters, directors etc.)	5,85,000	2,25,000	90,000	9,00,000
(9,00,000 shares in the ratio of 65 : 25 : 10)				
Less: Marked applications	<u>(1,19,500)</u>	<u>(57,500)</u>	<u>(10,500)</u>	<u>(1,87,500)</u>
	4,65,500	1,67,500	79,500	7,12,500

Less: Allocation of unmarked applications (including firm underwriting i.e. 7,00,000) in the ratio 65 : 25 : 10	(4,55,000)	(1,75,000)	(70,000)	(7,00,000)
	10,500	(7,500)	9,500	12,500
Surplus of Y allocated to X and Z in the ratio 65 : 10	(6,500)	7,500	(1,000)	—
Additional shares to be purchased by X & Z	4,000	—	8,500	12,500

7.

**In the Books of Y Ltd.
Realisation Account**

		₹		₹
To Sundry Assets:			By Retirement Gratuity Fund	60,000
Goodwill	75,000			
Land & Building	3,00,000		By Trade payables	2,40,000
Plant & Machinery	4,50,000		By X Ltd. (Purchase Consideration)	15,90,000
Inventory	5,25,000			
Trade receivables	3,00,000			
Bank	60,000	17,10,000		
To Preference Shareholders (Premium on Redemption)		30,000		
To Equity Shareholders (Profit on Realisation)		1,50,000		
		18,90,000		18,90,000

In the Books of X Ltd.

Journal Entries

	Dr.	Cr.
	₹	₹
Business Purchase A/c Dr.	15,90,000	
To Liquidators of Y Ltd. Account		15,90,000
(Being business of Y Ltd. taken over)		

Goodwill Account	Dr.	1,50,000	
Land & Building Account	Dr.	5,00,000	
Plant & Machinery Account	Dr.	4,00,000	
Inventory Account	Dr.	4,72,500	
Trade receivables Account	Dr.	3,00,000	
Bank Account	Dr.	60,000	
Unrecorded assets Account	Dr.	15,000	
To Retirement Gratuity Fund Account			60,000
To Trade payables Account			2,40,000
To Provision for Doubtful Debts Account			7,500
To Business Purchase A/c			15,90,000
(Being Assets and Liabilities taken over as per agreed valuation).			
Liquidators of Y Ltd. A/c	Dr.	15,90,000	
To 9% Preference Share Capital A/c			3,30,000
To Equity Share Capital A/c			12,00,000
To Securities Premium A/c			60,000
(Being Purchase Consideration satisfied as above)			

Balance Sheet of X Ltd. (after absorption)
as at 31st March, 2018

Particulars		Notes	₹
1	Equity and Liabilities		
	Shareholders' funds		
A	Share capital	1	48,30,000
B	Reserves and Surplus	2	2,70,000
2	Non-current liabilities		
A	Long-term provisions	3	2,10,000
3	Current liabilities		
A	Trade Payables	4	6,10,000
B	Short term provision	5	7,500
	Total		59,27,500

	Assets		
1	Non-current assets		
	Property, Plant and Equipment	6	33,00,000
	Intangible assets	7	3,00,000
2	Current assets		
A	Inventories	8	12,22,500
B	Trade receivables	9	8,80,000
C	Other current Assets	10	15,000
D	Cash and cash equivalents	11	<u>2,10,000</u>
	Total		59,27,500

Notes to accounts

	₹
1 Share Capital	
Equity share capital	
4,20,000 Equity Shares of ₹ 10 each fully paid (Out of above 1,20,000 Equity Shares were issued at 5% premium in consideration other than for cash)	42,00,000
Preference share capital	
6,300 9% Preference Shares of ₹ 100 each (Out of above 3,300 Preference Shares were issued in consideration other than for cash)	6,30,000
Total	48,30,000
2 Reserves and Surplus	
Securities Premium	60,000
General Reserve	2,10,000
Total	2,70,000
3 Long-term provisions	
Retirement Gratuity fund	2,10,000
4 Trade payables	
(3,90,000 + 2,40,000 - 20,000*)	6,10,000
* Mutual Owings eliminated.	
5 Short term Provisions	
Provision for Doubtful Debts	7,500

6	Property, Plant and Equipment	
	Land & Buildings	14,00,000
	Plant & Machinery	19,00,000
	Total	33,00,000
7	Intangible assets	
	Goodwill (1,50,000 + 1,50,000)	3,00,000
8	Inventories (7,50,000 + 4,72,500)	12,22,500
9	Trade receivables (6,00,000 + 3,00,000 - 20,000)	8,80,000
10	Other current Assets	15,000
11	Cash and cash equivalents (1,50,000 + 60,000)	2,10,000

Working Notes:

1. Computation of goodwill

₹

Profit of 2016-17	90,000
Profit of 2015-16 adjusted (₹ 78,000 + 10,000)	88,000
Profit of 2014-15 adjusted (₹ 72,000 – 25,000)	47,000
	<u>2,25,000</u>
Average profit	75,000

Goodwill to be valued at 2 times of average profits = ₹ 75,000 x 2 = ₹ 1,50,000

2.

Purchase Consideration:		₹
Goodwill		1,50,000
Land & Building		5,00,000
Plant & Machinery		4,00,000
Inventory		4,72,500
Trade receivables		3,00,000
Unrecorded assets		15,000
Cash at Bank		<u>60,000</u>
		18,97,500
Less: Liabilities:		
Retirement Gratuity	60,000	
Trade payables	2,40,000	
Provision for doubtful debts	<u>7,500</u>	<u>(3,07,500)</u>

Net Assets/ Purchase Consideration	15,90,000
To be satisfied as under:	
10% Preference Shareholders of Y Ltd.	3,00,000
Add: 10% Premium	<u>30,000</u>
9% Preference Shares of X Ltd.	3,30,000
Equity Shareholders of Y Ltd. to be satisfied by issue of 1,20,000 equity Shares of X Ltd. at 5% Premium	<u>12,60,000</u>
Total	<u>15,90,000</u>

8.

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 (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.)			5,78,000
(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 (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.)			3,82,000
(v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c (Being remaining trade payables sacrificed 50% of their claim.)			1,70,000
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (₹ 5) A/c			40,000
	To Reconstruction A/c (Being Directors' loan claim settled by issuing 12,000 equity shares of ₹ 5 each as per scheme of reconstruction.)			60,000
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c (Being payment made towards penalty of 5% for cancellation of capital commitments of ₹ 3 Lakhs.)			15,000
(viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c (Being refund of fees by directors credited to reconstruction A/c.)			1,00,000

(ix)	Reconstruction A/c To Bank A/c (Being payment of reconstruction expenses.)	Dr.	15,000	15,000
(x)	Provision for Tax A/c To Bank A/c To Reconstruction A/c (Being payment of tax liability in full settlement against provision for tax)	Dr.	1,00,000	75,000 25,000
(xi)	Land and Building A/c To Reconstruction A/c (Being appreciation in value of Land & Building recorded)	Dr.	2,00,000	2,00,000
(xii)	Reconstruction A/c To Goodwill A/c To Patent A/c To Profit and Loss A/c To Plant and Machinery A/c To Furniture & Fixture A/c To Trade Investment A/c To Inventory A/c To Trade Receivables A/c To Capital Reserve (bal. fig.) (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.)	Dr.	49,85,000	11,00,000 5,00,000 14,60,000 6,50,000 1,00,000 50,000 2,50,000 1,00,000 7,75,000

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	<u>55,000</u>
	<u>2,60,000</u>		<u>2,60,000</u>

Reconstruction Account

	₹		₹
To Bank (penalty)	15,000	By Equity Share Capital A/c	25,00,000
To Bank (reconstruction expenses)	15,000	By 9% Pref. Share Capital A/c	10,00,000
To Goodwill	11,00,000	By Mr. Y (Settlement)	5,78,000
To Patent	5,00,000	By Mr. Z (Settlement)	3,82,000
To P & L A/c	14,60,000	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.)	<u>7,75,000</u>		
	<u>50,15,000</u>		<u>50,15,000</u>

9.**Liquidator's Final Statement of Receipts and Payments A/c**

	₹	₹		₹
To Cash in hand		40,000	By Liquidator's remuneration and expenses	5,000
To Assets realised:			By Trade Payables	3,50,000
Fixed assets	1,68,000		By Preference shareholders	1,00,000
Inventory			By Equity shareholders @ ₹ 10 on 2,000 shares	20,000
(1,10,000 – 1,00,000)	10,000			
Book debts	<u>2,30,000</u>	4,08,000		
To Cash - proceeds of call on 1,800 equity shares @ ₹ 15*		<u>27,000</u>		
		<u>4,75,000</u>		<u>4,75,000</u>

Working Note:**Return per equity share**

	₹
Cash available before paying preference shareholders (₹ 4,48,000 – ₹ 3,55,000)	93,000
Add: Notional calls 1,800 shares (2,000-200) × ₹ 25	<u>45,000</u>
	1,38,000
Less: Preference share capital	<u>(1,00,000)</u>
Available for equity shareholders	<u>38,000</u>
Return per share = $\frac{₹ 38,000}{3,800 (4,000 - 200)} = ₹ 10$	
and Loss per Equity Share ₹ (100-10) = ₹ 90	

*Calls to be made @ ₹ 15 per share (₹ 90-75) on 1,800 shares.

10.

Form B – RA (Prescribed by IRDA)**Real General Insurance Co. Ltd****Revenue Account for the year ended 31st March, 2020****Fire and Marine Insurance Business**

	Schedule	Fire Current Year	Marine Current Year
		₹	₹
Premiums earned (net)	1	4,27,500	1,40,000
Profit / (Loss) on sale / redemption of investments		—	—
Others (to be specified)			
Interest, Dividends and Rent – Gross		—	—
Total (A)		<u>4,27,500</u>	<u>1,40,000</u>
Claims incurred (net)	2	82,000	88,000
Commission	3	40,000	20,000
Operating expenses related to Insurance business	4	<u>70,000</u>	<u>50,000</u>
Total (B)		<u>1,92,000</u>	<u>1,58,000</u>
Profit from Fire / Marine Insurance business (A-B)		2,35,500	(18,000)

Schedules forming part of Revenue Account

	<i>Fire</i>	<i>Marine</i>
	₹	₹
Schedule -1		
Premium earned (net)		
Premium received during the year	4,50,000	3,30,000
Add: Outstanding on 31 st March 2020	<u>30,000</u>	<u>20,000</u>
	4,80,000	3,50,000
Less: Reinsurance premiums	<u>(25,000)</u>	<u>(15,000)</u>
	4,55,000	3,35,000
Less: Adjustment for change in provision for unexpired risk	<u>(27,500)</u>	<u>(1,95,000)</u>
	<u>4,27,500</u>	<u>1,40,000</u>
Schedule – 2		
Claims incurred (net)		
Claims paid during the year	1,00,000	80,000
Add: Outstanding on 31 st March,2020	<u>10,000</u>	<u>15,000</u>
	1,10,000	95,000
Less: Outstanding on 1 st April,2019	<u>(28,000)</u>	<u>(7,000)</u>
	<u>82,000</u>	<u>88,000</u>
Schedule – 3		
Commission paid	<u>40,000</u>	<u>20,000</u>
Schedule – 4		
Operating expenses		
Expenses paid during the year	60,000	45,000
Add: Outstanding on 31 st March,2020	<u>10,000</u>	<u>5,000</u>
	<u>70,000</u>	<u>50,000</u>

Working note for changes in unexpired Risk Reserve

Reserve for unexpired Risk (Fire Insurance @50%)	
Opening Reserve (1)	₹ 2,00,000
Closing Reserve (₹ 4,55,000 X 50/100) (2)	₹ 2,27,500
Additional Transfer to Reserve (2 – 1)	₹ 27,500

Reserve for unexpired Risk (Marine Insurance @100%)	
Opening Reserve (1)	₹1,40,000
Closing Reserve (₹ 3,35,000 X 100/100) (2)	₹3,35,000
Additional Transfer to Reserve (2 – 1)	₹1,95,000

11. (a)

	Case 1	Case 2
	₹	₹
Sanctioned limit	60,00,000	45,00,000
Drawing power	56,00,000	42,00,000
Amount outstanding continuously from 1.01.2019 to 31.03.2019	48,00,000	30,00,000
Total interest debited	3,84,000	2,40,000
Total credits	-	320,000
Is credit in the account is sufficient to cover the interest debited during the period or amount is not 'overdue' for a continuous period of 90 days.	No	Yes
	NPA	NOT NPA

(b) The amount of rebate on bills discounted as on 31st March, 2019 the period which has not been expired upto that day will be calculated as follows:

Discount on ₹ 2,90,000 for 62 days @ 10%	4,926
Discount on ₹ 8,75,000 for 69 days @ 10%	16,541
Discount on ₹ 5,65,000 for 82 days @ 10%	12,693
Discount on ₹ 8,12,000 for 92 days @ 10%	20,467
Discount on ₹ 6,50,000 for 96 days @ 10%	<u>17,096</u>
Total	<u>71,723</u>

Note: The due date of the bills discounted is included in the number of days above.

The amount of discount to be credited to the profit and loss account will be:

	₹
Transfer from rebate on bills discounted as on 1.4. 2018	78,566
Add: Discount received during the year	<u>1,60,572</u>
	2,39,138
Less: Rebate on bills discounted as on 31.03. 2019 (as above)	<u>(71,723)</u>
	<u>1,67,415</u>

Journal Entries

	₹	₹
Rebate on bills discounted A/c Dr. To Discount on bills A/c (Transfer of opening unexpired discount on 31.03. 2018)	78,566	78,566
Discount on bills A/c Dr. To Rebate on bills discounted (Unexpired discount on 31.03. 2019 taken into account)	71,723	71,723
Discount on Bills A/c Dr. To P & L A/c (Discount earned in the year, transferred to P&L A/c)	1,67,415	1,67,415

12. Calculation of unrealized profit of each department and total unrealized profit

	Dept. X	Dept. Y	Dept. Z	Total
	₹	₹	₹	₹
Unrealized Profit of: Department X		$75,000 \times 50/150$ = 25,000	$48,000 \times 20/120$ = 8,000	33,000
Department Y	$50,000 \times .25$ = 12,500		$82,000 \times .15$ = 12,300	24,800
Department Z	$52,000 \times 30/130$ = 12,000	$56,000 \times 40/100$ = 22,400		<u>34,400</u>
				<u>92,200</u>

13.

M & S Co. Ltd.

Canberra, Australia Branch Trial Balance

As on 31st March 2020

	(\$ 'thousands)				(₹ 'thousands)
	Dr.	Cr.	Conversion rate per \$	Dr.	Cr.
Plant & Machinery (cost)	200		₹ 46	9,200	
Plant & Machinery Accumulated Dep.	-	130	₹ 46		5,980
Debtors/Creditors	60	30	₹ 53	3,180	1,590
Stock (1.4.2019)	20		₹ 50	1,000	

Cash & Bank Balances	10		₹ 53	530	
Purchase / Sales	20	123	₹ 51	1,020	6,273
Goods received from H.O.	5		Actual	100	
Wages & Salaries	45		₹ 51	2,295	
Rent	12		₹ 51	612	
Office expenses	18		₹ 51	918	
Commission Receipts		100	₹ 51		5,100
H.O. Current A/c		7	Actual		<u>120</u>
				18,855	19,063
Foreign Exchange Loss (bal. fig.)				<u>208</u>	
	<u>390</u>	<u>390</u>		<u>19,063</u>	<u>19,063</u>

14 (i) Users of financial statements:

Investors, Employees, Lenders, Supplies/Creditors, Customers, Government & Public

(ii) Qualitative Characteristics of Financial Statements:

Understandability, Relevance, Comparability, Reliability & Faithful Representation

(iii) Elements of Financial Statements:

Asset, Liability, Equity, Income/Gain and Expense/Loss

- 15.** The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, it is necessary to consider the validity of the going concern assumption having regard to the extent of insurance cover. Also, since it is said that the loss would be fully recovered by the insurance company, the fact should be disclosed by way of a note to the financial statements.
- 16.** (i) Change in useful life of machinery from 5 years to 3 years is a change in estimate and is not a change in accounting policy.
- (ii) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.
- 17.** (i) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

- (ii) As per AS 12 'Accounting for Government Grants', where the government grants are in the nature of promoters' contribution, i.e. they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.
- 18 (a) Para 10 of AS 16 'Borrowing Costs' states that to the extent the 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. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Vital Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2019-20 should be calculated as follows:

Actual interest for 2019-20 (10% of ₹ 150 crores)	₹ 15.00 crores
Less: Income on temporary investment from specific borrowings	(₹ 1.50 crores)
Borrowing costs to be capitalized during year	₹ 13.50 crores

- (b) Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

19. (a) As per AS 19, where sale and leaseback results in operating lease, then the accounting treatment in different situations is as follows:

Situation 1: Sale price = Fair Value

Profit or loss should be recognized immediately.

Situation 2: Sale Price < Fair Value

Profit should be recognized immediately. The loss should also be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

Situation 3: Sale Price > Fair Value

The excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

Following will be the treatment in the situations given in the question:

- (i) When fair value of leased machinery is ₹ 45 lakhs & sales price is ₹ 38 lakhs, then loss of ₹ 2 lakhs (40 – 38) to be immediately recognized by Viral Ltd. in its books provided loss is not compensated by future lease payment.
- (ii) When fair value is ₹ 40 lakhs & sales price is ₹ 50 lakhs then, profit of ₹ 10 lakhs is to be deferred and amortized over the lease period.
- (iii) When fair value is ₹ 46 lakhs & sales price is ₹ 50 lakhs, profit of ₹ 6 lakhs (46 less 40) to be immediately recognized in its books and balance profit of ₹ 4 lakhs (50-46) is to be amortized/deferred over lease period.

(b) Computation of Earnings per share

	2017-18 ₹	2018-19 ₹
EPS for the year 2017-18 as originally reported: (₹ 1,00,00,000 / 50,00,000 shares)	2.00	
EPS for the year 2017-18 restated for rights issue: ₹1,00,00,000 / (50,00,000 shares x 1.01)*	1.98	
EPS for the year 2018-19 including effects of rights issue Rs. 1,50,00,000 (50,00,000 x 1.01 x 3/12)+ (62,50,000 x 9/12)		2.52

* Computation of Earnings per share in case of Rights Issue requires computation of adjustment factor which is given as working note.

Working Notes:

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

Fair value of all outstanding shares immediately prior to exercise of rights + total amount received from exercise

Number of shares outstanding prior to exercise + Number of shares issued in the exercise

$$\frac{(\text{₹ } 101 \times 50,00,000 \text{ shares}) + (\text{₹ } 96 \times 12,50,000 \text{ shares})}{50,00,000 \text{ shares} + 12,50,000 \text{ shares}}$$

$$= \text{₹ } 62,50,00,000 / 62,50,000 = \text{₹ } 100$$

Therefore, theoretical ex-rights fair value per share is = ₹ 100

2. Computation of adjustment factor

$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex-rights value per share}} = \frac{\text{₹ } (101)}{\text{₹ } (100)} = 1.01$$

20. (a) As per AS 26, subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense. However, if the subsequent expenditure enables the asset to generate future economic benefits in excess of its originally assessed standard of performance or can be measured and attributed to the asset reliably, then such subsequent expenditure should be added to the cost of the intangible asset.

The legal costs incurred for both the trademarks do not enable them to generate future economic benefits in excess of its originally assessed standard of performance. They only ensure to maintain them if the case is decided in favour of the company. Therefore, such legal costs incurred for both trademarks must be recognized as an

- (b) (i) **A Contingent liability** is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

A present obligation that arises from past events but is not recognized because:

- (i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
- (ii) A reliable estimate of the amount of the obligation cannot be made.

An enterprise should not recognize a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. An enterprise should not recognize a contingent asset, since this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

- (ii) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognized. Alpha Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Alpha Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Alpha Ltd. should provide for the contingency amounting ₹ 2 crores as per AS 29.

PAPER – 6: AUDITING AND ASSURANCE

PART – I : ACADEMIC UPDATE

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

Revised Chapter 7-Company Audit-I is given hereunder:

1. Eligibility, Qualifications and Disqualifications of an Auditor



The provisions relating to eligibility, qualifications and disqualifications of an auditor are governed by **section 141** of the Companies Act, 2013 (hereinafter referred as the Act). The main provisions are stated below:

(1) A person shall be **eligible for appointment** as an auditor of a company **only if he is a chartered accountant**.

It may be noted that a firm whereof majority of partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

Fig.: Is the person eligible for appointment as auditor?¹

- (2) Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.
- (3) Under **sub-section (3) of section 141** along with **Rule 10** of the Companies (Audit and Auditors) Rules, 2014 (hereinafter referred as CAAR), the following persons shall not be eligible for appointment as an auditor of a company, namely -
 - (a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
 - (b) an officer or employee of the company;
 - (c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
 - (d) a person who, or his relative or partner -
 - (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company;

¹ Source of image: <http://yourfinancebook.com>

It may be noted that the relative may hold security or interest in the company of face value not exceeding ₹ 1,00,000.

It may also be noted that the condition of ₹ 1,00,000 shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities.

Students may also note that in the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified above shall be taken by the auditor **within 60** days of such acquisition or interest.

The following points merit consideration in this regard:

- (i) The value of shares of ₹ 1,00,000 that can be held by relative is the face value not the market value.
- (ii) The limit of ₹ 1,00,000 would be applicable where the securities are held by the relative of an auditor and not where the securities are held by an auditor himself or his partner. In case of an auditor or his partner, securities of even small value shall be a disqualification.
- (iii) Grace period of 60 days for corrective action shall apply only in respect of securities held by relatives. This would not apply to auditor or his partner.

[The term “relative”, as defined under the Companies Act, 2013, means anyone who is related to another as members of a Hindu Undivided Family; husband and wife; Father (including step- father), Mother (including step-mother), Son (including step- son), Son’s wife, Daughter, Daughter’s husband, Brother (including step- brother), Sister (including step- sister).]

EXAMPLES

Ex 1: Mr. A, a practicing Chartered Accountant, is holding securities of XYZ Ltd. having face value of ₹900. Whether Mr. A is qualified for appointment as an auditor of XYZ Ltd.?

As per section 141(3)(d)(i), an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

In the present case, Mr. A is holding security of ₹900 in XYZ Ltd. Therefore, he is not eligible for appointment as an auditor of XYZ Ltd.

Ex 2: Mr. P is a practicing Chartered Accountant and Mr. Q, the relative of Mr. P, is holding securities of ABC Ltd. having face value of ₹ 90,000. Whether Mr. P is qualified from being appointed as an auditor of ABC Ltd.?

As per section 141(3)(d)(i), a person is disqualified to be appointed as an auditor if he, or his relative or partner is holding any security of or interest in

the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Further, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

In the present case, Mr. Q. (relative of Mr. P), is having securities of ₹ 90,000 face value in ABC Ltd., which is as per requirement of proviso to section 141(3)(d)(i). Therefore, Mr. P will not be disqualified to be appointed as an auditor of ABC Ltd.

Ex 3: M/s BC & Co. is an Audit Firm having partners Mr. B and Mr. C, and Mr. A the relative of Mr. C, is holding securities of MWF Ltd. having face value of ₹ 1,01,000. Whether M/s BC & Co. is qualified from being appointed as an auditor of MWF Ltd.?

As per section 141(3)(d)(i), a person is disqualified to be appointed as an auditor if he, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Further as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

In the instant case, M/s BC & Co. will be disqualified for appointment as an auditor of MWF Ltd. as the relative of Mr. C (i.e. partner of M/s BC & Co.) is holding the securities in MWF Ltd. which is exceeding the limit mentioned in proviso to section 141(3)(d)(i).

Ex 4: M/s RM & Co. is an audit firm having partners CA. R and CA. M. The firm has been offered the appointment as an auditor of Enn Ltd. for the Financial Year 2016-17. Mr. Bee, the relative of CA. R, is holding 5,000 shares (face value of ₹ 10 each) in Enn Ltd. having market value of ₹ 1,50,000. Whether M/s RM & Co. is disqualified to be appointed as auditors of Enn Ltd.?

As per section 141(3)(d)(i), a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. However, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

In the instant case, M/s RM & Co. is an audit firm having partners CA. R and CA. M. Mr. Bee is a relative of CA. R and he is holding shares of Enn Ltd. of face value of ₹ 50,000 only (5,000 shares x ₹ 10 per share).

Therefore, M/s RM & Co. is not disqualified for appointment as an auditors of Enn Ltd. as the relative of CA. R (i.e. partner of M/s RM & Co.) is holding the securities in Enn Ltd. which is within the limit mentioned in proviso to section 141(3)(d)(i) of the Companies Act, 2013.

- (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 5,00,000; or
 - (iii) 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 ₹ 1,00,000.
- (e) 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 or Subsidiary of such holding company or associate company, of such nature as may be prescribed;

Students may note that for the purpose of clause (e) above, the term "business relationship" shall be construed as any transaction entered into for a commercial purpose, except –

- (i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
 - (ii) commercial transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.
- (f) a person whose relative is a Director or is in the employment of the Company as a director or key Managerial Personnel.
- (g) a person who 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.
- (h) a person who has been convicted by a Court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.
- (i) **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.**

It may be noted that, for the purposes of this clause, the term "directly or indirectly" shall have the same meaning as assigned to it in the Explanation to section 144, i.e.

In case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual, shall be termed as rendering of services directly or indirectly by the auditor; and

In case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners, shall be termed as rendering of services directly or indirectly by the auditor.

Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, 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:



- (i) accounting and book keeping services;
- (ii) internal audit;
- (iii) design and implementation of any financial information system;
- (iv) actuarial services;
- (v) investment advisory services;
- (vi) investment banking services;

Fig.: Auditor restrained from entering into certain services²

- (vii) rendering of outsourced financial services;
- (viii) management services; and
- (ix) any other kind of services as may be prescribed.

It may be noted that an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall comply with the provisions of this section before the closure of the first financial year after the date of such commencement.

Example: CA. Poshin is providing the services of investment banking to C Ltd. Later on, he was also offered to be appointed as an auditor of the company for the current financial year. Advise.

Section 141(3)(i) of the Companies Act, 2013 disqualifies a person for appointment as an auditor of a company who, **directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.** Section 144 of the Companies Act, 2013 prescribes certain

² Source of image: webuildbuzz.com

services not to be rendered by the auditor which includes investment banking services.

Therefore, CA. Poshin is advised not to accept the assignment of auditing as the investment banking service is specifically notified in the list of services not to be rendered by him as per section 141(3)(i) read with section 144 of the Companies Act, 2013.

- (4) Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in **sub-section (3)** after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

CASE STUDY

Facts of the Case: Mr. A, a chartered accountant, has been appointed as an auditor of Laxman Ltd. in the Annual General Meeting of the company held in September, 2016, which assignment he accepted. Subsequently in January, 2017 he joined Mr. B, another chartered accountant, who is the Manager Finance of Laxman Ltd., as partner.

Provisions and Explanation: Section 141(3)(c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor.

Conclusion: In the present case, Mr. A, an auditor of Laxman Ltd., joined as partner with Mr. B, who is Manager Finance of Laxman Limited. The given situation has attracted sub-section (3)(c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of Laxman Limited in accordance with sub-section (4) of section 141.

2. Appointment of Auditor

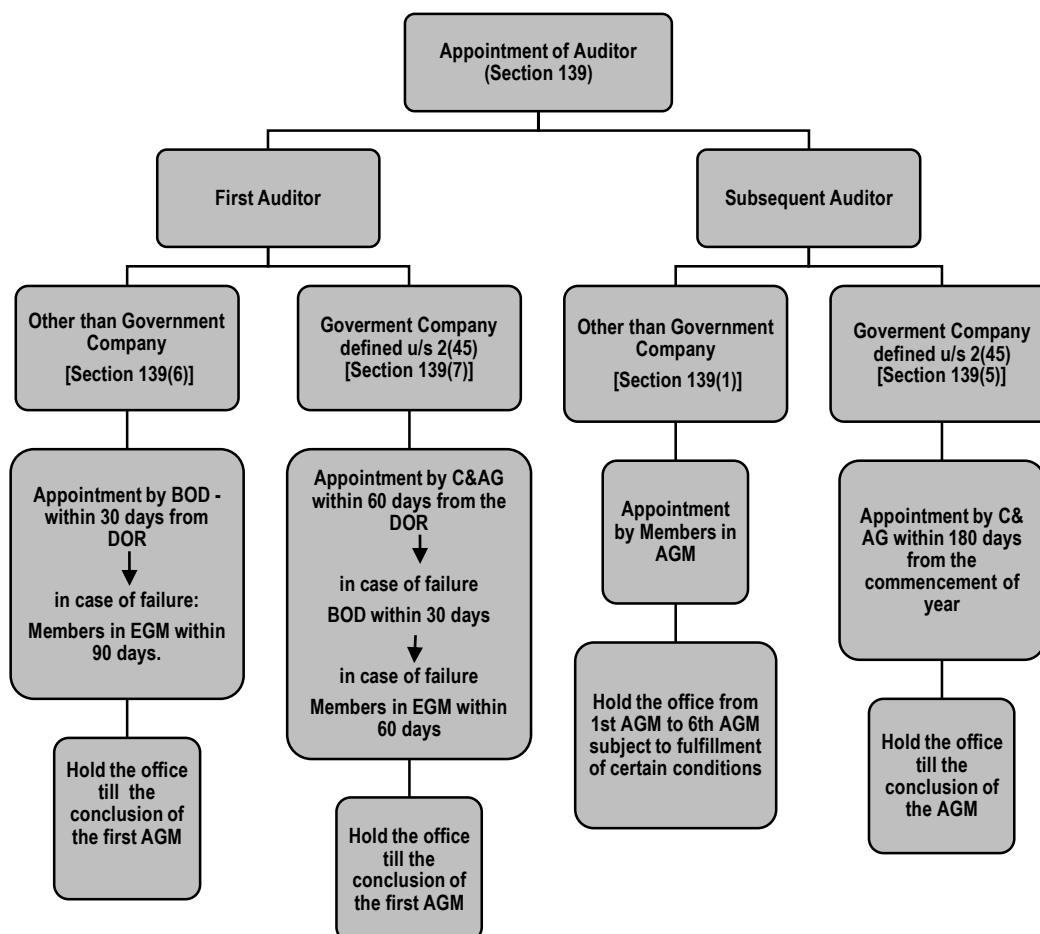


Section 139 of the Companies Act, 2013 contains provisions regarding Appointment of Auditors. Discussion on appointment of auditors may be grouped under two broad headings-

- I Appointment of First Auditors.
- II Appointment of Subsequent Auditors.

Fig: Meeting for appointment of Auditor³

³ Source of image: <http://newhavenscience.org>



2.1 Appointment of First Auditor

2.1.1 Appointment of First Auditors in the case of a company, other than a Government Company: As per **Section 139(6)**, 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.

CASE STUDY

Facts of the Case: Managing Director of Pigeon Ltd. himself wants to appoint CA. Champ, a practicing Chartered Accountant, as first auditor of the company.

Provisions and Explanation: Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company. In the instant case, the proposed appointment of CA. Champ, a practicing Chartered Accountant, as first auditor by the Managing Director of Pigeon Ltd. by himself is in violation of Section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company.

Conclusion: In view of the above, the Managing Director of Pigeon Ltd. should be advised not to appoint the first auditor of the company.

2.1.2 Appointment of First Auditors in the case of Government Company: A “Government company” is a company in which not less than 51% of the paid-up share capital is held 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, and includes a company which is a subsidiary company of such a Government company.

Section 139(7) 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.

CASE STUDY

Facts of the Case: The first auditor of Bhartiya Petrol Ltd., a Government company, was appointed by the Board of Directors.

Provisions and Explanation: In the case of a Government Company, the appointment of first auditor is governed by the provisions of Section 139(7) of the Companies Act, 2013 which states that in the case of a Government company, 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. Hence, in the case of Bhartiya Petrol Ltd., being a government company, the first auditor shall be appointed by the Comptroller and Auditor General of India.

Conclusion: Thus, the appointment of first auditor made by the Board of Directors of Bhartiya Petrol Ltd., is null and void.

2.2 Appointment of Subsequent Auditor/Reappointment of Auditor

2.2.1 Appointment of Subsequent Auditors in case of Non Government Companies:

Section 139(1) of the Companies Act, 2013 provides that 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.

The following points need to be noted in this regard-

- (i) Before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.
- (ii) The certificate shall also indicate whether the auditor satisfies the criteria provided in **section 141**.
- (iii) The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

2.2.2 Appointment of Subsequent Auditors in case of Government Companies: As per **section 139(5)**, 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.

2.3 Filling of a Casual Vacancy

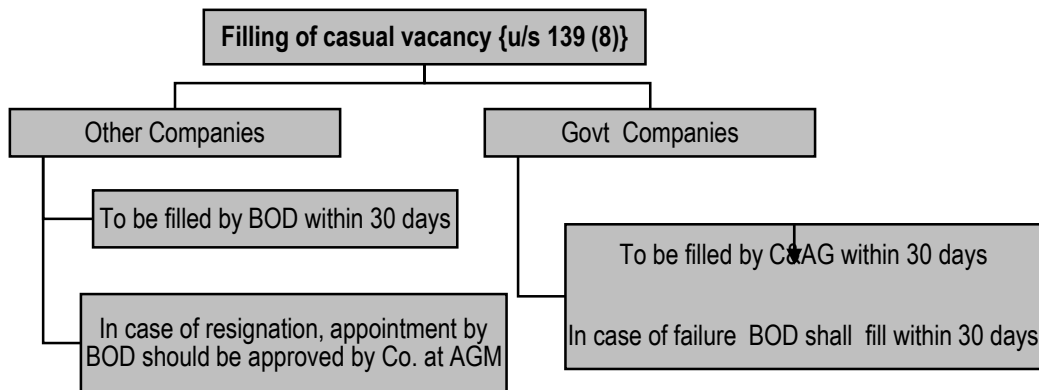
As per **Section 139(8)**, any casual vacancy in the office of an auditor shall-

- (i) **In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India**, be filled by the Board of Directors within 30 days.

If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

- (ii) **In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India**, be filled by the Comptroller and Auditor-General of India within 30 days.

It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the Board of Directors shall fill the vacancy within next 30 days.



2.3.1 Casual Vacancy by Resignation: As per **section 140(2) of the Act**, 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.

In case of the companies referred to in **section 139(5)** i.e. Government company, the auditor shall also file such statement with the CAG along with the company and the Registrar.

The auditor shall indicate the reasons and other facts as may be relevant with regard to his resignation.

In case of failure, the auditor shall be liable to a penalty of **fifty thousand rupees or the remuneration of the auditor, whichever is less**, and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of five lakh rupees as per **section 140(3)** (Companies (Amendment) Second Ordinance 2019 dated 21 February 2019).

CASE STUDY

Facts of the Case: CA. Donald was appointed as the auditor of PS Ltd. at the remuneration of ₹ 30,000. However, after 4 months of continuing his services, he could not continue to hold his office of the auditor as his wife got a government job at a distant place and he needs to shift along with her to the new place. Thus, he resigned from the company and did not perform his responsibilities relating to filing of statement to the

company and the registrar indicating the reasons and other facts as may be relevant with regard to his resignation.

How much fine may he be punishable with under section 140(3) for non-compliance of section 140(2) of the Companies Act, 2013?

Provisions and Explanation: For non-compliance of sub-section (2) of section 140 of the Companies Act, 2013, 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, under section 140(3) of the said Act.

Conclusion: Thus, the fine under section 140(3) of the Companies Act, 2013 shall not be less than ₹30,000 but which may extend to ₹5,00,000.

Other Important Provisions Regarding Appointment of Auditors

- (1) A retiring auditor may be re-appointed at an annual general meeting, if-
 - (a) he is not disqualified for re-appointment;
 - (b) he has not given the company a notice in writing of his unwillingness to be re-appointed; and
 - (c) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.
- (2) Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

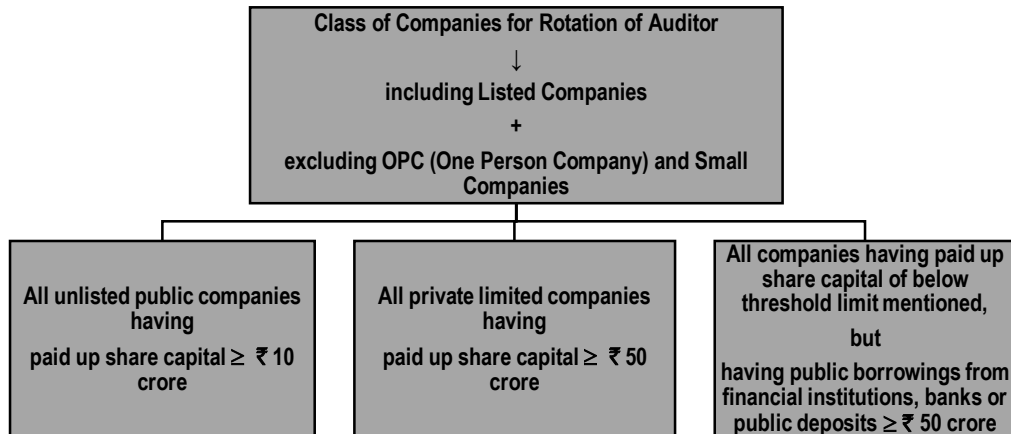
3. Rotation of Auditor

3.1 Applicability of Section 139(2) Rotation of Auditor: As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the **class of companies** shall mean the following classes of companies excluding one person companies and small companies-



Fig: Rotation of Auditors⁴

⁴ Source of image: thehindubusinessline.com



- (I) all unlisted public companies having paid up share capital of rupees ten crore or more;
- (II) all private limited companies having paid up share capital of rupees fifty crore or more;
- (III) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

Example: Rano Pvt. Ltd. is a private limited Company, having paid up share capital of ₹ 42 crore but having public borrowing from nationalized banks and financial institutions of ₹ 72 crore, manner of rotation of auditor will be applicable.

As per **section 139(2)**, no listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint-

- (a) an individual as auditor for more than one term of five consecutive years; and
- (b) an audit firm as auditor for more than two terms of five consecutive years. Provided that -
 - (i) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;
 - (ii) an audit firm which has completed its term under clause (b), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term.

Example: Jolly Ltd., a listed company, appointed M/s Polly & Co., a Chartered Accountant firm, as the statutory auditor in its AGM held at the end of September, 2016 for 11 years. Here, the appointment of M/s Polly & Co. is not valid as the appointment can be made only for one term of five consecutive years and then another one more term of five consecutive years. It can't be appointed for two terms in one AGM only. Further, a cooling period of five years from the completion of term is required i.e. the firm can't be re-appointed for further 5 years after completion of two terms of five consecutive years.

The following points merit consideration in this regard-

- (1) As on the date of appointment, no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

Example: *M/s XYZ & Co., is an audit firm having partner Mrs. X, Mr. Y and Mr. Z, whose tenure has expired in the company immediately preceding the financial year. M/s ABZ & Co., another audit firm in which Mr. Z is a common partner, will also be disqualified for the same company along with M/S XYZ & Co. for the period of five years.*

- (2) Every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this sub-section within a period which shall not be later than the date of the first annual general meeting of the company held, within the period specified under sub-section (1) of section 96, after three years from the date of commencement of this Act.

EXAMPLES

Ex 1: *Mr. Raj, a Chartered Accountant, is an individual auditor of Binaca Limited for last 5 years as on March, 2013 (i.e. existing on or before the date of Commencement of Companies Act, 2013). Keeping in view the transition period as stated in the Companies Act, 2013, Mr. Raj can continue the audit of Binaca Ltd. upto the first annual general meeting to be held after three years from the date of commencement of the Act.*

Ex 2: *M/s Raj & Associates, a Chartered Accountants Audit Firm, is doing audit of Binaca Limited for last 11 years as on March, 2013 (i.e. existing on or before the date of Commencement of Companies Act, 2013). Keeping in view the transition period as stated in the Companies Act, 2013, M/s Raj Associates can continue the audit of Binaca Ltd. upto the first annual general meeting to be held after three years from the date of commencement of the Act.*

Students may interlink the above example with Illustrative table explaining rotation in case of individual auditor as well as audit firm which has been given after the 3.2 i.e. Manner of rotation of Auditors by the Companies on Expiry of their Term.*

- (3) It has also been provided that right of the company to remove an auditor or the right of the auditor to resign from such office of the company shall not be prejudiced.
- (4) Subject to the provisions of this Act, members of a company may resolve to provide that-
 - (a) in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or
 - (b) the audit shall be conducted by more than one auditor.
- (5) The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors.

3.2 Manner of Rotation of Auditors by the Companies on Expiry of their Term: Rule 6 of the Companies (Audit and Auditors) Rules, 2014 prescribes the manner of rotation of auditors on expiry of their term which is given below-

- (1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
- (2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.
- (3) For the purpose of the rotation of auditors-
 - (i) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;
 - (ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

Explanation I - For the purposes of these rules the term “same network” includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

Explanation II - For the purpose of rotation of auditors,

- (a) a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;
- (b) if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

***Illustration explaining rotation in case of individual auditor**

Number of consecutive years for which an individual auditor has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of section 139(2)]	Maximum number of consecutive years for which he may be appointed in the same company (including transitional period)	Aggregate period which the auditor would complete in the same company in view of column I and II
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I	II	III
5 Years (or more than 5 years)	3 years	8 years or more
4 years	3 years	7 years
3 years	3 years	6 years
2 years	3 years	5 years
1 year	4 years	5 years

Note:

- (1) Individual auditor shall include other individuals or firms whose name or trade mark or brand is used by such individual, if any.
- (2) Consecutive years shall mean all the preceding financial years for which the individual auditor has been the auditor until there has been a break by five years or more.

***Illustration explaining rotation in case of audit firm**

Number of consecutive years for which an audit firm has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of section 139(2)]	Maximum number of consecutive years for which the firm may be appointed in the same company (including transitional period)	Aggregate period which the firm would complete in the same company in view of column I and II
I	II	III
10 Years (or more than 10 years)	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 year	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years
3 year	7 years	10 years
2 years	8 years	10 years
1 years	9 years	10 years

Note:

1. Audit Firm shall include other firms whose name or trade mark or brand is used by the firm or any of its partners.

2. Consecutive years shall mean all the preceding financial years for which the firm has been the auditor until there has been a break by five years or more.
- (4) Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

4 Provisions relating to Audit Committee

4.1 Applicability of section 177 i.e. Constitution of Audit Committee: Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

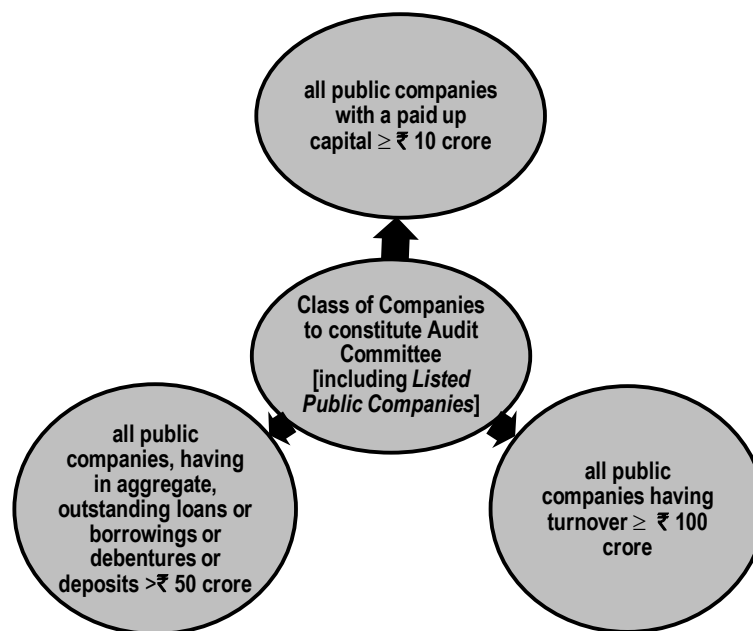


Diagram showing class of companies to constitute Audit Committee

It is important to know that in addition to **listed public companies**, following classes of companies shall constitute an Audit Committee -

- (i) all public companies with a paid up capital of ten crore rupees or more;
- (ii) all public companies having turnover of one hundred crore rupees or more;
- (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial

Statements shall be taken into account for the purposes of this rule.

Example: XYZ Ltd., a public company having paid up capital of ₹ 9 crore but having turnover of ₹ 150 crore, will be required to constitute an Audit Committee under section 177 because the requirement for constitution of Audit Committee arises if the company falls into any of the prescribed category.

4.2 Manner and procedure of selection and appointment of auditors- Rule 3 of CAAR, 2014 prescribes the following manner and procedure of selection and appointment of auditors -

- (1) In case of a company that is required to constitute an Audit Committee under section 177, the committee, and, in cases where such a committee is not required to be constituted, the Board, shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.

It may be noted that while considering the appointment, the Audit Committee or the Board, as the case may be, shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court.

- (2) The Audit Committee or the Board, as the case may be, may call for such other information from the proposed auditor as it may deem fit.
- (3) Subject to the provisions of sub-rule (1), where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment.
- (4) If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the annual general meeting.
- (5) If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.
- (6) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the annual general meeting; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the annual general meeting.
- (7) The auditor appointed in the annual general meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.

5. Auditor's Remuneration

As per section 142 of the Act, the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. However, board may fix remuneration of the first auditor appointed by it.

Further, the remuneration, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company. Therefore, it has been clarified that the remuneration to Auditor shall also include any facility provided to him.

6. Removal of Auditors

6.1 Removal of Auditor Before Expiry of Term: According to **Section 140(1)**, the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per **Rule 7 of CAAR, 2014-**



Fig: Auditor leaving office of the auditor⁵

(1) The application to the Central Government for removal of auditor shall be made in **Form ADT-2** and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.

(2) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.

(3) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard.

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,

⁵ Source of image: www.123rf.com

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 in 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.

6.2 Appointment of Auditor Other Than Retiring Auditor: Section 140(4) lays down procedure to appoint an auditor other than retiring auditor who was removed -

- (1) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or as the case may be, ten years, as provided under **sub-section (2) of section 139**.
- (2) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
- (3) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so, -
 - (a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and
 - (b) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company. and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.

Students may note that if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar.

Curtailling 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. Ceiling on Number of Audits

It has been mentioned earlier that before appointment is given to any auditor, the company must obtain a certificate from him to the effect that the appointment, if made, will not result in an excess holding of company audit by the auditor concerned over the limit laid down in **section 141(3)(g)** of the Companies Act, 2013 which prescribes that a person who 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, shall not be eligible for appointment as an Auditor of a Company.

In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere.

This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affairs.

CASE STUDY

"ABC & Co." is an Audit Firm having partners "Mr. A", "Mr. B" and "Mr. C", Chartered Accountants. "Mr. A", "Mr. B" and "Mr. C" are holding appointment as an Auditor in 4, 6 and 10 Companies respectively.

- (i) *Provide the maximum number of Audits remaining in the name of "ABC & Co."*
- (ii) *Provide the maximum number of Audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.*
- (iii) *Can ABC & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than ₹ 100 crore, 2 small companies and 1 dormant company?*
- (iv) *Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of ₹ 110 crore each?*

Fact of the Case: *In the instant case, Mr. A is holding appointment in 4 companies, whereas Mr. B is having appointment in 6 Companies and Mr. C is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.*

Provisions and Explanations: *Section 141(3)(g) of the Companies Act, 2013 states that the following persons shall not be eligible for appointment as an auditor of a company i.e. a person who 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.

As per section 141(3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

Conclusion:

- (i) Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies:

Total Number of Audits available to the Firm $= 20 \times 3 = 60$

Number of Audits already taken by all the partners

In their individual capacity $= 4 + 6 + 10 = 20$

Remaining number of Audits available to the Firm $= 40$

- (ii) With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g)- already holding appointments as an auditor. Hence
 (1) Mr. A can hold: $20 - 4 = 16$ more audits. (2) Mr. B can hold $20 - 6 = 14$ more audits and
 (3) Mr. C can hold $20 - 10 = 10$ more audits.

- (iii) In view of above discussed provisions, ABC & Co. can hold appointment as an auditor in all the 60 private companies having paid-up share capital less than ₹ 100 crore, 2 small companies and 1 dormant company as these are excluded from the ceiling limit of company audits given under section 141(3)(g) of the Companies Act, 2013.

- (iv) As per fact of the case, ABC & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than ₹ 100 crores. In the given case, out of the 60 private companies, ABC & Co. is offered 45 companies having paid-up share capital of ₹ 110 crore each.

Therefore, ABC & Co. can also accept the appointment as an auditor for 2 small companies, 1 dormant company, 15 private companies having paid-up share capital less than ₹ 100 crore and 40 private companies having paid-up share capital of ₹ 110 crore each in addition to above 20 company audits already holding.

Council General Guidelines, 2008 (Chapter VIII): In exercise of the powers conferred by clause (ii) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, the Council of the Institute of Chartered Accountants of India hereby specifies that a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he holds at any time appointment of more than the "specified number of audit assignments of the companies under Section 224 and /or Section 226 of the Companies Act, 1956 (now section 141(3)(g) of the Companies Act, 2013).

It may be noted that in the case of a firm of chartered accountants in practice, the specified number of audit assignments shall be construed as the specified number of audit assignments for every partner of the firm.

It may also be noted that where any partner of the firm of chartered accountants in practice is also a partner of any other firm or firms of chartered accountants in practice, the number of audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the specified number of audit assignments in the aggregate.

It is further provided that where any partner of a firm or firms of chartered accountants in practice accepts one or more audit assignments in his individual capacity, or in the name of his proprietary firm, the total number of such assignment which may be accepted by all firms in relation to such chartered accountant and by him shall not exceed the specified number of audit assignments in the aggregate.

- (1) In computing the specified number of audit assignments-
 - (a) the number of such assignments, which he or any partner of his firm has accepted whether singly or in combination with any other chartered accountant in practice or firm of such chartered accountants, shall be taken into account.
 - (b) the number of partners of a firm on the date of acceptance of audit assignment shall be taken into account.
 - (c) a chartered accountant in full time employment elsewhere shall not be taken into account.
- (2) A chartered accountant in practice as well as firm of chartered accountants in practice shall maintain a record of the audit assignments accepted by him or by the firm of chartered accountants, or by any of the partner of the firm in his individual name or as a partner of any other firm as far as possible, in the prescribed manner.

Ceiling on Tax Audit Assignments: The specified number of tax audit assignments that an auditor, as an individual or as a partner of a firm, can accept is **60 numbers**. ICAI has notified that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he accepts in a financial year, more than the specified number of tax audit assignments u/s 44AB.

8. Powers/Rights of Auditors

The auditor has the following powers/rights while conducting an audit:

(a) Right of access to books, etc. – Section 143(1) of the Act provides that the auditor of a company, at all times, shall have a right of access to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and he is entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor.

It may be noted that according to **section 2(59)** of the Act, the term 'officer' includes any director, manager or key managerial personnel or any person in accordance with whose directions or

instructions the Board of Directors or any one or more of the directors is or are accustomed to act;

The phrase 'books, accounts and vouchers' includes all books which have any bearing, or are likely to have any bearing on the accounts, whether these be the usual financial books or the statutory or statistical books; memoranda books, e.g., inventory books, costing records and the like may also be inspected by the auditor. Similarly the term 'voucher' includes all or any of the correspondence which may in any way serve to vouch for the accuracy of the accounts. Thus, the right of access is not restricted to books of account alone and it is for the auditor to determine what record or document is necessary for the purpose of the audit.

The right of access is not limited to those books and records maintained at the registered or head office so that in the case of a company with branches, the right also extends to the branch records, if the auditor considers it necessary to have access thereto as per **Section 143(8)**.

Example: *X Ltd. restrains its company auditor from visiting another branch at different location and having access to the inventory records maintained at that branch because the branch is already audited by another auditor and the report has been received. Here, it may be noted that the company auditor has right to visit the branch, even if the branch accounts are audited by another auditor, if he considers it necessary to do so for the performance of his duties as auditor.*

(b) Right to obtain information and explanation from officers - This right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor is a wide and important power. In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind derived by the directors from the company, which may not be known from an examination of the books. It is for the auditor to decide the matters in respect of which information and explanations are required by him. When the auditor is not provided the information required by him or is denied access to books, etc., his only remedy would be to report to the members that he could not obtain all the information and explanations he had required or considered necessary for the performance of his duties as auditors.

(c) Right to receive notices and to attend general meeting – The auditors of a company are entitled to attend any general meeting of the company (the right is not restricted to those at which the accounts audited by them are to be discussed); also to receive all the notices and other communications relating to the general meetings, which members are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.

Section 146 of the Companies Act, 2013 discusses right as well as duty of the auditor. According to the section 146:

"all notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to

be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.”

Thus, it is right of the auditor to receive notices and other communications relating to any general meeting and to be heard at such meeting, relating to the matter of his concern, however, it is duty of the auditor to attend the same or through his authorised representative unless otherwise exempted.

(d) Right to report to the members of the company on the accounts examined by him –

The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under this section and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

(e) Right to Lien – In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property. On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non payment of fees, for work done on the books and documents. The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions:

- (i) Documents retained must belong to the client who owes the money.
- (ii) Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.
- (iii) The auditor can retain the documents only if he has done work on the documents assigned to him.
- (iv) Such of the documents can be retained which are connected with the work on which fees have not been paid.

Under **section 128** of the Act, books of account of a company must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect under the Act. Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien, on them does not arise.

SA 230 issued by ICAI on Audit Documentation (explanatory text, A- 25), “Standard on Quality Control (SQC) 1, “Quality Control for Firms that Perform Audits and Reviews of Historical

Financial Information, and Other Assurance and Related Services Engagements”, issued by the Institute, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.”

9. Duties of Auditors

Sections 143 of the Companies Act, 2013 specifies the duties of an auditor of a company in a quite comprehensive manner. It is noteworthy that scope of duties of an auditor has generally been extending over all these years.

(1) Duty of Auditor to Inquire on certain matters: It is the duty of auditor to inquire into the following matters-

- (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
- (b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
- (c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
- (d) whether loans and advances made by the company have been shown as deposits;
- (e) whether personal expenses have been charged to revenue account;
- (f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

The opinion of the Research Committee of the Institute of Chartered Accountants of India on section 143(1) is reproduced below:

“The auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. In such a case, the content of the Auditor’s Report will remain exactly the same as the auditor has to inquire and apply his mind to the information elicited by the enquiry, in deciding whether or not any reference needs to be made in his report. In our opinion, it is in this light that the auditor has to consider his duties under section 143(1).”

Therefore, it could be said that the auditor should make a report to the members in case he finds answer to any of these matters in adverse.

- (2) **Duty to Sign the Audit Report:** As per section 145 of the Companies Act, 2013, the person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company, in accordance with the provisions of section 141(2).

Section 141(2) of the Companies Act, 2013 states that where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

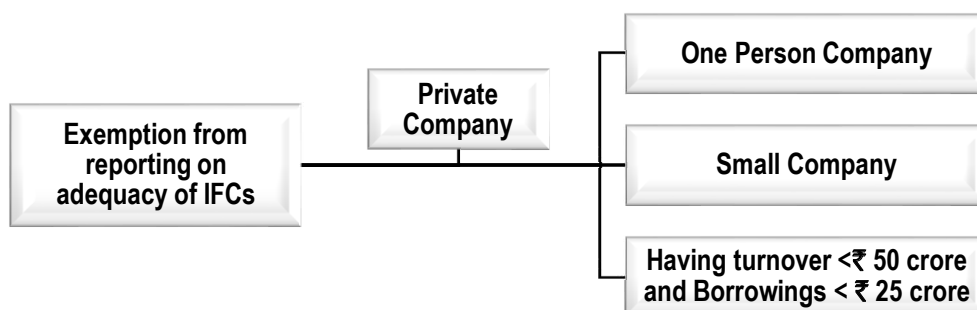
The qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting.

- (3) **Duty to comply with Auditing Standards:** As per **section 143(9)** of the Companies Act, 2013, every auditor shall comply with the auditing standards. Further, as per **section 143(10)** of the Act, the Central Government may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.
- (4) **Duty to report:** As per **section 143(3)**, the auditor's report shall also state –
- (a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;
 - (b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
 - (c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditors has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
 - (d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
 - (e) whether, in his opinion, the financial statements comply with the accounting standards;
 - (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

- (g) whether any director is disqualified from being appointed as a director under sub-section (2) of the section 164;
- (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
- (i) whether the company has adequate internal financial controls **with reference to financial statements** in place and the operating effectiveness of such controls;

However, it may be noted that the reporting requirement on adequacy of internal financial controls (IFCs) with reference to financial statements shall not be applicable to a private company which is a–

- (I) **One person company; or**
- (II) **Small company; or**
- (III) **Company having turnover less than ₹ 50 crore as per latest audited financial statement and having aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year less than ₹ 25 crore.**



- (j) such other matters as may be prescribed. Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditor's report. The auditor's report shall also include their views and comments on the following matters, namely:-
 - (i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
 - (ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
 - (iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

[Notes: (1) Students may note that the auditor is also required to report on certain additional matters specified under CARO, 2016 which is discussed later under Para 10 Reporting under Companies (Auditor's Report) Order, 2016.

(2) Students are also required to refer Guidance note on Reporting under section 143(3)(f) and (h) of the Companies Act, 2013.]

(5) Duty to report on frauds:

A. Reporting to the Central Government- As per **section 143(12)** of the Companies Act, 2013 read with **Rule 13** of the Companies (Audit and Auditors) Rules, 2014, 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, which involves or is expected to involve individually an amount of ₹ 1 crore or above, 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 prescribed.



Fig: Reporting of fraud⁶

B. Reporting to the Audit Committee or Board- 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 prescribed.

C. Disclosure in the Board's Report: 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 prescribed.

Sub-section (13) of section 143 of the Companies Act, 2013 safeguards the act of fraud reporting by the auditor if it is done in good faith. It states that no duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter above if it is done in good faith.

It is very important to note that the provisions regarding fraud reporting shall also apply, *mutatis mutandis*, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively. If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12) of section 143, he shall be punishable with fine which shall not be less than ₹ 1 lakh but which may extend to ₹ 25 lakh.

The auditor is also required to report under **clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016 [CARO, 2016]**, whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the

⁶ Source of image: www.oig.lsc.gov

year. If yes, the nature and the amount involved is to be indicated.

[Notes: For detailed provisions of CARO, 2016, students may refer Para 10 Reporting under Companies (Auditor's Report) Order, 2016]

Example: The head accountant of a company entered fake invoices of credit purchases in the books of account aggregate of ₹50 lakh and cleared all the payments to such bogus creditor. Here, the auditor of the company is required to report the fraudulent activity to the Board or Audit Committee (as the case may be) within 2 days of his knowledge of fraud. Further, the company is also required to disclose the same in Board's Report.

It may be noted that the auditor need not to report the central government as the amount of fraud involved is less than ₹1 crore, however, reporting under CARO, 2016 is required.

- (6) **Duty to report on any other matter specified by Central Government:** The Central Government may, in consultation with the National Financial Reporting Authority (NFRA), by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.

However, as per the notification dated 29.03.2016, till the time NFRA is constituted, the Central Government may hold consultation required under this sub-section with the Committee chaired by an officer of the rank of Joint Secretary or equivalent in the MCA and the Committee shall have the representatives from the ICAI and Industry Chambers and also special invitees from the National Advisory Committee on Accounting Standards (NACAS) and the office of the C&AG.

[Note: Students may note that Companies (Auditor's Report) Order, 2016 has been notified in this perspective which is discussed later under Para 10 Reporting under Companies (Auditor's Report) Order, 2016]

- (7) **Duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor are discussed separately in the chapter under heading 13 branch audit.**
- (8) **Duty to state the reason for qualification or negative report:** As per section 143(4), where any of the matters required to be included in the audit report is answered in the negative or with a qualification, the report shall state the reasons there for.

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

The Central Government, after consultation with the committee constituted under proviso to **section 143(11)** of the Companies Act, 2013, and in supersession of the Companies (Auditor's Report) Order, 2015 dated the 10th April, 2015, has issued the Companies (Auditor's Report) Order, 2016, (CARO, 2016) under section 143(11) of the Companies Act, 2013, dated 29th March, 2016. The requirements of the Order are supplemental to the existing provisions of section 143 of the Act regarding the auditor's report.

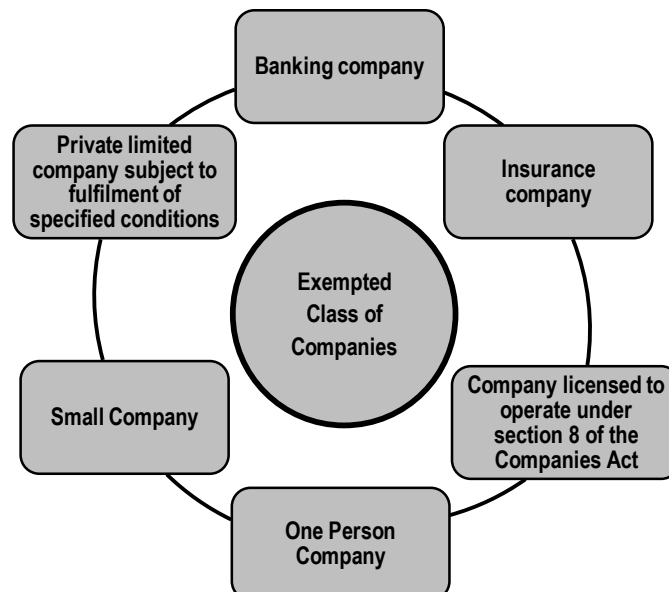
The Order is not intended to limit the duties and responsibilities of auditors but only requires a statement to be included in the audit report in respect of the matters specified therein.

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, 2013.

However, the Order specifically **exempts** the following class of companies-

- (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
- (ii) an insurance company as defined under the Insurance Act, 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;
- (v) a small company as defined under clause (85) of section 2 of the Companies Act; and
- (vi) 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 ₹ 1 crore as on the balance sheet date and which does not have total borrowings exceeding ₹ 1 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 ₹ 10 crore during the financial year as per the financial statements.

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



EXAMPLES

Ex. 1: 'Educating Child' is a limited company registered under section 8 of the Companies Act, 2013.

In the given case, 'Educating Child' is licensed to operate under section 8 of the Companies Act, 2013. Therefore, CARO, 2016 shall not be applicable to 'Educating Child' accordingly.

Ex. 2: Ashu Pvt. Ltd. has fully paid capital and reserves of ₹ 50 lakh. During the year, the company had borrowed ₹ 70 lakh each from a bank and a financial institution independently. It has the turnover of ₹ 900 lakh.

In the given case of Ashu Pvt. Ltd., it has paid capital and reserves of ₹ 50 lakh i.e. less than ₹ 1 crore, turnover of ₹ 9 crore i.e. less than ₹ 10 crore. However, it has maximum outstanding borrowings of ₹ 1.40 crore (₹ 70 lakh + ₹ 70 lakh) collectively from bank and financial institution.

Therefore, it fails to fulfill the condition relating to borrowings. Thus, CARO, 2016 shall be applicable to Ashu Pvt. Ltd. accordingly.

Matters to be included in the Auditor's Report: Paragraph 3 of the Order requires the auditor to include a statement in the auditor's report 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) where maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 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 with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at 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 constitute 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, 2013? 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.

Reasons to be Stated for Unfavourable or Qualified Answers: Where the answer to any of the questions referred to in **paragraph 3 of the Order** is unfavourable or qualified, in the auditor's report, the auditor shall also state the basis for such unfavourable or qualified answer, as the case may be.

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

Example: *The company has dispensed with the practice of taking inventory of their inventories at the year-end as in their opinion the exercise is redundant, time consuming and intrusion to normal functioning of the operations. Explain reporting requirement under CARO, 2016.*

Reporting for Physical Verification of Inventory: *Clause (ii) of Para 3 of CARO, 2016, requires the auditor to report 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.*

The physical verification of inventory is the responsibility of the management of the company which should verify all material items at least once in a year and more often in appropriate cases.

In the given case, the above requirement of physical verification of inventory by the management has not been taken place and therefore the auditor should point out the same under CARO, 2016. He may consider the impact on financial statement and report accordingly.

11. Disclosure in the Auditor's Report

The following paragraphs deal with the manner of qualification and the manner of disclosure, if any, to be made in the auditor's report.

AS-1 – Disclosure of Accounting Policies

In the case of a company, members should qualify their audit reports in case –

- (a) accounting policies required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013 have not been disclosed, or
- (b) accounts have not been prepared on accrual basis, or
- (c) the fundamental accounting assumption of going concern has not been followed and this fact has not been disclosed in the financial statements, or
- (d) proper disclosures regarding changes in the accounting policies have not been made.

Where a company has been given a specific exemption regarding any of the matters stated above but the fact of such exemption has not been adequately disclosed in the accounts, the member should mention the fact of exemption in his audit report without necessarily making it a subject matter of audit qualification.

In view of the above, the auditor will have to consider different circumstances whether the audit report has to be qualified or only disclosures have to be given.

In the case of enterprises not governed by the Companies Act, the member should examine the relevant statute and make suitable qualification in his audit report in case adequate disclosures regarding accounting policies have not been made as per the statutory requirements. Similarly, the member should examine if the fundamental accounting assumptions have been followed in preparing the financial statements or not. In appropriate cases, he should consider whether, keeping in view the requirements of the applicable laws, a qualification in his report is necessary.

In the event of non-compliance by enterprises not governed by the Companies Act, in situations where the relevant statute does not require such disclosures to be made, the member should make adequate disclosure in his audit report without necessarily making it a subject matter of audit qualification.

In making a qualification / disclosure in the audit report, the auditor should consider the materiality of the relevant item. Thus, the auditor need not make qualification / disclosure in respect of items which, in his judgement, are not material.

A disclosure, which is not a subject matter of audit qualification, should be made in the auditor's report in a manner that it is clear to the reader that the disclosure does not constitute an audit qualification. The paragraph containing the auditor's opinion on true and fair view should not include a reference to the paragraph containing the aforesaid disclosure.

12. Joint Audit

The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage.

In specific terms the **advantages** that flow may be the following:

- (i) Sharing of expertise.
- (ii) Advantage of mutual consultation.
- (iii) Lower workload.
- (iv) Better quality of performance.
- (v) Improved service to the client.
- (vi) Displacement of the auditor of the company taken over in a take - over often obviated.
- (vii) In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.
- (viii) Lower staff development costs.
- (ix) Lower costs to carry out the work.
- (x) A sense of healthy competition towards a better performance.

The general **disadvantages** may be the following:

- (i) The fees being shared.
- (ii) Psychological problem where firms of different standing are associated in the joint audit.
- (iii) General superiority complexes of some auditors.
- (iv) Problems of co-ordination of the work.
- (v) Areas of work of common concern being neglected.
- (vi) Uncertainty about the liability for the work done.

The Institute of Chartered Accountants of India has issued Standard on Auditing (SA) 299 (Revised), "Joint Audit of Financial Statements" which lays down the principles for effective conduct of joint audit to achieve the overall objectives of the auditor as laid down in SA 200 "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with Standards on Auditing". This Standard deals with the special considerations in carrying out audit by joint auditors. It requires that–

- (i) the engagement partner and other key members of the engagement team from each of the joint auditors should be involved in planning the audit.***
- (ii) the joint auditors should jointly establish an overall audit strategy which sets the***

scope, timing and direction of the audit, and also guides the development of the audit plan.

- (iii) before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:*
 - (1) identify division of audit areas and common audit areas;*
 - (2) ascertain the reporting objectives of the engagement;*
 - (3) consider and communicate among all joint auditors the factors that are significant in directing the engagement team's efforts;*
 - (4) consider the results of preliminary engagement activities, or similar engagements performed earlier.*
 - (5) ascertain the nature, timing and extent of resources necessary to accomplish the engagement.*
- (iv) each of the joint auditors should consider and assess the risks of material misstatement and communicate to other joint auditors.*
- (v) the joint auditors should discuss and document the nature, timing, and the extent of the audit procedures for (I) common and (II) specific allotted areas of audit to be performed.*
- (vi) the joint auditors should obtain common engagement letter and common management representation letter.*
- (vii) the work allocation document should be signed by all the joint auditors and communicated to those charged with governance.*

It further states that, in respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures. On the other hand, all the joint auditors shall be jointly and severally responsible for:

- (i) the audit work which is not divided among the joint auditors and is carried out by all joint auditors;*
- (ii) decisions taken by all the joint auditors under audit planning in respect of common audit areas;*
- (iii) matters which are brought to the notice of the joint auditors by any one of them and there is an agreement among the joint auditors on such matters;*
- (iv) examining that the financial statements of the entity comply with the requirements of the relevant statutes;*
- (v) presentation and disclosure of the financial statements as required by the applicable financial reporting framework;*

- (vi) *ensuring that the audit report complies with the requirements of the relevant statutes, applicable Standards on Auditing and other relevant pronouncements issued by ICAI.*

In case a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

It may be noted that the joint auditors are required to issue common audit report. However, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s).

[Note: Student may refer SA 299 (revised) "Joint Audit of Financial Statements" reproduced in "Auditing Pronouncements" for comprehensive knowledge.]

13. Audit of Branch Office Accounts

As per **section 128(1)** of the Companies Act, 2013, every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

It may be noted that all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company shall, within 7 days thereof, file with the Registrar a notice in writing giving the full address of that other place.

Students may also note that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

Sub-section (2) provides that where a company has a branch office in India or outside India, it shall be deemed to have complied with the provisions of sub-section (1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns periodically are sent by the branch office to the company at its registered office or the other place referred in (1).

Further, **sub-section (8) of section 143 of the Companies Act, 2013**, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a

country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:

It may be noted that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

Further as per **rule 12 of the Companies (Audit and Auditors) Rules, 2014**, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

Using the Work of another Auditor: When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in **SA 600, "Using the Work of another Auditor"**. It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

- (a) advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and
- (b) advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other

auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

14. Cost Audit

Cost Audit is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company.

It is covered by **Section 148** of the Companies Act, 2013. The audit conducted under this section shall be in addition to the audit conducted under section 143.

As per section 148 the Central Government may by order specify audit of items of cost in respect of certain companies.

Further, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies.

In this regard, the Central Government has notified the Companies (Cost Records and Audit) Rules, 2014 which prescribes the classes of companies required to include cost records in their books of account, applicability of cost audit, maintenance of records etc.

Applicability for 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 (A) Regulated sectors and (B) Non-regulated sectors.

Maintenance of Cost Records: As per Rule 5 of the Companies (Cost Records and Audit) Rules, 2014, every company under these rules including all units and branches thereof, shall, in respect of each of its financial year, is required to maintain cost records in Form CRA-1. The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

Additionally, as per **clause (vi) to Paragraph 3 of the CARO, 2016**, the auditor has to report 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.

Applicability of Cost Audit: Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 states the provisions related to the applicability of cost audit depending on the turnover of the company as follows-

- (i) Classes of companies specified under item (A) "Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 50 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 25 crore or more.
- (ii) Classes of companies specified under item (B) "Non-Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 100 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 35 crore or more.

Who can be Cost Auditor: The audit shall be conducted by a Cost Accountant who shall be appointed by the Board of such remuneration as may be determined by the members in such manner as may be prescribed.

It may be noted that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records.

It may also be noted that the auditor conducting the cost audit shall comply with the cost auditing standards ("cost auditing standards" mean such standards as are issued by the Institute of Cost Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government).

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 180 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.

Every referred company 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.

The 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.

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.

Casual Vacancy in the Office of a Cost Auditor: Any casual vacancy in the office of a Cost Auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within 30 days of occurrence of such vacancy and the company shall inform the central government in Form CRA-2 within 30 days of such appointment of cost auditor.

Remuneration of Cost Auditor: As per rule 14 of the Companies (Audit and Auditors) Rules, 2014-

- (a) in the case of companies which are required to constitute an audit committee-
 - (i) the Board shall appoint an individual, who is a cost accountant, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;
 - (ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;
- (b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

Qualification, Disqualification, Rights, Duties and Obligations of Cost Auditor: The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter shall, so far as may be applicable, apply to a cost auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.

Submission of Cost Audit Report:

(i) **To the Board of Directors of the Company-** The cost auditor shall submit the cost audit report along with his reservations or qualifications or observations or suggestions, if any, in Form CRA-3. He shall forward his report to the Board of Directors of the company within a period of 180 days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.

(ii) **To the Central Government-** The company shall within 30 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.

Provided that the companies which have got extension of time of holding AGM under section 96 (1) of the Companies Act, 2013, may file form CRA-4 within resultant extended period of filing financial statements under section 137 of the Companies Act, 2013 (*As per MCA notification dated 3 December 2018*)

If, after considering the cost audit report and the information and explanation furnished by the company as above, the Central Government is of the opinion, that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

Duty to Report on Fraud: The provisions of **section 143(12)** of the Companies Act, 2013 and the relevant rules on duty to report on fraud shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules.

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.

Penal Provisions in Case of Default: If any default is made in complying with the provisions of this section,

- (a) the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;
- (b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

15. Punishment for non-compliance

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, whichever 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, whichever 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 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 or criminal as provided in this Act or in any other law for the time being in

force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

It may be noted that in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner(s), who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.

16. Audit report

Management is responsible for the preparation of the financial statements. Management also accepts responsibility for necessary internal controls to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The purpose of an audit is to enhance the degree of confidence of intended users of the financial statements. The aforesaid purpose is achieved by the expression of an independent reporting by the auditor as to whether the financial statements exhibit a true and fair view of the affairs of the entity.

Thus, an Audit report is an opinion drawn on the entity's financial statements to make sure that the records are true and fair representation of the transactions they claim to represent. This involves considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply with the relevant statutory requirements. The main users of audit report are shareholders, members and all other stakeholders of the company.

17. Forming an Opinion on the Financial Statements- Objective of the Auditor

17.1 The objectives of the auditor as per SA 700 (Revised), "Forming An Opinion And Reporting On Financial Statements" are:

- (a) To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- (b) To express clearly that opinion through a written report.

The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

17.2 To form opinion - Auditor to obtain Reasonable assurance

In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

That conclusion shall take into account:

- (a) whether sufficient appropriate audit evidence has been obtained;
- (b) whether uncorrected misstatements are material, individually or in aggregate;

- (c) The evaluations

17.3 Evaluations by the Auditor



The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.

This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

17.3.1 Qualitative Aspects of the Entity's Accounting Practices

1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
2. SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.
3. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:
 - (i) The selective correction of misstatements brought to management's attention during the audit

Example

-  Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.
-  The combination of several deficiencies affecting the same significant account or disclosure (or the same internal control component) could amount to a significant deficiency (or material weakness if required to be communicated in the jurisdiction). This evaluation requires judgment and involvement of audit executives.

- (ii) Possible management bias in the making of accounting estimates.
4. SA 540 addresses possible management bias in making accounting estimates.

Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

17.4 Specific Evaluations by the auditor

In particular, the auditor shall evaluate whether :

- (a) The financial statements adequately disclose the significant accounting policies selected and applied;

- (b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- (c) The accounting estimates made by management are reasonable;
- (d) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- (e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- (f) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

Example:

- ✎ If an amount or disclosure in the financial statements is under greater scrutiny by users of the financial statements, then a smaller misstatement may be considered more significant.
- ✎ A misstatement may be objectively determinable or may involve a degree of subjectivity through estimation, allocation or uncertainty.

17.5 Form of Opinion

Unmodified Opinion: The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Modified Opinion: If the auditor:

(a) concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

(b) is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement,

the auditor shall modify the opinion in the auditor's report in **accordance with SA 705**.

17.6 Auditor's Report

The auditor's report shall be in writing. A written report encompasses reports issued in hard copy and those using an electronic medium.

This SA-700 requires the use of specific headings, which are intended to assist in making auditor's reports that refer to audits that have been conducted in accordance with SAs more recognizable.

17.6.1 Auditor's Report for Audits Conducted in Accordance with Standards on Auditing**Basic Elements of an Audit Report are given below:**

1 Title: The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor.

For example, "Independent Auditor's Report," distinguishes the independent auditor's report from reports issued by others.

2 Addressee: The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed.

The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.

3 Auditor's Opinion: The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."

The Opinion section of the auditor's report shall also:

- (a) Identify the entity whose financial statements have been audited;
- (b) State that the financial statements have been audited;
- (c) Identify the title of each statement comprising the financial statements;
- (d) Refer to the notes, including the summary of significant accounting policies; and
- (e) Specify the date of, or period covered by, each financial statement comprising the financial statements.

Expressing an unmodified opinion on financial statements

When expressing an unmodified opinion on financial statements, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

- (a) In our opinion, the accompanying financial statements **present fairly, in all material respects**, [...] in accordance with [the applicable financial reporting framework]; or
- (b) In our opinion, the accompanying financial statements **give a true and fair view of** [...] in accordance with [the applicable financial reporting framework].

"Present fairly, in all material respects" or "give a true and fair view"

The phrases "present fairly, in all material respects," and "give a true and fair view" are regarded as being equivalent

When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as “with the foregoing explanation” or “subject to” in relation to the opinion, as these suggest a conditional opinion or a weakening or modification of opinion.

4. Basis for Opinion:

The auditor’s report shall include a section, directly following the Opinion section, with the heading “**Basis for Opinion**”, that:

- (a) States that the audit was conducted in accordance with Standards on Auditing;
- (b) Refers to the section of the auditor’s report that describes the auditor’s responsibilities under the SAs;
- (c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor’s other ethical responsibilities in accordance with these requirements.
- (d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor’s opinion.

5. Going Concern: Where applicable, the auditor shall report in accordance with SA 570 (Revised).

6. Key Audit Matters: For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor’s report in accordance with SA 701.

When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor’s report, the auditor shall do so in accordance with SA 701.

Law or regulation may require communication of key audit matters for audits of entities other than listed entities,

For example, entities characterized in such law or regulation as public interest entities.

The auditor may also decide to communicate key audit matters for other entities, including those that may be of significant public interest, for example because they have a large number and wide range of stakeholders and considering the nature and size of the business.

Examples of such entities may include financial institutions (such as banks, insurance companies, and pension funds), and other entities such as charities.

7. Responsibilities for the Financial Statements: The auditor’s report shall include a section with a heading “Responsibilities of Management for the Financial Statements.”

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation

of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

This section of the auditor's report shall describe management's responsibility for:

- (a) **Preparing the financial statements** in accordance with the applicable financial reporting framework, **and for such internal control** as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; [because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and
- (b) **Assessing the entity's ability to continue as a going concern** and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

- ❖ Auditor cannot conclude that management has provided with all relevant information agreed in the terms of the audit engagement agreement without confirming with management whether such information has been provided.
- ❖ When those individuals who have signed the engagement agreement at the start of the audit have left the entity, the auditor would request those who are giving the representations to acknowledge their responsibilities within the letter of representations.
- ❖ A management representation as to the amount required for a particular provision is not a substitute for the audit procedures regarding the provision that the auditor would expect to perform.

Periods covered by the letter: The auditor to obtain representations for all financial statements and periods referred to in our auditor's report. Auditor would obtain a specific representation if a restatement is made to correct a material misstatement in the prior period financial statements that affects the comparative information in the financial statements. If current management was not present during all periods covered by auditor's report, he still would obtain written representations from current management on all such periods.

SA 210 requires the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.

Oversight of the financial reporting process: This section of the auditor's report shall also identify those responsible for the oversight of the financial reporting process, when those

responsible for such oversight are different from Management. In this case, the heading of this section shall also refer to “Those Charged with Governance”

8. Auditor’s Responsibilities for the Audit of the Financial Statements:

The auditor’s report shall include a section with the heading “**Auditor’s Responsibilities for the Audit of the Financial Statements.**”

This section of the auditor’s report shall:

- (a) State that the objectives of the auditor are to:
 - (i) **Obtain reasonable assurance** about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
 - (ii) **Issue an auditor’s report** that includes the auditor’s opinion.
- (b) State that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and
- (c) State that misstatements can arise from fraud or error, and either:
 - (i) Describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements; or
 - (ii) Provide a definition or description of materiality in accordance with the applicable financial reporting framework.

The Auditor’s Responsibilities for the Audit of the Financial Statements section of the auditor’s report shall further:

- (a) State that, as part of an audit in accordance with SAs, the auditor exercises professional judgment and maintains professional skepticism throughout the audit; and
- (b) Describe an audit by stating that the auditor’s responsibilities are:
 - (i) To identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error; to design and perform audit procedures responsive to those risks; and to obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor’s opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

1. To identify and assess the risks of material misstatement of the financial statements.
2. to design and perform audit procedures in response to those risks
3. to obtain sufficient and appropriate audit evidence.

- (ii) To obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.
- (iii) To evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- (iv) To conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report also shall:

- (a) State that **the auditor communicates with those charged with governance** regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that the auditor identifies during the audit;
- (b) For audits of financial statements of listed entities, state that the auditor provides those charged with governance with a statement that the auditor has complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards; and
- (c) For audits of financial statements of listed entities and any other entities for which key audit matters are communicated in accordance with SA 701, state that, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. The auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure.

9. Location of the description of the auditor's responsibilities for the audit of the financial statements: The description of the auditor's responsibilities for the audit of the financial statements shall be included:

- (a) Within the body of the auditor's report;
- (b) Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix; or
- (c) By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so.

ILLUSTRATION

The following is an illustration of how such a reference to an appendix could be made in the auditor's report:

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is included in appendix X of this auditor's report. This description, which is located at [*indicate page number or other specific reference to the location of the description*], forms part of our auditor's report.

10. Other Reporting Responsibilities: If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled -

"Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the SAs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the SAs.

If other reporting responsibilities are presented in the same section as the related report elements required by the SAs, the auditor's report shall clearly differentiate the other reporting responsibilities from the reporting that is required by the SAs.

If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements stated above shall be included under a section with a heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the Audit of the Financial Statements."

11. Signature of the Auditor: The auditor's report shall be signed. The report is signed by the auditor (i.e. the engagement partner) in his personal name. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm.

The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India. They also include the registration number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them

12. Auditor's Address: The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.

13. Date of the Auditor's Report: The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:

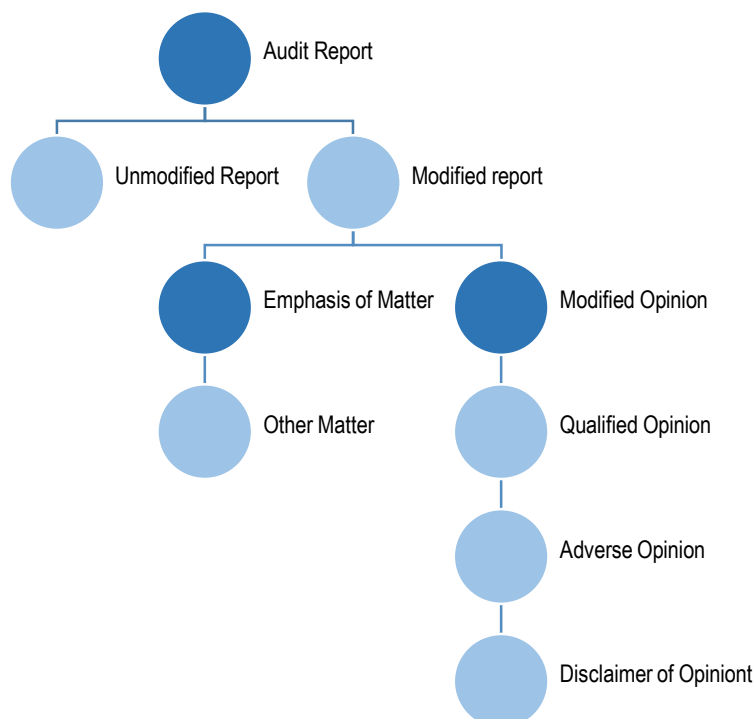
- (a) All the statements that comprise the financial statements, including the related notes, have been prepared; and
- (b) Those with the recognized authority have asserted that they have taken responsibility for those financial statements.

The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in SA 560.

18. Modifications to the opinion in the independent Auditor's Report

Standard on Auditing (SA) 705 "Modifications to the opinion in the Independent Auditor's Report" deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised) "**Forming An Opinion And Reporting On Financial Statements**", the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

This SA also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion.



18.1 Circumstances When a Modification to the Auditor's Opinion Is Required

The auditor shall modify the opinion in the auditor's report when:

- (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

18.2 Objective of the auditor - to express clearly an appropriately modified opinion

As per Standard on Auditing (SA) 705 "Modifications To The Opinion In The Independent Auditor's Report", the objective of the auditor is **to express clearly an appropriately modified opinion** on the financial statements that is necessary when:

- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

18.3 Types of Modified Opinions

There are three types of modified opinions, namely-

1. A qualified opinion
2. An adverse opinion
3. A disclaimer of opinion.

Qualified Opinion	Adverse Opinion	Disclaimer of Opinion
<ul style="list-style-type: none"> The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements are material, but not pervasive 	<ul style="list-style-type: none"> The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive 	<ul style="list-style-type: none"> The auditor shall disclaim an opinion when he is unable to obtain sufficient appropriate audit evidence and he concludes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

Qualified Opinion

The auditor shall express a qualified opinion when:

- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Disclaimer of Opinion 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.

Definition of Pervasive – A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.

Pervasive effects on the financial statements are those that, in the auditor's judgment:

- (i) Are not confined to specific elements, accounts or items of the financial statements;
- (ii) If so confined, represent or could represent a substantial proportion of the financial statements; or
- (iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.

18.4 Which type of opinion is appropriate?

The decision regarding which type of modified opinion is appropriate depends upon:

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

The table below illustrates how the auditor's judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but Not Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

18.5 Basis for Opinion

When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised)

- Amend the heading "Basis for Opinion" required by para of SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and
- Within this section, include a description of the matter giving rise to the modification.

19. Emphasis of matter paragraphs and other matter paragraphs in the independent Auditor's Report.

19.1 Objective of the Auditor as per SA 706

As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report", the objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:

- A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or
- As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Definitions:
Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Other Matter paragraph – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

19.2 Emphasis of Matter Paragraphs in the Auditor's Report

If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

- (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and
- (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

19.2.1 Separate section for Emphasis of Matter paragraph

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
- (b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and
- (c) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

19.3 Other Matter Paragraphs in the Auditor's Report

If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, the auditor shall include an Other Matter paragraph in the auditor's report, provided:

- (a) This is not prohibited by law or regulation; and
- (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

19.3.1 Separate section for Other Matter paragraph

When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall include the paragraph within a separate section with the heading "Other Matter," or other appropriate heading.

20. Communicating Key Audit Matters In The Independent Auditor's Report

Definition of Key Audit Matters: Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

20.1 Purpose of communicating key audit matters

As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", the purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

20.2 Objectives of the auditor regarding Key Audit Matters

As per SA 701, "Communicating Key Audit Matters in The Independent Auditor's Report", the objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report.

20.3 Determining Key Audit Matters

The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit.

In making this determination, the auditor shall take into account the following:

- (a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
- (b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- (c) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters determined in accordance with above stated para were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

20.4 Communicating Key Audit Matters

The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters". The introductory language in this section of the auditor's report shall state that:

- (a) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and
- (b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

20.5 Communicating key audit matter- not a substitute for disclosure in the financial statements etc.:

Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:

- (a) A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- (b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
- (c) A substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- (d) A separate opinion on individual matters

In Chapter 5-Vouching, the topic "Payments controlled by the Companies Act, 2013" given at page no. 5.11 has been revised and given hereunder:

In the case of a company, payments or transactions, directly or indirectly, have been controlled/restricted by the Companies Act, 2013 (hereinafter referred as the Act). This may be understood with some of the provisions of the Act as discussed below -

- (i) Only such expenses which are incurred related to the business of the company are chargeable to statement of profit and loss. The auditor is, therefore in terms of section 143(1)(e) of the Act, required to inquire whether personal expenses have been charged to the revenue account. In case of any special comments to the said inquiry, he is also required to report on the same.
- (ii) Section 180 of the Act specifically restricts the powers of the Board *i.e.* the Board of Directors of a company can exercise the following powers but only with the consent of the company by a special resolution, namely -
 - (a) sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking,

of the whole or substantially the whole of any of such undertakings.

- (b) invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation.
- (c) borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business.

It is provided that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

- (d) remit, or give time for the repayment of, any debt due from a director.
- (iii) Under section 181, the Board of Directors of a company can contribute to the *bonafide* charitable and other funds any amount in any financial year. However, prior permission of the company in general meeting is required if the aggregate of such contribution exceeds 5% of its average net profits for the three immediately preceding financial years.
- (iv) Section 182 deals with prohibition and restriction regarding political contributions. According to this section, a government company or any other company which has been in existence for less than three financial years cannot contribute any amount directly or indirectly to any political party. Notwithstanding anything contained in any other provision of this Act, a Company, other than a Government Company and a company which has been in existence for less than three financial years, may contribute any amount directly or indirectly to any political party.

Every company shall disclose in its profit and loss account the total amount contributed by it under this section during the financial year to which the account relates.

The contribution under this section shall not be made except by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account.

- (v) Section 183 permits the Board and other person to make contributions to the National Defence Fund or any other Fund approved by the Central Government for the purpose of National Defence to any extent as it thinks fit.

PART – II: QUESTIONS AND ANSWERS**PART – II A: Multiple Choice Questions based on Integrated Case Scenarios****Integrated Case Scenario-1**

M/s JJ & associates having office in Chennai are statutory auditors under Companies Act, 2013 of a company viz. **Sweet Aroma Private Limited** engaged in business of obtaining and manufacturing rice from paddy catering to both domestic as well as international market mainly in Gulf nations. The company has a huge plant capacity for rice extraction in one of the states in Northern India. Needless to state that inventories are in huge quantity in such type of business consisting of raw material, work in progress and finished goods. The auditors want to obtain sufficient appropriate audit evidence regarding inventories.

In above context, answer the following questions: -

1. Which of the following is most likely correct in relation to obtaining of sufficient appropriate audit evidence regarding existence and condition of inventory?
 - (a) It is mandatory for the auditor to attend physical inventory counting on the date of financial statements in all circumstances.
 - (b) Physical inventory counting may be attended by auditor on the date of financial statement or at a date other than date of financial statements in his discretion mandatorily in all circumstances.
 - (c) The attendance of auditors at physical inventory counting is impracticable due to time and costs involved because of auditor's office location vis-à-vis company's plant location. Hence, attendance at physical inventory counting may be skipped and alternative audit procedures may be performed to obtain sufficient appropriate evidence.
 - (d) The auditor shall attend at physical inventory counting unless impracticable. However, issue of time and costs involved because of auditor's office location vis-à-vis company's plant location is not a valid basis for skipping physical inventory counting.
2. Below are given certain cluster of matters which are relevant in planning attendance of auditor at physical inventory counting. Which of the following clusters consists of a likely inappropriate combination?
 - (a) Nature of inventory, timing of physical inventory counting and stages of completion of work in progress
 - (b) Nature of inventory, timing of physical inventory counting and valuation method of inventory
 - (c) Nature of inventory, timing of physical inventory counting, considerations regarding maintenance of a perpetual inventory system

- (d) Risks of material misstatements related to inventory, nature of internal control pertaining to inventory, considerations regarding maintenance of a perpetual inventory system
3. Which of the following is the most likely logical sequence of steps in relation to attendance at physical inventory counting by auditor?
- (a) Observance of performance of management's count procedures, inspection of inventory, performing test counts and evaluation of management's procedures for recording and controlling results of physical inventory counting
 - (b) Observance of performance of management's count procedures, performing test counts, inspection of inventory and evaluation of management's procedures for recording and controlling results of physical inventory counting
 - (c) Performing test counts, inspection of inventory, Observance of performance of management's count procedures and evaluation of management's procedures for recording and controlling results of physical inventory counting
 - (d) Evaluation of management's procedures for recording and controlling results of physical inventory counting, Observance of performance of management's count procedures, inspection of inventory and performing test counts
4. During attendance at physical inventory counting, the auditor inspects inventory. Following outcomes stated as I, II & III are given below of this inspection procedure: -
- Outcome I ---Existence of inventory
Outcome II ---Ownership of inventory
Outcome III ---Condition of inventory
- Which of following statements is most likely true?**
- (a) Outcomes I, II and III are all necessarily established after inspection.
 - (b) Only Outcomes I and III are established after inspection and Outcome II is never established.
 - (c) Outcomes I and III are established after inspection. However, outcome II may not be necessarily established.
 - (d) Outcome II and III are established after inspection. However, outcome I may not be necessarily established.
5. It was observed by auditors that, out of total rice physically counted on 31st March, 2020 about 67 quintals of rice belonged to M/s PQR, a proprietary concern which had sent paddy to this company's plant for extraction of rice. What would be treatment of this item in financial statements of company?
- (a) The value of 67 quintals rice would be reflected in company's financial statements as per method of valuation adopted by the company.

- (b) The value of 67 quintals rice would be reflected in company's financial statements as per method of valuation adopted by the proprietary concern.
- (c) The value of 67 quintals rice would not be reflected in company's financial statements.
- (d) The value of 67 quintals rice would be reflected in proprietary concern's financial statements as per method of valuation adopted by the company.

Integrated Case Scenario-2

A partnership firm of Chartered Accountants, YZ and Associates were appointed as auditor of company UV Private Limited. The financial year for which YZ and Associates were to audit books of accounts of UV Private Limited began on 1 April, 2018 and ended on 31 March, 2019.

YZ and Associates consisted of four partners namely Mr. Y, Mr. Z, Mr. G and Mr. H.

While auditing books of accounts of UV Private Limited for the period beginning on 1 April, 2018 and ending on 31 March, 2019, one of the partners of YZ and Associates namely Mr. H took up the expenses part for the purpose of audit.

The management of UV Private Limited had adopted various accounting policies and principles related to expenses which Mr. H as auditor of UV Private Limited was unable to understand. Some of the issues which Mr. H was unable to understand are mentioned as follows:

- (1) Power and Fuel expenses paid for the months of April, 2019 and May, 2019 have been included and shown as Power and Fuel expenses for the period beginning 1 April, 2018 and ending 31 March, 2019.
- (2) Personal Rent Expenses of the son of one of the director, Mr. T of UV Private Limited have been shown as Rent Expenses of business of UV Private Limited.
- (3) Repair and Maintenance Expenses for the months of February 2019 and March 2019 were still outstanding and were not shown in Balance Sheet of UV Private Limited.
- (4) Repair and Maintenance Expenses for the financial year 1 April, 2018 to 31 March, 2019 were very high as compared to financial year 1 April, 2017 to 31 March, 2018. The auditor Mr. H asked the appropriate authority about the reasons for such huge differences in amounts of two financial years.
- (5) While verifying the insurance expenses, the insurance policies were not shown to auditor Mr. H.

The above mentioned five points were some of the issues which Mr. H was unable to understand.

Answer the following questions:

- (1) As per the point number (1) mentioned in the above case, the Power and Fuel Expenses paid for the months of April 2019 and May 2019 must be shown under asset side of balance sheet of UV Private Limited as on 31 March, 2019 as:
 - (a) Outstanding Power and Fuel Expenses

- (b) Prepaid Power and Fuel Expenses
 - (c) Power and Fuel Expenses
 - (d) Power and Fuel Expenses Payable
- (2) As per point number (2) mentioned above in the case, the Personal Rent Expenses of the son of one of the director Mr. T were added to Rent Expenses of business of UV Private Limited. The amount of personal rent expenses of the son of the director Mr. T must be:
- (a) Subtracted from Rent Expenses of business of UV Private Limited
 - (b) Remain Added to Rent Expenses of business of UV Private Limited
 - (c) Again Added to Rent Expenses of business of UV Private Limited
 - (d) Subtracted twice from Rent Expenses of business of UV Private Limited
- (3) As per point number (3) mentioned above in the case, the Repair and Maintenance Expenses outstanding for the months of February 2019 and March 2019 must be shown under liability side of balance sheet of UV Private Limited as on 31 March, 2019 as:
- (a) Prepaid Repair and Maintenance Expenses
 - (b) Repair and Maintenance Expenses
 - (c) Repair and Maintenance Expenses paid in advance
 - (d) Repair and Maintenance Expenses Payable
- (4) As per point number (4) mentioned in the case above, the auditor Mr. H asked the appropriate authority for reasons of huge differences in the amount of two financial years of repair and maintenance expenses. By appropriate authority Mr. H was referring to:
- (a) All employees of UV Private Limited
 - (b) Management of UV Private Limited
 - (c) Members of UV Private Limited
 - (d) Any one director of UV Private Limited
- (5) As per point number (5) mentioned in the case above, in verifying insurance expenses the insurance policies would provide auditor Mr. H as:
- (a) Invalid Supporting
 - (b) No Supporting
 - (c) Lack of proper Supporting
 - (d) Valid Supporting

MCQ's not based on Case Scenario

1. M/s KYC & Co. is a reputed Audit firm in Mumbai. They are appointed as Statutory Auditors of Blessed Ltd. Which of the below is the responsibility of M/s KYC & Co.
 - (a) Preparation of financial statements
 - (b) Designing, implementation and maintenance of internal control system
 - (c) Reporting on true and fair view of financial statements
 - (d) Compliance with the applicable law and regulation
2. Mr. A, auditor and Mr. B, Finance Manager of XYZ Pvt Ltd are friends. Mr. A prepares the audit report according to the wishes and directions of Mr. B. In this situation which essential quality of the auditor has been compromised:
 - (a) Professional Competence
 - (b) Independence
 - (c) Professional Skepticism
 - (d) Due care
3. Mr. Salman, is an engagement partner of Khan & co. chartered accountants for an audit of Lava Ltd., he died of a stroke on 30.09.2019 after completing the entire routine audit work of Lava Ltd. Mr. Shoaib, one of the partners of Khan & Co. will be signing the accounts of Lava Ltd. What is the course of action to be taken by Mr. Shoaib?
 - (a) Sign the accounts of Lava Ltd without reviewing the work of his partner
 - (b) Sign the balance sheet after reviewing the work of his partner
 - (c) Withdraw the audit as the person who has performed the audit is no more
 - (d) Issue an adverse report
4. Auditor Compares Gross Profit Ratio with that of Previous year and it is discovered that there has been a fall in the ratio. This is an example of :
 - (a) Analytical Procedure
 - (b) Test of Controls
 - (c) Walk Through Test
 - (d) Audit Sampling
5. While conducting the audit of Saraswati Ltd, a packaged water making company, it was found that a purchase of motor car was made in the name of the company. Your Article Assistant has performed the following audit procedures. Identify which of the following procedure is incorrect.
 - (a) Ascertain whether the purchase of car has been properly authenticated.

- (b) Check invoice of the car dealer to confirm the purchase price
- (c) Examine registration with Transport Authorities to verify the ownership
- (d) Ensure that the motor car has been included in the Closing inventory of goods

PART II B – DESCRIPTIVE QUESTIONS

1. State with reason (in short) whether the following statements are true or false:
 - (i) Overall audit plan sets the scope, timing and direction of the audit, and guides the development of the more detailed audit strategy.
 - (ii) The Constitution of India contains no specific provisions regarding the appointment, salary and duties and powers of the C&AG. Moreover, the constitution does not guarantee the independence of the C&AG of India.
 - (iii) When we are designing audit procedures to address an inherent risk or “what can go wrong”, we consider the nature of the risk of material misstatement.
 - (iv) If an entity has a known number of employees at fixed rates of pay throughout the period, there would be more need to perform tests of details on the payroll.
 - (v) The term “**relative**”, as defined under the Companies Act, 2013, means anyone who is closely related to another.
 - (vi) According to **Section 140(1)**, the auditor appointed under section 139 may be removed from his office before the expiry of his term only by passing a Board resolution.
 - (vii) An intangible asset is an identifiable monetary asset.
 - (viii) One of the key principles of accrual basis of accounting requires that an asset’s cost is proportionally expensed based on the period over which the asset is expected to be used.

Chapter 1- Nature of Auditing

2. (a) **Professional skepticism** refers to 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. The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated. Explain giving examples.
- (b) Both accounting and auditing are closely related with each other. Explain
3. Explain what an auditor is expected to do if, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor’s ability to continue performing the audit.

Chapter 2- Basic Concepts in Auditing

4. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement and also by the quality of such audit evidence. Obtaining more audit evidence, however, may not compensate for its poor quality. Explain also stating the factors affecting auditor's judgment as to sufficiency of audit evidence.
5. A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls. Explain and also state when will the auditor design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls.

Chapter 3- Preparation for an Audit

6. (a) The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors. Explain giving examples.
(b) **The auditor shall document** the overall audit strategy, the audit plan and any significant changes made to the overall audit strategy or the audit plan. Explain in detail giving examples.
7. (a) Evolving one audit programme applicable to all business under all circumstances is not practicable. Explain clearly stating in detail the meaning of audit programme.
(b) Sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk leads to erroneous conclusions. Explain in detail distinguishing it from non-sampling risk with examples.
8. Explain the factors that should be considered for deciding upon the extent of checking on a sampling plan.
9. As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. Explain clearly stating the meaning of engagement partner and also the actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement.
10. The firm should **establish policies and procedures** designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.
Explain the purpose of monitoring compliance with quality control policies and procedures.

Chapter 4- Risk Assessment and Internal Control

11. The internal control required by a sole proprietor of small business is not identical with that required for a large industrial organisation. Explain.
12. (a) Sometimes batch computer systems are just an extension of manual systems. Explain the attributes possessed by such computer systems.
(b) The use of computers may result in the design of systems that provide less visible evidence than those using manual procedures. In addition, these systems may be accessible by a larger number of persons. Explain the system characteristics that would result from the nature of CIS processing.

Chapter 5 and 6- Vouching and Verification of Assets and Liabilities

13. XYZ Ltd. has prepared financial statements for the year 2017-18. It mentioned in the significant accounting policies that depreciation on tangible fixed assets is provided on SLM basis over the useful lives of the assets as estimated by the management. The company has ignored the useful lives of the assets mentioned in Schedule II of the Companies Act, 2013. As a Statutory Auditor of the Company, how would you deal with this?
14. *Name the assertions for the following audit procedures:*
 - (i) *Year end inventory verification.*
 - (ii) *Depreciation has been properly charged on all assets.*
 - (iii) *The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.*
 - (iv) *All liabilities are properly recorded in the financial statements.*
 - (v) *Related party transactions are shown properly.*
15. How will you vouch/verify the following?
 - (a) Trademarks and copyrights
 - (b) Investments income in the case of charitable institutions
 - (c) Contingent liabilities
 - (d) Leasehold rights

Chapter 7 and 8 - The Company Audit -1 and 2

16. Alpha Ltd. intends to maintain its books of accounts in electronic form. State the conditions that the company should comply with in this regard.
17. Explain the circumstances in which Option on Shares arises.
18. (a) During the audit of PQR Ltd. you as an auditor requested officers of the company to have access to secretarial records and correspondence which they refused to provide. Comment.

- (b) At the AGM of HDB Pvt. Ltd., Mr. R was appointed as the statutory auditor. He, however, resigned after 3 months since he wanted to pursue his career in banking sector. The Board of Director has appointed Mr. L as the statutory auditor in board meeting within 30 days. Comment on the matter with reference to the provisions of Companies Act, 2013.
19. Define Emphasis of Matter Paragraph and how it should be disclosed in the Independent Auditor's Report?
20. "The company has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilized these funds for repayment of long term loans and advances." Advise the auditor regarding reporting requirements under CARO, 2016.
21. The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion". Explain what is included in this "Basis for Opinion" section.

Chapter 9- Audit of Different Types of Entities

22. (a) In the case of audit of a charitable institution, what attentions should be paid by the auditor regarding audit of expenditure items?
- (b) You have been appointed auditor of M/s. Divine Children Hospital. Discuss important points that would attract your attention while audit.

SUGGESTED ANSWERS / HINTS

ANSWERS - MULTIPLE CHOICE QUESTIONS- Integrated Case Scenario-1

1. (d)
2. (b)
3. (d)
4. (c)
5. (c)

ANSWERS - MULTIPLE CHOICE QUESTIONS- Integrated Case Scenario-2

1. (b)
2. (a)
3. (d)
4. (b)
5. (d)

General MCQ's

1. (c)
2. (b)
3. (b)
4. (a)
5. (d)

DESCRIPTIVE ANSWERS

1. (i) **Incorrect:** Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.
- (ii) **Incorrect:** The Constitution of India contains specific provisions regarding the appointment, salary and duties and powers of the C&AG. The constitution guarantees the independence of the C&AG of India by prescribing that he shall be appointed by the President of India and shall not be removed from office except on the ground of proven mis-behaviour or incapacity.
- (iii) **Correct :** When we are designing audit procedures to address an inherent risk or “what can go wrong”, we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. When inherent risk is higher, we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.
- (iv) **Incorrect:** If an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll.
- (v) **Incorrect:** The term “relative”, as defined under the Companies Act, 2013, means anyone who is related to another as members of a Hindu Undivided Family; husband and wife; Father (including step- father), Mother (including step-mother), Son (including step- son), Son's wife, Daughter, Daughter's husband, Brother (including step- brother), Sister (including step-sister).
- (vi) **Incorrect:** According to **Section 140(1)**, the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per **Rule 7 of CAAR, 2014**
- (vii) **Incorrect:** An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

(viii) **correct:** One of the key principles of accrual basis of accounting requires that an asset's cost is proportionally expensed based on the period over which the asset is expected to be used. Both depreciation and amortization are methods that are used to prorate the cost of a specific type of asset over its useful life. Depreciation represents systematic allocation of the depreciable value of an item of PPE over its useful life while amortisation represents systematic allocation of the depreciable amount of an intangible asset over its useful life.

2. (a) The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated.

Professional skepticism includes being alert to, for example:

- ◆ Audit evidence that contradicts other audit evidence obtained.
 - ◆ Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
 - ◆ Conditions that may indicate possible fraud.
 - ◆ Circumstances that suggest the need for audit procedures in addition to those required by the SAs.
 - ◆ Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:
 - Overlooking unusual circumstances.
 - Over generalising when drawing conclusions from audit observations.
 - ◆ Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.
- (b) Both accounting and auditing are closely related with each other as auditing reviews the financial statements which are nothing but a result of the overall accounting process. It naturally calls on the part of the auditor to have a thorough and sound knowledge of generally accepted principles of accounting before he can review the financial statements. In fact, auditing as a discipline is also closely related with various other disciplines as there is lot of linkages in the work which is done by an auditor in his day-to-day activities. To begin with, it may be noted that the discipline of auditing itself is a logical construct and everything done in auditing must be bound by the rules of logic. Ethical precepts are the basis on which the foundation of the entire accounting profession rests. The knowledge of language is also considered essential in the field of auditing as the auditor shall be required to communicate, both in writing as well as orally, in day-to-day work.

3. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:
 - (a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
 - (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and
 - (c) If the auditor withdraws:
 - (i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
 - (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.
4. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. **Auditor's judgment as to sufficiency may be affected by the factors such as:**
 - (i) Materiality
 - (ii) Risk of material misstatement
 - (iii) Size and characteristics of the population.
 - (a) **Materiality** may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements. Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand if assertions are more material to the users of the financial statements, more evidence would be required.
 - (b) **Risk of material misstatement** may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components described as follows at the assertion level (a) Inherent risk—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls. (b) Control risk—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control. Less evidence would be required in case

assertions that have a lower risk of material misstatement. But on the other hand if assertions have a higher risk of material misstatement, more evidence would be required.

- (c) **Size of a population** refers to the number of items included in the population. Less evidence would be required in case of smaller, more homogeneous population but on the other hand in case of larger, more heterogeneous populations, more evidence would be required.
5. Test of controls may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:

- (a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or
- (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

6. (a) The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work.

The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:

1. The size and complexity of the entity.
2. The area of the audit.
3. The assessed risks of material misstatement

Example

An increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work.

4. The capabilities and competence of the individual team members performing the audit work.

Example

We may have identified a problem related to the production process that raised concerns about inventory obsolescence. After obtaining an understanding of the entity's process that raised concerns about inventory obsolescence (which we had identified as a significant class of transactions), we concluded that additional tests of details were required. Therefore, the senior will likely take part, along with the team, in the discussions with management about the provision for obsolescence and examine related documentation supporting the provision, rather than just reading the memo on file. These procedures should be completed as the work is being performed rather than as an after the fact review. The extent of the senior's involvement requires judgment, taking into consideration the complexity of the area and the experience of the team.

(b) The auditor shall document:

- (a) the overall audit strategy;
- (b) the audit plan; and
- (c) any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team.

Example

The auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit.

The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan

finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.

Example

The following things should form part of auditor's documentation:

- ◆ A summary of discussions with the entity's key decision makers.
- ◆ Documentation of audit committee pre-approval of services, where required.
- ◆ Audit documentation access letters.
- ◆ Other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services.
- ◆ Auditor's report on the entity's financial statements.

Other reports as specified in the engagement agreement (e.g., debt covenant compliance letter).

7. (a) Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable. However, it becomes a necessity to specify in detail in the audit programme the nature of work to be done so that no time will be wasted on matters not pertinent to the engagement and any special matter or any specific situation can be taken care of.

It is desirable that in respect of each audit and more particularly for bigger audits an audit programme should be drawn up. Audit programme is a list of examination and verification steps to be applied and set out in such a way that the inter-relationship of one step to another is clearly shown and designed, keeping in view the assertions discernible in the statements of account produced for audit or on the basis of an appraisal of the accounting records of the client.

Definition : An audit programme consists of a series of verification procedures to be applied to the financial statements and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements.

In other words, an audit programme is a detailed plan of applying the audit procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.

- (b) **Sampling Risk.** The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

- (i) In the case of a test of controls, that controls are more effective than they actually

are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

- (ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Non-Sampling Risk. The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

Example

Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognize a misstatement or deviation.

Sources of Non Sampling risk are :

Human Mistakes	Misinterpreting the sample results
Applying audit procedures not appropriate to the objectives of audit	
Relying on erroneous information e.g. erroneous confirmation	

Non sampling risk can never be mathematically measured.

8. The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:
 - (i) Size of the organisation under audit.
 - (ii) State of the internal control.
 - (iii) Adequacy and reliability of books and records.
 - (iv) Tolerable error range.
 - (v) Degree of the desired confidence.
9. As per SA 220 “Quality Control for an Audit of Financial Statements”, the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned.

The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:

- (a) The importance to audit quality of:

- (i) Performing work that complies with professional standards and regulatory and legal requirements;
 - (ii) Complying with the firm's quality control policies and procedures as applicable;
 - (iii) Issuing auditor's reports that are appropriate in the circumstances; and
 - (iv) The engagement team's ability to raise concerns without fear of reprisals; and
- (b) The fact that quality is essential in performing audit engagements.

Engagement partner refers to the partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

10. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

- (a) Adherence to professional standards and regulatory and legal requirements;
- (b) Whether the quality control system has been appropriately designed and effectively implemented; and
- (c) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

11. The internal control required by a sole proprietor of small business is not identical with that required for a large industrial organisation. A small trader having a grocery shop hardly needs more than one or two assistants. He decides the work to be done by the assistants. He always knows his own inventory, cash and bank position. He has the knowledge of daily sales. He himself knows the sources for purchases. He arranges transport and makes the purchases. He keeps the record of the trade receivables and trade payables. The assistants merely help him in delivering goods to customers or to arrange the goods in proper order.

From the above, it can be observed that control is entirely centralised with the owner and there is no significant delegation of duties. However, as the business grows in size it soon reaches a stage where the owner can no longer keep him intimately informed about the detailed operations of his business, activities of the employees and the discharge of their responsibilities. To cope with the increasing size and volume of business, he has to employ more and more people and for systematically carrying on the business, he has to specify the tasks for each person. For remote operations he has also to rely upon these people, for carrying out the work, for the custody of the materials, documents and equipments entrusted to them. He has also to ensure that the equipment and facilities are properly

maintained. For this purpose, he has to give shape to a form of organisation from which he would be in a position to know the broad details of the work involved and the persons responsible for such work. Also, he has to work out a plan of delegation of duties and authority for the simple reason that, for anything and everything, people need not come to him for advice or decision, because, under such circumstances, he would not be able to find time to apply his mind to matters of more importance.

12. (a) Sometimes batch computer systems are just an extension of manual systems. These systems have the following attributes:
- (1) The system logic is straightforward and there are no special routines resulting from the use of the computer to process data.
 - (2) Input transactions are batched and control can be maintained through the normal methods, for example, separation of duties and management supervision.
 - (3) Processing primarily consists of sorting the input data and updating the master file sequentially.
 - (4) There is a clear audit trail and detailed reports are prepared at key processing points within the system.
 - (5) The task environment is relatively constant and few stresses are placed on the system.
- (b) The use of computers may result in the design of systems that provide less visible evidence than those using manual procedures. In addition, these systems may be accessible by a larger number of persons. System characteristics that may result from the nature of CIS processing include:
- (a) Absence of input documents—data may be entered directly into the computer system without supporting documents. In some on-line transaction systems, written evidence of individual data entry authorization (e.g. approval for order entry) may be replaced by other procedures, such as authorization controls contained in computer programs (e.g. credit limit approval).
 - (b) 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 a CIS environment, however, the transaction trail may be partly in machine-readable form, and furthermore it may exist only for a limited period of time.
 - (c) Lack of visible output—certain transactions or results of processing may not be printed. In a manual system, and in some CIS systems, it is normally possible to examine visually the results of processing. In other CIS systems, the results of processing may not be printed, or only summary data may be printed. Thus, the

lack of visible output may result in the need to access data retained on files readable only by the computer.

- (d) Ease of access to data and computer programs—data and computer programs may be accessed and 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 alteration of, data and programs by persons inside or outside the entity.

- 13. Providing Depreciation ignoring Schedule II to the Companies Act, 2013:** Section 129 of the Companies Act, 2013, requires that the financial statements shall give a true and fair view of the state of affairs of the company and are in compliance with Accounting Standards.

Further, as per Schedule II to the Companies Act, 2013 on 'Useful Lives to Compute Depreciation', the useful life of an asset shall not ordinarily be different from the useful life specified therein.

However, if such a company uses a useful life of the asset which is different from the above limits, it shall disclose the justification for the same in its financial statement.

In the given case, XYZ Limited has mentioned in the significant accounting policies that the depreciation on tangible fixed assets is provided on the straight line method over the useful lives of the assets as estimated by the management and ignored the useful lives of the assets as provided under Schedule II to the Companies Act, 2013.

Therefore, the statutory auditor of the company should ensure that the management has disclosed the justification for consideration of different useful life of the assets from that as indicated under Schedule II. If the justification has not been provided then the auditor of the company shall suggest the management for the same and if management refuses, the auditor should qualify his report accordingly.

- 14. (i) Year end inventory verification:** Existence Assertion.
- (ii) Depreciation has been properly charged on all assets:** Valuation Assertion.
- (iii) Title deed of lands disclosed in the Balance Sheet are held in the name of the Company:** Rights & Obligations Assertion.
- (iv) All liabilities are properly recorded in the financial statements:** Completeness.
- (v) Related party transactions are shown properly:** Presentation & Disclosure.
- 15. (a) Trademarks and Copyrights:**
- (i) Obtain schedule of Trade Marks and Copyrights duly signed by the responsible officer and scrutinise the same and confirm that all of them are shown in the Balance Sheet.

- (ii) Examine the written agreement in case of assignment of Copyrights and Assignment Deed in case of transfer of trade marks. Also ensure that trademarks and copyrights have been duly registered.
- (iii) Verify existence of copyright by reference to contract between the author & the entity and note down the terms of payment of royalty.
- (iv) See that the value has been determined properly and the costs incurred for the purpose of obtaining the trademarks and copyrights have been capitalised.
- (v) Ascertain that the legal life of the trademarks and copyrights has not expired.
- (vi) Ensure that amount paid for both the intangible assets is properly amortised having regard to appropriate legal and commercial considerations, as per the principles enunciated under AS 26 on Intangible Assets.

(b) Investment Income in the case of Charitable Institution:

- (i) Vouching the amounts received with the dividend and interest counterfoils.
- (ii) Checking the calculations of interest received on securities bearing fixed rates of interest.
- (iii) Checking that the appropriate dividend has been received where any investment has been sold ex-dividend or purchased cum-dividend.
- (iv) Comparing the amounts of dividend received with schedule of investments making special enquiries into any investments held for which no dividend has been received.

(c) Contingent liabilities:

- (i) Inspect the minute books of the company to ascertain all contingent liabilities known to the company.
- (ii) Examine the contracts entered into by the company and the likelihood of contingent liabilities emanating therefrom.
- (iii) Scrutinise the lawyer's bills to track unreported contingent liabilities.
- (iv) Examine bank letters in respect of bills discounted and not matured.
- (v) Examine bank letters to ascertain guarantees on behalf of other companies or individuals.
- (vi) Discuss with various functional officers of the company about the possibility of contingent liability existing in their respective field.
- (vii) Obtain a certificate from the management that all known contingent liabilities have been included in the accounts and they have been properly disclosed.

- (viii) Ensure that proper disclosure has been made as per Schedule III to the Companies Act, 2013 and AS 29, "Provisions, Contingent Liabilities and Contingent Assets".

(d) Leasehold Rights:

- (i) Inspect the lease or assignment thereof to ascertain the amount of premium, if any, for securing the lease, and its terms and conditions; and that the lease has been duly registered. A lease exceeding one year is not valid unless it has been granted by a registered instrument.
- (ii) Ascertain that all the conditions, the failure to comply with which might result in the forfeiture or cancellation of the lease, e.g., payment of ground rent on the due dates, insurance of property, its maintenance in a satisfactory state of repairs, etc. prescribed by the lease, are being duly complied with.
- (iii) Examine the counterpart of the tenants' agreements, if part of the leasehold property has been sublet.
- (iv) Make certain that due provisions for any claim that might arise under the dilapidation clause on the expiry of the lease has been made, and, if no such provision has been made, draw the client's attention to the matter.
- (v) Ensure that the outlay as well as any legal expenses incurred to acquire the leases which are shown as an asset in the Balance Sheet is being written off at a rate which could completely wipe off the asset over the unexpired term of the lease.

16. Electronic form of Books of accounts: Second proviso to section 128(1) read with the Companies (Accounts) Rules, 2014 allows a company to keep its books of account or other relevant papers in electronic mode.

However, the books of account and other relevant books and papers maintained in electronic mode shall comply with the following conditions:

- (a) the books of account and other relevant books and papers shall remain accessible in India so as to be usable for subsequent reference.
- (b) the books of account and other relevant books and papers shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.
- (c) the information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches.
- (d) the information in the electronic record of the document shall be capable of being displayed in a legible form.

- (e) there shall be a proper system for storage, retrieval, display or printout of the electronic records as the audit committee, if any, or the board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law.
 - (f) the back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis.
- 17. Schedule III, Part I, requires disclosure of the particulars of any option on unissued share capital. An option on shares arises when a person has acquired a right under an agreement with the company to subscribe for share in the company if he so chooses.**

Such options generally arise under the following circumstances:

- (i) Under the promoter's agreements, subsequently ratified by the company;
 - (ii) Collaboration agreement;
 - (iii) Loan agreements, debenture deeds
 - (iv) Agreements to convert preference shares into equity shares; and
 - (v) Other contracts, such as for supply of capital goods and/or merchandise.
- 18. (a) Right of Access to secretarial records and correspondence:**
- 1. Section 143(1) of the Companies Act, 2013 grants powers to the auditor that every auditor has a right of access, at all times, to the books of account and vouchers of the company kept at Registered or Head Office, branches and subsidiaries in the case of a Holding Company for conducting the audit.
 - 2. Further, he is also entitled to require from the officers of the company such information and explanations which he considers necessary for the proper performance of his duties as Auditor. Therefore, he has a statutory right to inspect the secretarial records and correspondence.
 - 3. In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company. It is, therefore, essential for the auditor to refer to the secretarial records and correspondence which also includes Minute book. In the absence of the same, the auditor may not be able to vouch/verify certain transactions of the company.
 - 4. The refusal to provide access to secretarial records and correspondence shall constitute limitation of scope as far as the auditor's duties are concerned.
 - 5. The auditor may examine whether by performing alternative procedures, the auditor can substantiate the assertions or else he shall have to either qualify the report or give a disclaimer of opinion.

- (b) **Casual Vacancy by Resignation:** As per Section 139(8), any casual vacancy in the office of an auditor shall in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days. If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

Further, 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 with the company and the Registrar. In the instant case, R resigned after three months of his appointment as statutory auditor as he wanted to pursue his career in banking sector.

Therefore, the board of director has appointed Mr. L as the statutory auditor with in 30 days is in order subject to such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board. Further, it is also the duty of the auditor to file, within a period of 30 days from the date of resignation, a statement in the prescribed Form with the company and the Registrar in compliance with section 140(2) of the Companies Act, 2013.

19. **Emphasis of Matter paragraph:** A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (i) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
 - (ii) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and
 - (iii) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.
20. **The auditor is required to report as per clause xiv of paragraph 3 of CARO 2016,** 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;

In view of the above clause, the auditor would report that funds raised by the company for expansion and diversification of business have not been used for the said purpose rather the company has utilised these funds for repayment of long term loans and advance.

21. Basis for Opinion: The auditor's report shall include a section, directly following the Opinion section, with the heading "**Basis for Opinion**", that:

- (a) States that the audit was conducted in accordance with Standards on Auditing;
- (b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- (c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- (d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

22. (a) Audit of Expenditure of Charitable Institution:

- (i) Vouching payment of grants also verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and that no trustee, director or member of the management committee has benefited there from either directly or indirectly.
- (ii) Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test basis.
- (iii) Check payment along with supporting documents in regard to salary and other expenses. Verify that all payments are made after proper sanction by appropriate authority.
- (iv) Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.
- (v) Verifying the cash and bank balances/payments.

(b) AUDIT OF HOSPITAL

The important points involved in such an audit are stated below -

- (i) **Register of patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
- (ii) **Collection of Cash:** Check cash collections as entered in the Cash Book with

the receipts, counterfoils and other evidence. For eg. copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills etc.

- (iii) **Income from Investments, Rent etc.:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends and interest on securities have been collected.
- (iv) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- (v) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- (vi) **Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of the Managing Committee and that appointments and increments to staff have been duly authorised.
- (vii) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
- (viii) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
- (ix) **Internal Check:** Examine the internal check as regards the receipt and issue of stores, medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
- (x) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
- (xi) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
- (xii) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check the percentage of the items physically, also compare their total values with respective ledger balances.
- (xiii) **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

QUESTIONS

Multiple Choice Questions

Q. No.(s) 1 to 5 are based on the Case Scenario.

A group of five friends from the same batch of course of post-graduation in computer science, on the successful completion of their course, decided to initiate a startup of their own. They launched a company with the name HIREME Ltd. under the website URL www.HIREME.com that enables searching and hiring of software provider companies. HIREME Ltd. has well adopted the concept of Business Process Management (BPM) to improve its end-to-end business processes in various stages and aims to grow their revenues quickly while controlling their resource costs. The website provides the entire details of various projects, architect designs and assignments handled by these vendors nationwide. The needy companies can review and analyze the promising offers of these vendors through the website www.HIREME.com and can directly contact them with their bid for their requirement. The vendors review all the bids and select the company for further processing.

DEF is an event management company that organizes the events for high profile people. The company through the website www.HIREME.com decided to hire a software provider Mr. X to develop a Burglar Alarm System for their events scheduled in different locations, for which HIREME Ltd was to be paid ₹ 50,000 as service charges apart from the payment of ₹ 2 lakhs to Mr. X. After completion of project, DEF released the payment of ₹ 50,000 and ₹ 2 lakhs to HIREME Ltd. and Mr. X respectively through net banking. Though Mr. X received his payment; due to some technical snag, the bank statement of the HIREME Ltd. did not reflect that the said amount of ₹ 50,000 has been credited in its account.

Read the above case scenario and answer the following questions.

1. We know that HIREME Ltd. adopted Business Process Management (BPM) to improve their end-to-end business processes. Identify the phase from the following phases of BPM Life cycle where HIREME Ltd. evaluated the potential solution to meet its business process modelling.
 - (a) Implementation
 - (b) Design
 - (c) Optimize
 - (d) Analysis

2. While developing the Burglar Alarm System for its client DEF, Mr. X followed all the steps involved in Information System Life Cycle. Which phase of Information System Life Cycle will provide an answer to the question "How will the new solution be put in effect"?
 - (a) System Maintenance and Review
 - (b) System Testing
 - (c) System Implementation
 - (d) System Analysis
3. In purview of the case scenario, what do you think is the e-Commerce model that is adopted by HIREME Ltd.?
 - (a) Consumer to Consumer e-Commerce
 - (b) Consumer to Business e-Commerce
 - (c) Business to Employee e-Commerce
 - (d) Business to Consumer e-Commerce
4. The situation in which the fixed amount was deducted from DEF's account but was not credited in bank account of HIREME Ltd., the transaction does not qualify as a successful transaction. Which of the following prerequisite of Transaction Processing System is not satisfied in this case?
 - (a) Isolation
 - (b) Consistency
 - (c) Atomicity
 - (d) Durability
5. During this pandemic COVID 19, Mr. X scheduled many video conferencing sessions with his team members to discuss on the work-in progress regarding development of Burglar Alarm System for its client DEF. The hardware, storage, servers and infrastructure were provided to Mr. X and his team members by Cloud Computing Service providers on pay as per usage basis. Which of the following statement is false regarding Cloud Computing?
 - (a) Storing information in the cloud provides strict security against threats and hackers.
 - (b) Once we register ourselves in the cloud, we can access the information from anywhere.
 - (c) Cloud computing is one of the most cost-efficient method to use, maintain and upgrade.
 - (d) In the cloud, software integration is usually something that occurs automatically.

Descriptive Questions

Chapter 1: Business Process Management & IT

6. ABC company is manufacturer and supplier of Diaries, Calendars, Notebooks and Duplex Cartons. To enhance the customer satisfaction and to reduce the process cycle time, the company decides to implement Six Sigma strategy. Briefly explain the Life Cycle of Six Sigma.
7. ABC Ltd. has adopted Business Process Management Systems (BPMS) to improve its business processes and to reduce expenses. After two years of adoption of BPMS, ABC Ltd. observed that BPMS is not successful and not yielding the desired results. Enlist the reasons for failure of BPMS.

Chapter 2: Information Systems and IT Fundamentals

8. Mobile Computing allows business organizations to conduct business anywhere and establishes a seamless communication with its employees. Enlist few Business applications of Mobile Computing.
9. Explain the role of Bluetooth and Wi-Fi Technologies in our daily operations.

Chapter 3: Telecommunication and Networks

10. In Three-tier architecture of computer system, network user interfaces are developed and maintained as independent modules on separate platform. Describe the advantages and disadvantage of this architecture.
11. Mr. X is head of testing team in a software development company. He discussed with his team members; the various vulnerabilities that render software susceptible to a threat. Elaborate the points of discussion of Mr. X.

Chapter 4: Business Information Systems

12. In an organization, different levels of Information Systems are used at various levels by different group of people. Explain in brief about these group of people.
13. Describe all the components of Enterprise Information System (EIS) that links data from various sources both internal and external to provide the amount of information that executives find useful.

Chapter 5: Business Process Automation through Application Software

14. Business Applications are used to fulfill a person's / organizations' need for regular occupation or commercial activity. In consideration of this statement, classify the Business Applications on the basis on Nature of processing.
15. ABC Ltd., a financial management company, uses certain controls under Application Controls to ensure that the data delivered to its users is presented, formatted, and delivered in secured manner. Identify the underlying control and explain its functions.

SUGGESTED ANSWERS/HINTS**Multiple Choice Answers**

1. (d) Analysis
2. (c) System Implementation
3. (d) Business to Consumer e-Commerce
4. (c) Atomicity
5. (a) Storing information in the cloud provides strict security against threats and hackers.

Descriptive Answers

6. Life Cycle of Six Sigma having phases Define, Measure, Analyze, Improve and Control (or DMAIC) are described as follows:
 - (i) **Define:** Customers are identified and their requirements are gathered. Measurements that are critical to customer satisfaction [Critical to Quality, (CTQ)] are identified for further project improvement.
 - (ii) **Measure:** Process output measures that are attributes of CTQs are determined and variables that affect these output measures are identified. Data on current process are gathered and current baseline performance for process output measures are established. Variances of output measures are graphed and process sigma are calculated.
 - (iii) **Analyze:** Using statistical methods and graphical displays, possible causes of process output variations are identified. These possible causes are analyzed statistically to determine root cause of variation.
 - (iv) **Improve:** Solution alternatives are generated to fix the root cause. The most appropriate solution is identified using solution prioritization matrix and validated using pilot testing. Cost and benefit analysis are performed to validate the financial benefit of the solution. Implementation plan is drafted and executed.
 - (v) **Control:** Process is standardized and documented. Before and after analysis is performed on the new process to validate expected results, monitoring system is implemented to ensure process is performing as designed. Project is evaluated and lessons learned are shared with others.
7. Business Process Management Systems (BPMS) are primarily fail due to inadequate investment in ongoing training for involved personnel, as well as lack of corporate policy protecting the integrity of the data in the BPM systems. Some of the other reasons for failure of BPMS are as follows:
 - Superficial or deficient executive involvement.
 - Deficient project management.

- Breakdown in gap analysis.
 - Limited options for customization of the BPM software is required.
 - Not flexible enough or too complicated to be customized to meet the precise workflow and business process.
 - Failure to identify future business needs.
 - Inadequate assessment of the need for change management.
 - Persistent compatibility problems with the diverse legacy systems of the partners.
 - Resources not available when desirable.
 - Software fails to meet business needs.
 - System may be over-engineered when compared to the actual requirements.
 - Technological obsolescence.
8. Some examples of Business applications of Mobile Computing are as follows:
- There is increase in workforce productivity as mobile device enables employees to work from anywhere, anytime by accessing and updating information as required. For example: employees can read/respond to emails using laptops, PDAs or smart phones from office, residence and even when on the move.
 - Customer service can be improved by responding to customer queries on site or off site. For example: customer complaints can be accessed and responded by accessing past/latest information of client as required.
 - Incident management can be improved by resolving problems faster without limitation of time as the concerned employees can attend to these regardless of their location. Further, escalations can be updated in real time which ensures timely resolution of problems. For example: Computer breakdowns can be serviced by service engineers from their desks/outside by logging into the specific computer, identify problem and resolve it online.
 - Business processes can be transformed by using mobile devices. Enterprises can reengineer core business processes. The new and reengineered processes can focus on utilizing the key features of location and time independence. Enterprises can focus on providing customers and employees with access to information in different ways and provide the latest information. This enables employees, customers, and businesses to be available to one another as per their choice. For example: billing can be done by employees using hand-held devices at customer site and the information updated online and deliveries to customers can be speeded up.
 - Enterprises can dynamically modify and update their offerings and offer new products and services altogether. For example: enterprises can implement telecommuting with flexible working hours and locations allowing for cost savings and better efficiency.

- Mobile computing gives users the freedom to roam, with access to data and services at any time and in any place. Most of the high-end ERP and business software applications for SMEs have in-built capabilities of mobile computing enabling users to access data. Used with proper security, enterprises can harness the power of this technology to create innovative opportunities for improving the quality and efficiency of business processes and services. Mobile devices are increasingly acquiring the must-have status for enterprises on account of the increasing acceptance as business tools.

9. **Bluetooth:** It is a wireless technology standard for exchanging data over short distances up to 50 meters (164 feet) from fixed and mobile devices, creating Personal Area Networks (PANs) with high levels of security. It is a feature which is used every day through a number of compatible devices. Bluetooth is really like a very low-power, short-range radio signal. Bluetooth signals are secure from the moment they are sent, so unlike any other wireless network we don't have to worry about turning on security. Few devices that utilize Bluetooth technology are- Keyboards and mice, Printers, Cell phones and headsets, PDAs (Personal Digital Assistants), Desktop and laptop computers, Digital cameras, and Remotes: replacing IR (infrared). Using a mobile phone with Bluetooth enabled in them; we can send pictures, videos, exchange business cards and also transfer files to our PC. Both data and voice transmissions can be sent and received through the use of short-range networks.

Wi-Fi: Wi-Fi is the name of a popular wireless networking technology that uses radio waves to provide wireless high-speed Internet and network connections. Wi-Fi networks have limited range. A typical wireless access point might have a range of 32 meters (120 ft.). Wi-Fi can be less secure than wired connections because an intruder does not need a physical connection. Wi-Fi networks use radio technologies called 802.11 to provide secure, reliable, fast wireless connectivity. A Wi-Fi network can be used to connect electronic devices to each other, to the Internet, and to wired networks (which use Ethernet technology). Large corporations and campuses use enterprise-level technology and Wi-Fi products to extend standard wired Ethernet networks to public areas like meeting rooms, training classrooms and large auditoriums. Many corporations also provide wireless networks to their off-site and telecommuting workers to use at home or in remote offices. Large companies and campuses often use Wi-Fi to connect buildings. Wi-Fi networks also work well for small businesses, providing connectivity between mobile sales-people, floor staff and behind-the-scenes finance and accounting departments. Because small businesses are dynamic, the built-in flexibility of a Wi-Fi network makes it easy and affordable for them to change and grow.

10. The **advantages** of Three-Tier systems are as follows:
- **Clear separation of user-interface-control and data presentation from application-logic:** Through this separation more clients are able to have access to a wide variety of server applications. The two main advantages for client applications are quicker development through the reuse of pre-built business-logic components and a shorter test phase.

- **Dynamic load balancing:** If bottlenecks in terms of performance occur, the server process can be moved to other servers at runtime.
- **Change management:** It is easy and faster to exchange a component on the server than to furnish numerous PCs with new program versions.

The **disadvantages** of Three-Tier systems are as follows:

- It creates an increased need for network traffic management, server load balancing, and fault tolerance.
- Current tools are relatively immature and are more complex.
- Maintenance tools are currently inadequate for maintaining server libraries. This is a potential obstacle for simplifying maintenance and promoting code reuse throughout the organization.

11. The facts responsible for occurrence of vulnerabilities in the software are as follows:

- ◆ **Software Bugs** - Software bugs are so common that users have developed techniques to work around the consequences, and bugs that make saving work necessary every half an hour or crash the computer every so often are considered to be a normal part of computing. For example - buffer overflow, failure to handle exceptional conditions, access validation error, input validation errors are some of the common software flaws.
- ◆ **Timing Windows** - This problem may occur when a temporary file is exploited by an intruder to gain access to the file, overwrite important data, and use the file as a gateway for advancing further into the system.
- ◆ **Insecure default configurations** - Insecure default configurations occur when vendors use known default passwords to make it as easy as possible for consumers to set up new systems. Unfortunately, most intruders know these passwords and can access systems effortlessly.
- ◆ **Trusting Untrustworthy information** - This is usually a problem that affects routers, or those computers that connect one network to another. When routers are not programmed to verify that they are receiving information from a unique host, bogus routers can gain access to systems and do damage.
- ◆ **End users** - Generally, users of computer systems are not professionals and are not always security conscious. For example, when the number of passwords of a user increases, user may start writing them down, in the worst case to places from where they are easy to find. In addition to this kind of negligence towards security procedures users do human errors, for example save confidential files to places where they are not properly protected.

12. The group of people that are served at different levels of Information System are as follows:

- ◆ **Strategic Level:** These are senior managers or Top-level managers that hold the titles such as Chief Executive Officers, Chief Financial Officers, Chief Operational Officers, Chief Information Officers and Chair Person of the Board, President, Vice President and Corporate Head Managers take decisions that will affect the entirety of the organization. Top Managers do not direct the day-to-day activities of the firm; rather they set goals for the organization and direct the company to achieve them. Top Managers are ultimately responsible for the performance of the organization, and often, these managers have very visible jobs.
- ◆ **Management Level:** These are Middle Managers that are in the levels below top managers and hold the job titles like General Manager, Regional manager etc. Middle-level Managers are responsible for carrying out the goals set by Top Management. They do so by setting goals for their department and other business units. Middle Managers can motivate and assist First-line Managers achieve business objectives. Middle Managers may also communicate upwards, by offering suggestions and feedback to Top Managers. Because Middle Managers are more involved in the day-to-day workings of a company, they may provide valuable information to Top Managers to help improve the performance of an organization.
- ◆ **Knowledge Level:** These 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:** These include Operational Managers or supervisors that are responsible for the daily management of the line workers who actually produce the product or offer the service. There are First-line Managers in every work unit in the organization. Although First-line Managers typically do not set goals for the organization, they have a very strong influence on the company. These are the managers that most employees interact with on a daily basis, and if the managers perform poorly, employees may also perform poorly, may lack motivation, or may leave the company.

13. The components of an Enterprise Information System (EIS) are as follows:

- **Hardware** - Includes Input data-entry devices, CPU, Data Storage files and Output Devices.
- **Software** - Includes Text base software, Database, and Graphic types such as time series charts, scatter diagrams, maps, motion graphics, sequence charts, and comparison-oriented graphs (i.e., bar charts) Model base.

- **User Interface** - Includes hardware (physical) and software (logical) components by which people (users) interact with a machine. Several types of interfaces can be available to the EIS structure, such as scheduled reports, questions/answers, menu driven, command language, natural language, and input/output.
 - **Telecommunication** - Involves transmitting data from one place to another in a reliable networked system.
14. The business applications based on Nature of processing can be classified as under:
- **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 workday, for example, when computing capacities are not needed for other tasks. It is possible to perform repetitive tasks on many 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. For 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.
 - **Real-time Processing:** Real time processing is a subset of interactive or online processing. Input is continuously, automatically acquired from sensors, for example, which is processed immediately to respond to the input in as little time as possible. After the system is finished responding, it reads the next set of input data immediately to process that. This system does not need a user to control it, it works automatically. Whenever there is a rapid reaction required due to some sort of change, real time processing can take action without the need of a user or long processing time beforehand. Real time processing is used in warning systems on aircraft, alarm systems in hazardous zones, burglar alarms etc.
15. **Output controls** under Application Controls are the controls that ensure the data delivered to users will be presented, formatted and delivered in a consistent and secured manner. The functions of Output Controls are as follows:
- **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.

SECTION – B: STRATEGIC MANAGEMENT

Multiple Choice Questions

1. Connect Private Limited, a Mumbai based company is launching a smartphone, under the brand name of Poppy. The company recognizes plethora of options that customers have from Chinese manufacturers flooding the smartphone landscape. With recent COVID-19 pandemic hurting the global sentiment towards Chinese products, the company plans to play on the patriotic card and advertise Poppy as the “Desi” smartphone of India.

Strategic Arm of the company undertook an industry analysis and reported, that, budget phone segment was overtaken by the Chinese brands completely; however, the low segment of smartphones was still open for exploration. Thus, the company planned to enter the market with two models, Poppy A and Poppy B, priced at ₹ 4,499 and ₹ 5,499.

The company is also aware that their product can easily be imitated at same costing as well as pricing, and thus the very essence of their product can be lost. A team of marketing professionals was hired to tackle this issue. The solution they suggested was to take the first mover advantage by spending huge sums in advertising and promotion.

Based on sound consciousness of the competition from huge money backed international players, the company decided to manufacture smartphone covers and accessories with the same “Desi” tag, along with Poppy smartphones. This shall help them mitigate the risk of being completely thrown out of business. Consequently, they invested a fairly good amount in manufacturing of these accessories.

The investors made it an objective for the team to reach an annual sales volume of 15,000 handsets and 70,000 pieces of accessories. The accessories sales surpassed the expectations by a fairly good margin. However, Poppy A and Poppy B did not receive the much anticipated response and the leadership decided to reduce the scope and focus purely on accessories business going forward.

With a new focus on accessories production, the “Desi” tag will still play an important part in the success. However, they need to ensure creation of strong barriers to entry for domestic players, and for that, they have plans to increase the production to enormous levels. This shall reduce their unit cost, thus, eliminating the new entrants due to extremely competitive pricing.

Based on the above case scenario, answer the multiple choice questions which are as follows:

- (i) Connect Private Limited, entered a saturated market of smartphones, after a due market study of understanding the competitive landscape. Put the below steps in correct sequence of understanding the competitive landscape.

- (I) Understanding the competitors
 - (II) Determining strengths and weaknesses of the competitors
 - (III) Identify the competitors
 - (IV) Put all information gathered together
 - (a) (I),(III),(II),(IV)
 - (b) (III),(I),(II),(IV)
 - (c) (II),(III),(IV),(I)
 - (d) (I),(III),(II),(IV)
- (ii) Annual sales volume as an objective by the investors was crucial to establish the company in the market. In which stage of strategic management are such annual objectives especially important?
- (a) Formulation
 - (b) Control
 - (c) Evaluation
 - (d) Implementation
- (iii) Following the sales numbers reported at the end of year, the leadership took a serious strategic stand point to move forward and shift to a new core business which was more profitable. Under which of the following category of business strategy can this decision be categorized?
- (a) Retrenchment strategy
 - (b) Strategic alliance
 - (c) Diversification strategy
 - (d) Market development
- (iv) After getting results from the market, accessories business of the company can be classified under which category of BCG's growth share matrix?
- (a) Star
 - (b) Question mark
 - (c) Cash cow
 - (d) Dog

- (v) In the second phase of shifting the business focus to peripheral accessories production, Connect Private Limited has planned setting up entries to barrier for its potential competitors. Which of the following barrier have they planned to implement?
- (a) Capital requirement
 - (b) Product differentiation
 - (c) Access to distribution channels
 - (d) Economies of scale
2. Velvet Limited is a full-service airline. The company is making the following decisions:
- (i) Should a 'no-frills', 'low-fare' subsidiary be set-up?
 - (ii) If it is set-up, how should the cabin staff be recruited?
- Which of the above decisions will be taken by corporate level managers?
- (a) Only (i)
 - (b) Only (ii)
 - (c) Both (i) & (ii)
 - (d) Neither (i) nor (ii)
3. Read the following statements:
- (i) Functional-level managers are responsible for the specific business functions.
 - (ii) Functional-level managers take decisions related to human resources, purchasing, product development, customer service, and so on.
- Select the correct alternative:
- (a) Both (i) and (ii) truly explain features of functional-level manager.
 - (b) Only (i) truly explains features of functional-level manager.
 - (c) Only (ii) truly explains features of functional-level manager.
 - (d) None of (i) and (ii) truly explains features of functional-level manager.
4. GetWellSoon Limited is a health provider and has only large, edge of town hospitals. It is considering setting-up additional small city centre clinics capable of treating less-serious day cases. Which of the following will fall under "Strategy Implementation"?
- (1) Acquiring and fitting out clinics
 - (2) Hiring and/or transferring staff

- (3) Publicity, so that patients know where and when to go
 - (4) Liaison with general practitioners and the main hospitals
 - (a) Only (d)
 - (b) (b) & (d)
 - (c) (a), (b) & (d)
 - (d) (a), (b), (c) & (d)
5. Which of the following statements is true?
- (a) Consumer and Customer is always the same person
 - (b) Customer may or may not be the consumer
 - (c) Environmental study is optional for any business
 - (d) Micro Environment is a part of Internal Environment
6. The Niche strategy is the best way to enter a:
- (a) New market
 - (b) Growing market
 - (c) Matured market
 - (d) None of the above

Descriptive Questions

Chapter 1-Business Environment

7. A Manager faces different problems while trying to understand the environment. Discuss.
8. What are the strategic responses of an organization to its environment? Explain.

Chapter 2-Business Policy and Strategic Management

9. Mr Raj has been hired as a CEO by XYZ Ltd a FMCG company that has diversified into affordable cosmetics. The company intends to launch Feelgood brand of cosmetics. XYZ wishes to enrich the lives of people with its products that are good for skin and are produced in ecologically beneficial manner using herbal ingredients. Draft vision and mission statement that may be formulated by Raj.
10. "Strategy is partly proactive and partly reactive." Discuss.

Chapter 3-Strategic Analysis

11. What is 'situational analysis'? What factors are to be considered about the situation to choose a strategy?

12. Write a short note on the role of ADL Matrix in assessing competitive position of a firm.

Chapter 4-Strategic Planning

13. General public is discerning from buying air conditioning units based on the Health Ministry guidelines regarding emergence of a contagious viral pandemic. Consequently, Nebula Pvt. Ltd, a manufacturer of evaporation coils used in air conditioning units has faced significant loss in working capital due to sharp fall in demand. The company conducted financial assessment and developed a workable action plan based on short and long term financial needs. But for immediate needs, an emergency plan has been implemented. It includes selling scrap, asset liquidation and overheads cost reduction. Further, to avoid any such untoward event in future, they plan to diversify into newer business areas along with its core business. Identify and explain the strategy opted by M/s. Nebula Pvt. Ltd.?
14. What is Divestment strategy? When is, it adopted?

Chapter 5-Formulation of Functional Strategy

15. Mr. Vicky Verma, a Gwalior based entrepreneur, has entered into an exclusive-retail deal with an Italian company selling 'Fantasy-3D', a Hologram LED Fan, which is being used for advertising at public places. Mr. Verma procured a total of 500 units of the product and paid upfront as per the seller's policy. This resulted in blocking of his working capital significantly and the shipment is expected in a month. Meanwhile his continued efforts of establishing relations with the marketing heads of corporates resulted in a series of meetings, where he demonstrated his specialist product knowledge by changing the hologram images to personalise basis specifications of the customer. The management of a big automotive company was impressed with the quality and adaptability of the product, and awarded a contract of 125 units to be displayed in the auto-maker's showrooms. Identify and explain the product promotion strategy adopted by Mr. Verma.
16. How would you argue that Research and Development Personnel are important for effective strategy implementation?

Chapter 6-Strategy Implementation and Control

17. Delta is an organization specializing in Information Technology enables Services (ITeS) and Communications business. Previous year the organization had successfully integrated an Artificial Intelligence (AI) tool named 'Zeus' into the existing ERP system. The AI tool using Deep Learning technique provided a digital leap transformation in various business processes and operations. It has significantly diminished the role played by specialist managers of the middle management. This technological tool in addition to saving organisational costs by replacing many tasks of the middle management, has also served as a link between top and bottom levels in the organization and assists in faster decision making. The skewed middle level managers now perform cross-functional duties. Which type of organisational structure is the company transitioning into?

18. How can you differentiate between transformational and transactional leaders?

Chapter 7-Reaching Strategic Edge

19. Elaborate the following principles that guide the Total Quality Management Philosophy:
- (i) Universal quality responsibility
 - (ii) Preventing rather than detecting defects
 - (iii) Continuous improvement and learning
20. "Firms can use benchmarking process to achieve improvement in diverse range of management functions." Elucidate.

SUGGESTED ANSWERS/HINTS

1. (i) b (ii) d (iii) a (iv) c (v) d
2. a
3. a
4. d
5. b
6. c
7. In trying to understand the environment, managers face different problems as follows:
 - ◆ **Diversity:** The environment contains many different influences and the difficulty is in making sense of this diversity in a way which can contribute to strategic decision-making. Listing all conceivable environmental influences may be possible, but it may not be of much use.
 - ◆ **Uncertainty:** It is difficult to understand the future external influences on an organisation. The pace of technological change and the speed of global communications may also increase the pace of change.
 - ◆ **Complexity:** Managers like other individuals may tend to simplify complexity by focusing on aspects of the environment, which may confirm to their prior views. One of the tasks of the strategic manager is to find ways & means to break out of oversimplification or bias in the understanding of their environment, while still achieving a useful and usable level of analysis.
8. 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.

9. Feelgood brand of cosmetics may have following vision and mission:

Vision: Vision implies the blueprint of the company's future position. It describes where the organisation wants to land. Mr Raj should aim to position "Feelgood cosmetics" as India's beauty care company. It may have vision to be India's largest beauty care company that improves looks, give extraordinary feeling and bring happiness to people.

Mission: Mission delineates the firm's business, its goals and ways to reach the goals. It explains the reason for the existence of the firm in the society. It is designed to help potential shareholders and investors understand the purpose of the company:

Mr Raj may identify mission in the following lines:

- ◆ To be in the business of cosmetics to enhance the lives of people, give them confidence to lead.
 - ◆ To protect skin from harmful elements in environment and sun rays.
 - ◆ To produce herbal cosmetics using natural ingredients.
10. Strategy is partly proactive and partly reactive. In proactive strategy, organizations will analyze possible environmental scenarios and create strategic framework after proper planning and set procedures and work on these strategies in a predetermined manner.

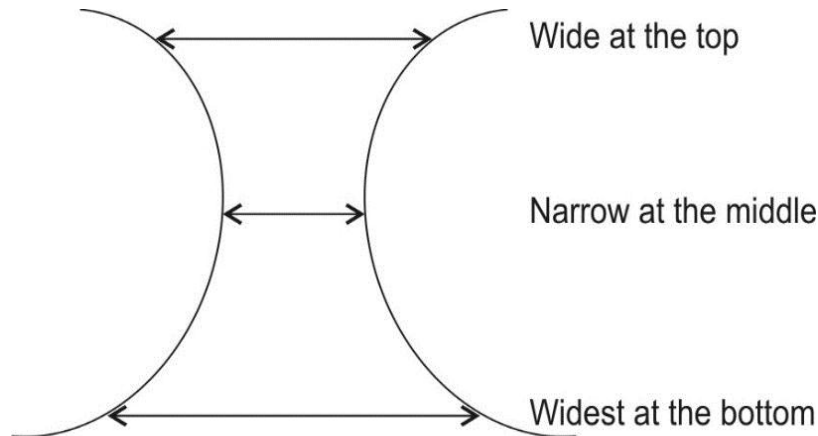
However, in reality no company can forecast both internal and external environment exactly. Everything cannot be planned in advance. It is not possible to anticipate moves of rival firms, consumer behaviour, evolving technologies and so on.

There can be significant deviations between what was visualized and what actually happens. Strategies need to be attuned or modified in the light of possible environmental changes. There can be significant or major strategic changes when the environment demands. Reactive strategy is triggered by the changes in the environment and provides ways and means to cope with the negative factors or take advantage of emerging opportunities.

11. Situational analysis forms an essential part of any business plan. Situational analysis implies that Organizational managers scan the external environment, identify potentially important environmental forces, assess their impact and influence, and adapt its direction and strategy as needed. A preliminary introduction as to what to take into account when conducting a situational analysis and provide a checklist of the important factors to consider are:
 - ◆ **Environmental factors:** What external and internal environmental factors are there that needs to be taken into account. This can include economic, political, demographic or sociological factors that have a bearing on the performance.
 - ◆ **Opportunity and issue analysis:** What are the current opportunities that are available in the market, the main threats that business is facing and may face in the future, the strengths that the business can rely on and any weaknesses that may affect the business performance.
 - ◆ **Competitive situation:** Analyze main competitors of the organization: Who are they, what they up to are, how they compare. What are their competitive advantages?
 - ◆ **Product situation:** The details about current product. The details about current product may be divided into parts such as the core product and any secondary or supporting services or products that also make up what you sell. It is important to observe this in terms of its different parts in order to relate this back to core client needs.
12. The ADL matrix has derived its name from Arthur D. Little which is a portfolio analysis method based on product life cycle. The approach forms a two dimensional matrix based on stage of industry maturity and the firm's competitive position, environmental assessment and business strength assessment. The role of ADL matrix is to assess the competitive position of a firm based on an assessment of the following criteria:
 - ◆ **Dominant:** This is a comparatively rare position and in many cases is attributable either to a monopoly or a strong and protected technological leadership.

- ◆ **Strong:** By virtue of this position, the firm has a considerable degree of freedom over its choice of strategies and is often able to act without its market position being unduly threatened by its competitors.
 - ◆ **Favourable:** This position, which generally comes about when the industry is fragmented and no one competitor stand out clearly, results in the market leaders a reasonable degree of freedom.
 - ◆ **Tenable:** Although the firms within this category are able to perform satisfactorily and can justify staying in the industry, they are generally vulnerable in the face of increased competition from stronger and more proactive companies in the market.
 - ◆ **Weak:** The performance of firms in this category is generally unsatisfactory although the opportunities for improvement do exist.
13. M/s. Nebula Pvt Ltd has opted Turnaround Strategy as the company while facing serious working capital crunch persistently conducted an assessment of current problem and developed a workable action plan based on short and long term financial needs and strategic issues. A workable action plan for turnaround would involve:
- Stage One – Assessment of current problems:** In the first step, assess the current problems and get to the root causes and the extent of damage.
- Stage Two – Analyze the situation and develop a strategic plan:** Identify major problems and opportunities, develop a strategic plan with specific goals and detailed functional actions.
- Stage Three – Implementing an emergency action plan:** If the organization is in a critical stage, an appropriate action plan must be developed to stop the bleeding and enable the organization to survive.
- Stage Four – Restructuring the business:** If the core business is irreparably damaged, then the outlook for the entire organization may be bleak. Efforts to be made to position the organization for rapid improvement.
- Stage Five – Returning to normal:** In the final stage of turnaround strategy process, the organization should begin to show signs of profitability, return on investments and enhancing economic value-added.
14. Divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit centre or SBU. For a multiple product company, divestment could be a part of rehabilitating or restructuring plan called turnaround.
- ◆ A divestment strategy may be adopted due to various reasons:
 - ◆ When a turnaround has been attempted but has proved to be unsuccessful.

- ◆ A business that had been acquired proves to be a mismatch and cannot be integrated within the company.
 - ◆ Persistent negative cash flows from a particular business create financial problems for the whole company.
 - ◆ Severity of competition and the inability of a firm to cope with it.
 - ◆ Technological upgradation is required if the business is to survive but where it is not possible for the firm to invest in it.
 - ◆ A better alternative may be available for investment.
15. Mr. Vicky Verma established personal contacts with potential buyers of the product and persuaded the marketing department over several physical meetings, and was finally able to make sales. The personal relation establishment and physical demonstration, indicates that Mr. Verma used the Personal Selling method of Promotion. Modern marketing is highly promotional oriented and include personal selling, advertising, publicity and sales promotion. Personal selling involves face to face interaction of sales persons with the prospective customers and provides a high degree of personal attention. It involves working with one customer at a time and hence not cost effective. The intention of oral communication is sale.
16. Research and Development (R&D) personnel can play an integral part in strategy implementation. These individuals are generally charged with developing new products and improving old products in a way that will allow effective strategy implementation. R&D employees and managers perform tasks that include transferring complex technology, adjusting processes to local raw materials, adapting processes to local markets, and altering products to particular tastes and specifications.
- Strategies such as product development, market penetration, and concentric diversification require that new products be successfully developed and that old products be significantly improved. But the level of management support for R&D is often constrained by resource availability.
17. The company Delta is transitioning into the Hourglass organization structure because it has used technological tools to transform various business processes and operations and has significantly diminished the role played by specialist managers of the middle management. The technological tool in addition to savings organisational costs by replacing many tasks of the middle management has also served as a link between top and bottom levels in the organization and assists in faster decision making. The skewed middle level managers now perform cross-functional duties. All these factors indicate towards Hourglass organization structure.



18. 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 office to exchange rewards such as pay, status symbols 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 static environment, in growing or mature industries and in organisations that are performing well.
3. Transformational leaders inspire employees by offering 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.

- 19. (i) Universal quality responsibility:** TQM requires that everyone takes responsibility for quality. The responsibility for quality is not restricted to an organization's quality assurance department, but is a guiding philosophy shared by everyone in an organization.
- (ii) Preventing rather than detecting defects:** TQM is a management philosophy that seeks to prevent poor quality in products and services, rather than simply to detect and sort out defects. This saves cost, time and wastages.
- (iii) Continuous improvement and learning:** TQM adopts a philosophy of continuous improvement in all areas. Improvement and learning need to be embedded in the way an organization operates. They should be a regular part of daily work, seeking to eliminate problems at their source.

20. Benchmarking is a process of finding the best practices within and outside the industry to which an organisation belongs. Knowledge of the best practices helps in setting standards and finding ways to match or even surpass own performances with the best performances.

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 such as mentioned below:

- Maintenance operations,
- Assessment of total manufacturing costs,
- Product development,
- Product distribution,
- Customer services,
- Plant utilisation levels; and
- Human resource management.

**Applicability of Standards/Guidance Notes/Legislative Amendments etc.
for November, 2020 – Intermediate (IPC) Examination**

Paper 5: Advanced Accounting

Accounting Standards

- AS 4: Contingencies and Events occurring after the Balance Sheet Date
- AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
- AS 11: The Effects of Changes in Foreign Exchange Rates
- AS 12: Accounting for Government Grants
- AS 16: Borrowing Costs
- AS 19: Leases
- AS 20: Earnings Per Share
- AS 26: Intangible Assets
- AS 29: Provisions, Contingent Liabilities and Contingent Assets.

Note:

I. Applicability of the Companies Act, 2013 and other Legislative Amendments for November, 2020 Examination

The relevant notified Sections of the Companies Act, 2013 and legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authorities up to 30th April, 2020 will be applicable for November, 2020 Examination.

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

Amendments made by MCA on 30.3.2016 in the Companies (Accounting Standards) Rules, 2006 are applicable for November, 2020 examination.

III. Non-Applicability of Ind AS for November, 2020 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, 2020 Examination.

Paper 6: Auditing and Assurance

I. Standards on Auditing (SAs)

S.No.	SA	Title of Standard on Auditing
1	SA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing

2	SA 210	Agreeing the Terms of Audit Engagements
3	SA 220	Quality Control for Audit of Financial Statements
4	SA 230	Audit Documentation
5	SA 240	The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements
6	SA 250	Consideration of Laws and Regulations in An Audit of Financial Statements
7	SA 260	Communication with Those Charged with Governance (Revised)
8	SA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
9	SA 299	Joint Audit of Financial Statements (Revised)
10	SA 300	Planning an Audit of Financial Statements
11	SA 315	Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
12	SA 320	Materiality in Planning and Performing an Audit
13	SA 330	The Auditor's Responses to Assessed Risks
14	SA 402	Audit Considerations Relating to an Entity Using a Service Organization
15	SA 450	Evaluation of Misstatements Identified during the Audits
16	SA 500	Audit Evidence
17	SA 501	Audit Evidence - Specific Considerations for Selected Items
18	SA 505	External Confirmations
19	SA 510	Initial Audit Engagements-Opening Balances
20	SA 520	Analytical Procedures
21	SA 530	Audit Sampling
22	SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
23	SA 550	Related Parties
24	SA 560	Subsequent Events
25	SA 570	Going Concern (Revised)
26	SA 580	Written Representations
27	SA 600	Using the Work of Another Auditor
28	SA 610	Using the Work of Internal Auditors (Revised)
29	SA 620	Using the Work of an Auditor's Expert
30	SA 700	Forming an Opinion and Reporting on Financial Statements (Revised)
31	SA 701	Communication Key Audit Matters in the Independent Auditor's Report (New)

32	SA 705	Modifications to the Opinion in the Independent Auditor's Report (Revised)
33	SA 706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report (Revised)
34	SA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements
35	SA 720	The Auditor's Responsibilities Relating to Other Information (Revised)

II. Applicability of the Companies Act, 2013 and other Legislative Amendments for November, 2020 Examination:

- (i) Students are expected to be updated with the notifications, circulars and other legislative amendments made upto 6 months prior to the examination. For instance, for **November, 2020** examination, significant notifications and circulars issued upto 30th April, 2020 would be relevant.

The relevant notified Sections of the Companies Act, 2013 and legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authority up to 30th April, 2020 will be applicable for November, 2020 Examination. It may be noted that the legislative and other amendments applicable for November, 2020 Examination would be given as Academic Update in the Revision Test Paper for November 2020 Examination.

- (ii) Companies (Auditor's Report) Order, 2016 issued by Ministry of Corporate Affairs on 29th March, 2016 is applicable for November, 2020 Examination.

List of topic-wise exclusion in the syllabus.

I. Statements

Statement on Reporting under Section 227(1A) of the Companies Act, 1956 (Section 143 (1) of the Companies Act, 2013).

II. Guidance Notes

1. Guidance Note on Audit of Inventories.
2. Guidance Note on Audit of Debtors, Loans and Advances.
3. Guidance Note on Audit of Investments.
4. Guidance Note on Audit of Cash and Bank Balances.
5. Guidance Note on Audit of Liabilities.
6. Guidance Note on Audit of Revenue.
7. Guidance Note on Audit of Expenses.
8. Guidance Note on Reporting under section 143(3) (f) and (h) of the Companies Act, 2013.