Auditing and Assurnce Answer Key (old syllabus)

1. A.

Types of Companies Covered Under CARO, 2016: The Companies (Auditor's Report) Order, 2016 is an additional reporting requirement Order which has been issued by the Central Government in consultation with the Institute of Chartered Accountants of India under section 143(11) of the Companies Act, 2013. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2O13. 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 rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.***

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

B.

Fundamental Accounting Assumptions: As per AS 1 on "Disclosure of Accounting Policies", accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements. There is no single list of accounting policies which are applicable to all circumstances. The choice of the appropriate accounting principles and the methods of applying those principles in specific circumstances call for judgement by the management. The profit or loss can be significantly affected by the accounting policies followed. Therefore, disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated.

In this context, AS 1 states that certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed. The following have been generally accepted as fundamental accounting assumptions-

(i) ***Going Concern:*** The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

(ii) ***Consistency:***It is assumed that accounting policies are consistent from one period to another.

(iii) ***Accrual:*** Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

Thus, if the fundamental accounting assumptions, viz., Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. However, if a fundamental accounting assumption is not followed, the fact should be disclosed.

C.

(c) ***Responsibility of Joint Auditor:*** The principles governing to responsibilities of joint auditor are prescribed in SA 299, "Responsibility of Joint Auditor". As per SA 299, if joint auditors are appointed, they should divide the audit work among themselves by mutual discussion. The division of work would usually be in terms of audit of identifiable units or specified areas. Such division of work should be adequately documented and preferably communicated to the entity.

It is the responsibility of each joint auditor to determine the nature, timing and extent of audit procedures to be applied in relation to the area of work allocated to him. The issue such as appropriateness of using test checks, sampling or other audit techniques should be decided by each joint auditor individually in relation to his work. Thus, the responsibility will not be shared by the other auditor. Therefore, it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him.

Hence, in respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. However, all the joint auditors are jointly and severally responsible in respect of the audit work which is not divided among the joint auditors and is carried out by all of them, in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors, in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors, for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute and for ensuring that the audit report complies with the requirements of the relevant statute.

2. A. Incorrect : Teeming and lading is one of the techniques of suppressing cash receipts and not of inflating cash payments. Money received from one customer is misappropriated and the account is adjusted with the subsequent receipt from another customer and so on.

B.

(vii) ***Incorrect***, it is the responsibility of the management for the maintenance of internal control system rather than of the Auditor. Because, Internal control is the process designed, implemented and maintained by those charged with governance, management to provide reasonable assurance about the achievement of entity's objectives.

C.

(j) Incorrect: As per section 139(6) of the Companies Act, 2013, if Board of Directors fail to appoint the first auditor in case of a company other than a Government company, 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.

D.

(ix) Incorrect: According to section 139 of the Companies Act, 2013, the provisions related to rotation of auditor are applicable to all private limited companies having paid up share capital of ₹ 50 crore or more; and 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 ₹ 50 crore or more.

Although company A is a private limited company having paid up share capital of ₹ 15 crores yet it is having public borrowings from nationalized bank of ₹ 50 crores, therefore it would be governed by provisions of rotation of auditor.

E.

(i) Correct: An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.

F.

(b) Incorrect. Examination in depth implies examination of a few selected transactions from the beginning to the end through the entire flow of the transaction. This examination consists of studying the recording of transactions at the various stages through which they have passed. At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so in terms of the prescribed procedure.

3. A.

Concept of "True and Fair": The concept of "true and fair" is a fundamental concept in auditing. The phrase "true and fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit.

This requires that the auditor should examine the accounts with a view to verifying that all assets and liabilities, incomes and expenses are stated at the amounts which are in accordance with accounting principles and policies, and no material item has been omitted.

The importance of the concept of true and fair view can also be understood and appreciated from the facts that sections 128, 129 and 143 of the Companies Act, 2013 also discusses this concept in relation to account books, financial statements and reporting on financial statements respectively.

Section 128(1) of the said Act provides that 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. The company shall be in a position to explain the transactions effected both at the registered office and its branches. Such books of Accounts shall be kept on accrual basis and according to the double entry system of accounting.

Section 129(1) of the Companies Act, 2013 provides that the financial statements shall give a true and fair view of the state of affairsof the company or companies, comply with the accounting standards notified under section 133 of the Companies Act, 2013, (in which the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority) and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III to the said Act.

The term "financial statement" shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under the said Act.

It may be noted that nothing contained in sub-section (1) shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

However, the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose-

(a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;

(b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;

(c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;

(d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

It may be noted that where the financial statements of a company do not comply with the accounting standards referred to in sub-section (1), the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

Further, according to section 143(2) of the said Act, the auditor is required to make a report to the members of the company indicating that, to the best of his information and knowledge, the 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.

SA 700 "Forming an Opinion and Reporting on Financial Statements", requires the auditor to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and express clearly that opinion through a written report that also describes the basis for the opinion. The auditor is required to express his opinion on the financial statements that it gives a true and fair view in conformity with the accounting principles generally accepted in India (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX; (b) in the case of the Statement of Profit and Loss, of the profit/ loss for the year ended on that date; and (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

B.

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

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

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

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

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

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

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

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

(viii) Inherent limitations of Audit.

4 A.

(c) Management's Responsibility for Compliance with Laws and Regulations: According to SA 250 on "Consideration of Laws and Regulations in an Audit of Financial Statements", it is management's responsibility, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations. Laws and regulations may affect an entity's financial statements in different ways for example, most directly; they may affect specific disclosures required of the entity in the financial statements. The following are the procedures an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations-

(i) Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.

(ii) Instituting and operating appropriate systems of internal control.

(iii) Developing, publicising and following a code of conduct.

(iv) Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.

(v) Engaging legal advisors to assist in monitoring legal requirements.

(vi) Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

(vii) Ensuring employees are properly trained and understand the code of conduct.

B.

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

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

C.

(viii) As per AS-26 on Intangible Assets, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. Therefore, computer software which is the integral part of the related hardware should be treated as fixed asset.

5 A.

(b) (i) Travelling Expenditure ₹ 50,000

- Expenditure has been actually incurred for the purpose of travelling.
- Travelling has been undertaken during the year under consideration.
- Total amount of expenditure incurred is ₹ 50,000 during the year.
- It has been treated as revenue expenditure and charged to Statement of Profit and Loss.

(ii) Trade receivable ₹ 2,00,000

- These include all sales transaction occurred during the year.
- These have been recorded properly and occurred during the year.
- These constitute assets of the entity.
- These have been shown at proper value, i.e. after showing the deduction on account of provision for bad and doubtful debts.

B.

Circumstances where Retiring Auditor Cannot be Reappointed: In the following circumstances, the retiring auditor cannot be reappointed-

(i) A specific resolution has not been passed to reappoint the retiring auditor.

(ii) The auditor proposed to be reappointed does not possess the qualification prescribed under section 141 of the Companies Act, 2013.

(iii) The proposed auditor suffers from the disqualifications under section 141(3), 141(4) and 144 of the Companies Act, 2013.

(iv) He has given to the company notice in writing of his unwillingness to be reappointed.

(v) A resolution has been passed in AGM appointing somebody else or providing expressly that the retiring auditor shall not be reappointed.

(vi) A written certificate has not been obtained from the proposed auditor to the effect that the appointment or reappointment, if made, will be in accordance within the limits specified under section 141(3)(g) of the Companies Act, 2013.

C.

(a) *Purchase of Goods on Credit by the Auditor:* Section 141(3)(d)(ii) of the Companies Act, 2013 specifies that a person shall be disqualified to act as an auditor if he is indebted to the company for an amount exceeding five lakh rupees.

Where an auditor purchases goods or services from a company audited by him on credit, he is definitely indebted to the company and if the amount outstanding exceeds rupees five lakh, he is disqualified for appointment as an auditor of the company.

It will not make any difference if the company allows him the same period of credit as it allows to other customers on the normal terms and conditions of the business. The auditor cannot argue that he is enjoying only the normal credit period allowed to other customers. In fact, in such a case he has become indebted to the company and consequently he has deemed to have vacated his office.

6 A.

(a) *Goods Sent Out on Sale or Return Basis:*

(i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.

(ii) See that price of such goods is unloaded from the sales account and the trade receivable's record. Refer to the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.

(iii) Ensure that the goods in respect of which the period of approval has expired at the close of the year either have been received back subsequently or customers' accounts have been debited.

(iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the close of the year lying with the party, has been included in the closing inventory.

B.

(a) *Advertisement Expenses:*

(i) Verify the bill/invoice from advertising agency to ensure that rates charged for different types of advertisement are as per contract.

(ii) See that advertisement relates to client's business.

(iii) Inspect the receipt issued by the agency.

(iv) Ascertain the nature of expenditure – revenue deferred and see that it has been recorded properly.

(v) Ascertain the period for which payment is made and see that pre-paid is carried forward to balance sheet.

(vi) Compare the statement of account with the ledger account.

(vii) See that all outstanding advertisement bills have been provided for.

C.

(b) Verification of Assets Acquired on Lease:

(i) Examine the terms and conditions of the lease deed.

(ii) If a part of the leasehold property has been sublet, examine the tenant's agreement.

(iii) Verify relevant document to check the cost of property.

(1) In case of acquisition of an asset is on operating lease, lease payment should be recognized as an expense in the Statement of Profit and Loss on a straight line basis over the lease term;

(2) In case of acquisition of an asset is on finance lease, ensure all the substantial risks and rewards to ownership are transferred, considering the indication as prescribed in AS-19, the lessee should recognize the lease as an asset and as a liability. Such recognition should be at an amount equal to the fair value of the leased assets at the inception of the lease. Ensure contingent rents are recognized as expense in the statement of profit & loss for the period in case of Finance lease.

(iv) Ensure assets acquired under finance lease are segregated from the assets owned.

(v) Ensure that the assets under lease have been properly disclosed as per requirement of Schedule III to the Companies Act, 2013.

7 A.

Unqualified Opinion: The auditor should express an unqualified opinion when he concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for preparation and presentation of the financial statements.

An unqualified opinion indicates that:

(i) The financial statements have been prepared using the generally accepted accounting principles and being constantly followed.

(ii) The financial statements comply with relevant statutory requirements and regulations.

(iii) All material matters relevant to proper presentation of the financial information, subject to statutory requirement, if applicable, have been adequately disclosed.

B.

(b) Significant Difficulties Encountered During the Audit: As per SA 260 "Communication with Those Charged with Governance", significant difficulties encountered during the audit may include such matters as-

(i) Significant delays in management providing required information.

(ii) An unnecessarily brief time within which to complete the audit.

(iii) Extensive unexpected effort required to obtain sufficient appropriate audit evidence.

(iv) The unavailability of expected information.

(v) Restrictions imposed on the auditor by management.

(vi) Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

(vii) In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.

C.

(a) Self-revealing Errors: These are such errors the existence of which becomes apparent in the process of compilation of accounts.

A few illustrations of such errors are given hereunder, showing how they become apparent-

(i)	Omission to post a part of a journal entry to the ledger.	Trial balance is thrown out of agreement.
(ii)	Wrong totaling of the Purchase Register.	Control Account (e.g., the Sundry Creditors Account) balances and the aggregate of the balances in the personal ledger will disagree.
(iii)	A failure to record in the cash book amounts paid into or withdrawn from the bank.	Bank reconciliation statement will show up error.
(iv)	A mistake in recording amount received from X in the account of Y.	Statements of account of parties will reveal mistake.

From the above, it is clear that certain apparent errors balance almost automatically by double entry accounting procedure and by following established practices that lie within the accounting system but not being generally considered to be a part of it, like bank reconciliation or sending monthly statements of account for confirmation.

<u>Costing and Financial Management Answer Key (Old Syllbus)</u>

1 a.

(i) Minimum stock of A

Re-order level – (Average consumption × Average time required to obtain delivery)

= 8,000 kg. – (200 units × 10 kg. × 2 weeks) = 4,000 kg.

(ii) Maximum stock of B

Re-order level – (Min. Consumption × Min. Re-order period) + Re-order quantity

= 4,750 kg. – (175 units × 4 kg. × 3 weeks) + 5,000 kg.

= 9,750 - 2,100 = 7,650 kg.

(iii) Re-order level of C

Maximum re-order period × Maximum Usage

= 4 weeks × (225 units × 6 kg.) = 5,400 kg.

OR

= Minimum stock of C + (Average consumption × Average delivery time)

= 2,000 kg. + [(200 units × 6 kg.) × 3 weeks] = 5,600 kg.

(iv) Average stock level of A

= Minimum stock level of A + $\frac{1}{2}$ Re-order quantity

= 4,000 kg. + $\frac{1}{2}$ 10,000 kg. = 4,000 + 5,000 = 9,000 kg.

OR

$= \frac{\text{Minimum stock + Maximum stock}}{2}$ (Refer to Working Note)

$= \frac{4{,}000 + 16{,}250}{2} = 10{,}125$ kg.

Working note

Maximum stock of A = ROL + ROQ – (Minimum consumption × Minimum re-order period)

= 8,000 kg. + 10,000 kg. – [(175 units × 10 kg.) × 1 week] = 16,250 kg.

1 b.

Statement of Equivalent Production

Process III

Input Details	Units	Output Particulars	Units	Equivalent Production					
				Material-A		Material-B		Labour & Overhead	
				%	Units	%	Units	%	Units
Opening WIP	1,600	Work on Op. WIP	1,600	-	-	20	320	40	640
Process - II Transfer	55,400	Introduced & completed during the month	50,600	100	50,600	100	50,600	100	50,600
		Normal loss (5% of 52,800 units)	2,640	-	-	-	-	-	-
		Closing WIP	4,200	100	4,200	70	2,940	50	2,100
		Abnormal Gain	(2,040)	100	(2,040)	100	(2,040)	100	(2,040)
	57,000		57,000		52,760		51,820		51,300

Working note:

Production units = Opening units + Units transferred from Process-II – Closing Units

= 1,600 units + 55,400 units – 4,200 units

= 52,800 units

Statement of Cost

	Cost (₹)	Equivalent units	Cost per equivalent units (₹)
Material A (Transferred from previous process)	6,23,250		
Less: Scrap value of normal loss (2,640 units × ₹ 5)	(13,200)		
	6,10,050	52,760	11.5627
Material B	2,12,400	51,820	4.0988
Labour	96,420	51,300	1.8795
Overheads	56,400	51,300	1.0994
	9,75,270		18.6404

Statement of apportionment of Process Cost

		Amount (₹)	Amount (₹)
Opening WIP	Material A		24,000
Completed opening WIP units -1600	Material B (320 units × ₹ 4.0988)	1311.62	
	Wages (640 units × ₹ 1.8795)	1202.88	
	Overheads (640 units × ₹ 1.0994)	703.62	3,218.12
Introduced & Completed - 50,600 units	50,600 units × ₹ 18.6404		9,43,204.24

Total cost of 52,200 finished goods units			9,70,422.36
Closing WIP units - 4,200	Material A (4,200 units × ₹ 11.5627)		48,563.34
	Material B (2,940 units × ₹ 4.0988)		12,050.47
	Wages (2,100 units × ₹ 1.8795)		3,946.95
	Overheads (2,100 units × ₹ 1.0994)		2,308.74
			66,869.50
Abnormal gain units - 2,040	(2,040 units × ₹ 18.6404)		38026.42

Process III A/c

Particulars	Units	Amount (₹)	Particulars	Units	Amount (₹)
To Balance b/d	1,600	24,000	By Normal loss	2,640	13,200
To Process II A/c	55,400	6,23,250	By Finished goods	52,200	9,70,422.36
To Direct material		2,12,400	By Closing WIP	4,200	66,874.06*
To Direct wages		96,420			
To Production overheads		56,400			
To Abnormal gain	2,040	38,026.42			
	59,040	10,50,496.42		59,040	10,50,496.42

* Difference in figure due to rounding off has been adjusted with closing WIP

2 a.

Statement of Cost and Profit under Marginal Costing for the year ending 31st March, 2014

Output = 3,20,000 units

Particulars	Amount (₹)	Amount (₹)
Sales: 3,10,000 units @ ₹ 80		2,48,00,000
Marginal cost / variable cost:		
Variable cost of production (3,20,000 × ₹ 40)	1,28,00,000	
Add: Opening stock 40,000 units @ ₹ 40	16,00,000	
	1,44,00,000	
Less: Closing Stock $\left(\frac{₹1,44,00,000}{3,60,000\text{units}} \times 50,000\text{units}^*\right)$	(20,00,000)	
Variable cost of production of 3,10,000 units	1,24,00,000	
Add: Variable selling expenses @ ₹ 12 per unit	37,20,000	1,61,20,000
Contribution (sales – variable cost)		86,80,000
Less: Fixed production cost	24,00,000	
Fixed selling expenses	16,00,000	(40,00,000)
Actual profit under marginal costing		46,80,000

* Closing stock = 40,000 + 3,20,000 – 3,10,000 = 50,000 units

Statement of Cost and Profit under Absorption Costing for the year ending 31st March, 2014

Output = 3,20,000 units

Particulars	Amount (₹)	Amount (₹)
Sales: 3,10,000 units @ ₹ 80		2,48,00,000
Less: Cost of Goods sold:		
Variable cost of production (3,20,000 @ ₹ 40)	1,28,00,000	
Add: Fixed cost of production absorbed 3,20,000 units @ ₹ 6 [(1)]	19,20,000	
	1,47,20,000	
Add: Opening Stock: $\left(\frac{₹1,47,20,000}{3,20,000} \times 40,000\right)$	18,40,000	
	1,65,60,000	
Less: Closing Stock: $\left(\frac{₹1,65,60,000}{3,60,000} \times 50,000\right)$	(23,00,000)	
Production cost of 3,10,000 units	1,42,60,000	
Adjustment for Over/ under-absorption:		
Under absorption of fixed production overheads [(2)]	4,80,000	
Cost of Goods Sold	1,47,40,000	
Selling expenses:		
Variable: ₹ 12 × 3,10,000 units	37,20,000	
Fixed	16,00,000	(2,00,60,000)
Actual profit under absorption costing		47,40,000

Workings:

1. Absorption rate for fixed cost of production = $\frac{₹\ 24,00,000}{4,00,000 \text{ units}}$ = ₹ 6 per unit

2. Fixed production overhead under absorbed = ₹ (24,00,000 – 19,20,000)
   = ₹ 4,80,000.

2 b.

Working Note:

Average number of workers on roll:

$$\text{Labour turnover rate under replacement method} = \frac{\text{No. of replacements}}{\text{Average number of workers on roll}} \times 100$$

$$\text{Or, } \frac{5}{100} = \frac{30}{\text{Average number of workers on roll}}$$

$$\text{Or Average number of workers on roll} = \frac{30 \times 100}{5} = 600$$

(1) *Number of workers recruited and joined :*

$$\text{Labour turnover rate (Flux method)} = \frac{\text{No. of separations * (S)} + \text{No. of accessions(A)}}{\text{Average number of workers on roll}} \times 100$$

$$\text{Or } \frac{10}{100} = \frac{18^* + A}{600}$$

$$\text{Or } A = \left[\frac{6000}{100} - 18\right] = 42$$

No. of workers recruited and joined 42.

(2) *Number of workers left and discharged :*

$$\text{Labour turnover rate (\textit{Separation method})} = \frac{\text{No. of separations(S)}}{\text{Average number of workers on roll}} \times 100$$

$$\frac{3}{100} = \frac{S}{600}$$

$$\text{Or } S^* = 18$$

Hence, number of workers left and discharged comes to 18.

3 a.

$$A = P\left(\frac{I(1+I)^n}{(1+I)^n - 1}\right)$$

Where,

A = Amount of Instalment

P = Principal amount of loan

I = Interest rate

n = Loan repayment period.

$$A = 30{,}00{,}000\left(\frac{0.14(1+0.14)^{10}}{(1+0.14)^{10} - 1}\right)$$

$$A = 30{,}00{,}000 \times \frac{0.14 \times 3.707}{2.707}$$

A = 5,75,153

Or

$$A = \frac{P}{PVIFA_{n,I}}$$

$$A = \frac{30{,}00{,}000}{PVIFA_{10,0.14}} = \frac{30{,}00{,}000}{5.216} = 5{,}75{,}153$$

3 b.

(a) Pattern of raising additional finance

Equity	70% of ₹ 10,00,000	= ₹ 7,00,000
Debt	30% of ₹ 10,00,000	= ₹ 3,00,000

The capital structure after raising additional finance:

		(₹)
Shareholders' funds		
Equity Capital	(7,00,000–2,10,000)	4,90,000
Retained earnings		2,10,000
Debt (Interest at 10% p.a.)		1,80,000
(Interest at 16% p.a.)	(3,00,000–1,80,000)	1,20,000
Total Funds		10,00,000

(b) Determination of post-tax average cost of additional debt

$K_d = I\,(1 - t)$

Where,

I = Interest Rate

t = Corporate tax-rate

On ₹ 1,80,000 = 10% (1 – 0.5) = 5% or 0.05

On ₹ 1,20,000 = 16% (1 – 0.5) = 8% or 0.08

Average Cost of Debt

$$= \frac{(₹\ 1{,}80{,}000 \times 0.05) + (₹\ 1{,}20{,}000 \times 0.08)}{₹\ 3{,}00{,}000} \times 100 = 6.2\%$$

(c) Determination of cost of retained earnings and cost of equity applying Dividend growth model:

$$K_e = \frac{D_1}{P_0} + g$$

Where,

K_e = Cost of equity

$D_1 = D_0(1+ g)$

D_0 = Dividend paid (i.e., 50% of EPS = 50% × ₹ 4 = ₹ 2)

g = Growth rate

P_0 = Current market price per share

Then, $$K_e = \frac{₹\ 2(1.1)}{₹\ 44} + 0.10 = \frac{₹\ 2.2}{₹\ 44} + 0.10 = 0.05 + 0.10 = 0.15 = 15\%$$

4 a.

Statement showing the requirements of Working Capital

Particulars	**(₹)**	**(₹)**
A. Current Assets:		
Inventory:		
Stock of Raw material (₹96,600 × 2/12)	16,100	
Stock of Work-in-progress (As per Working Note)	16,350	
Stock of Finished goods (₹1,46,500 × 10/100)	14,650	
Receivables (Debtors) (₹1,27,080 × 2/12)	21,180	
Cash in Hand	8,000	
Prepaid Expenses:		
Wages & Mfg. Expenses (₹66,250 × 1/12)	5,521	
Administrative expenses (₹14,000 × 1/12)	1,167	
Selling & Distribution Expenses (₹13,000 × 1/12)	1,083	
Advance taxes paid {(70% of ₹10,000)× 3/12}	1,750	
Gross Working Capital	85,801	85,801
B. Current Liabilities:		
Payables for Raw materials (₹1,12,700 × 1.5/12)	14,088	
Provision for Taxation (Net of Advance Tax) (₹10,000 × 30/100)	3,000	
Total Current Liabilities	17,088	17,088
C. Excess of CA over CL		68,713
Add: 10% for unforeseen contingencies		6,871
Net Working Capital requirements		75,584

Working Notes:

(i) Calculation of Stock of Work-in-progress

Particulars	(₹)
Raw Material (₹ 84,000 × 15%)	12,600
Wages & Mfg. Expenses (₹62,500 × 15% × 40%)	3,750
Total	16,350

(ii) Calculation of Stock of Finished Goods and Cost of Sales

Particulars	(₹)
Direct material Cost [₹ 84,000 + ₹ 12,600]	96,600
Wages & Mfg. Expenses [₹ 62,500 + ₹ 3,750]	66,250
Depreciation	0
Gross Factory Cost	1,62,850
Less: Closing W.I.P	(16,350)
Cost of goods produced	1,46,500
Less: Closing stock	(14,650)
	1,31,850
Add: Administrative Expenses	14,000
Cost of Goods Sold	1,45,850
Add: Selling and Distribution Expenses	13,000
Total Cash Cost of Sales	1,58,850
Debtors (80% of cash cost of sales)	1,27,080

(iii) Calculation of Credit Purchase

Particulars	(₹)
Raw material consumed	96,600
Add: Closing Stock	16,100
Less: Opening Stock	-
Purchases	1,12,700

4 b.

Two Basic Functions of Financial Management

Procurement of Funds: Funds can be obtained from different sources having different characteristics in terms of risk, cost and control. The funds raised from the issue of equity shares are the best from the risk point of view since repayment is required only at the time of liquidation. However, it is also the most costly source of finance due to dividend expectations of shareholders. On the other hand, debentures are cheaper than equity shares due to their tax advantage. However, they are usually riskier than equity shares. There are thus risk, cost and control considerations which a finance manager must consider while procuring funds. The cost of funds should be at the minimum level for that a proper balancing of risk and control factors must be carried out.

Effective Utilization of Funds: The Finance Manager has to ensure that funds are not kept idle or there is no improper use of funds. The funds are to be invested in a manner such that they generate returns higher than the cost of capital to the firm. Besides this, decisions to invest in fixed assets are to be taken only after sound analysis using capital budgeting techniques. Similarly, adequate working capital should be maintained so as to avoid the risk of insolvency.

5.

Statement of Cash Flow for the year ending 31st Mach, 20X8

	(₹)
Cash flow from Operating Activities	
Surplus during the year (₹3,00,000 – ₹2,10,000)	90,000
Adjustments:	
Add: Transfer to General Reserve	25,000
Provision for Tax	96,000
Proposed Dividend	1,44,000
Profit before Tax	3,55,000
Depreciation:	
Land and Building (₹7,00,000 – ₹6,50,000)	50,000
Plant and Machinery	1,20,000
Loss on sale of Plant and Machinery	9,000
Goodwill written off (₹1,00,000 – ₹80,000)	20,000
Interest on 11% Debentures (11% of ₹3,00,000)	33,000
Less: Profit on sale of Investments	(15,000)
Operating profit before working capital changes	5,72,000
Decrease in Prepaid expenses	4,000
Decrease in Inventories	15,000
Increase in Trade receivables	(1,27,000)
Increase in Trade payables	30,000
Cash generated from operations	4,94,000
Less: Income tax paid	(71,000)
Net Cash from Operating activities (A)	4,23,000
Cash flow from Investing Activities	
Sale of investment {(₹2,40,000 – ₹2,20,000) + ₹15,000}	35,000
Sale of Plant and Machinery	36,000
Purchase of Plant and Machinery	(2,25,000)
Net cash from Investing activities (B)	(1,54,000)
Cash Flow from Financing Activities	
Issue of 8% Preference shares	1,00,000
Premium received in issue of shares	25,000
Redemption of 11% Debentures (including premium)	(2,20,000)
Dividend paid	(1,36,000)
Interest paid to 11% Debenture holders	(33,000)
Net cash from Financing activities (C)	(2,64,000)
Net Increase/(Decrease) in cash and cash equivalents (A+B+C)	5,000
Cash and cash equivalent at the beginning of the year	88,000
Cash and cash equivalent at the end of the year	93,000

Working Notes:

(1) Provision for the Tax Account

	(₹)		(₹)
To Bank (paid)	71,000	By Balance b/d	80,000
To Balance c/d	1,05,000	By Statement of P&L	96,000
	1,76,000		1,76,000

(2) Investment Account

	(₹)		(₹)
To Balance b/d	2,40,000	By Bank A/c	35,000
To Statement of P&L (Profit on sale)	15,000	By Balance c/d	2,20,000
	2,55,000		2,55,000

(3) Plant and Machinery Account

	(₹)		(₹)
To Balance b/d	6,00,000	By Bank (sale)	36,000
To Bank a/c (Purchase)	2,25,000	By Statement of P&L (Loss on sale)	9,000
		By Depreciation	1,20,000
		By Balance c/d	6,60,000
	8,25,000		8,25,000

Note: Since the date of redemption of debentures is not mentioned in the question, therefore, it is assumed that the debentures are redeemed at the beginning of the year.

(ii) Schedule of Changes in Working Capital

Particulars	31st March		Change in Working Capital	
	20X7 (₹)	20X8 (₹)	Increase (₹)	Decrease (₹)
Current Assets				
Inventories	4,00,000	3,85,000	--	15,000
Trade receivables	2,88,000	4,15,000	1,27,000	--
Prepaid Expenses	15,000	11,000	–	4,000
Cash and Bank	88,000	93,000	5,000	--
Total (A)	7,91,000	9,04,000		
Current Liabilities				
Trade payables	1,85,000	2,15,000	--	30,000
Total (B)	1,85,000	2,15,000		
Working Capital (A – B)	6,06,000	6,89,000		
Increase in Working Capital	83,000	--	--	83,000
	6,89,000	6,89,000	1,32,000	1,32,000

Business law, Ethics and Communication Ans Key

1.

The Iron Law of Responsibility: The institution of business exists only because it performs invaluable services for society. Society gives business its license to exist and this can be amended or revoked at any time if it fails to live up to society's expectations. Therefore, if a business intends to retain its existing social role and power, it must respond to society's needs constructively. This is known as the "Iron Law of Responsibility". In the long-term those who do not use power in a manner that society considers responsible, will tend to lose it.

Businesses have been delegated economic power and have access to productive resources of a community. They are obliged to use these resources for the common good of society so that more wealth for its betterment may be generated. Technical and creative resources are also helpful to it. A business organisation sensitive to community needs would in its own self interest like to have a better community within which the business may be conducted. This way, the resulting benefits would be:

(a) Decrease in crime

(b) Easier labour recruitment

(c) Reduced employee absenteeism.

(d) Easier access to international capital, better conditions for loans on international money markets.

(e) Dependable and preferred as supplier, exporter, importer and retailer of responsibly manufactured components and products.

This way a better society would produce a better environment in which the business may gain long term profit maximization.

2.

Comprehensive rules and regulations have been incorporated into the Companies Act, 2013 in respect of this basic document which is the only source of vital information for the investors to ascertain the soundness or otherwise of the company. Since the prospectus is intended to save the investing public from victimisation, the Legislature has aimed at securing the fullest disclosure of all material and essential particulars and laying the same before all the prospective buyers of shares and imposing stringent liabilities for violations.

Briefly the rules and regulations are as follows:

(i) **Matters to be stated in a Prospectus** – In order to provide a thorough and comprehensive information on all aspects of the company and the proposed issue, section 26 (1) of the Companies Act, 2013 lists down a large list of items that must be stated in the Prospectus.

(ii) Registration of prospectus – Section 26 (4) provides that no prospectus shall be issued by or on behalf of a company or in relation to an intended company, unless on or before the date of its publication, there has been delivered to the Registrar for registration, a copy thereof signed by every person or his duly authorized representative, who is named therein as a director or proposed director of the company.

Under sub section (7) it is provided that the Registrar shall not register the prospectus unless the requirements for registration under section 26 are complied with and the prospectus is accompanied by the consent of all the persons named in the prospectus.

(iii) Approval of prospectus by various agencies: The draft prospectus has to be approved by various agencies before it is filed with the ROC of the concerned State.

(iv) The lead financial institution underwriting the issue, if applicable: The draft prospectus is vetted by SEBI to ensure adequacy of disclosures. However, vetting by SEBI does not amount to approval of prospectus. SEBI does not take any responsibility for the correctness of the statements made or opinions expressed in the prospectus.

3.

Meaning: "Corporate governance is about promoting corporate fairness, transparency and accountability. It is concerned with the structures and processes for decision-making, accountability, control and behavior at the top level of organizations. It influences how the objectives of an organization are set and achieved, how risk is monitored and assessed and how performance is optimized.

Measures: In general, corporate governance measures include appointing non-executive directors, placing constraints on management power and ownership concentration, as well as ensuring proper disclosure of financial information and executive compensation. Many companies have established ethical and/or social responsibility committees on their Boards to review strategic plans, assess progress and offer guidance on social responsibilities of their business. In addition to having committees and Boards, some companies have adopted guidelines governing their own policies around such issues like board diversity, independence, and compensation. Indian companies are also required to comply with Clause 49 of the listing agreement.

4.

A formal communication flows along prescribed channels which all organizational members desirous of communicating with one another are obliged to follow. Every organization has built-in hierarchical system, communication in an organization is multidirectional. On the basis of various directions in which communications are sent, we can classify formal communication in these forms:

(i) Downward Communication

(ii) Upward Communication

(iii) Horizontal or Lateral Communication

(iv) Diagonal or Crosswise Communication

Communication generally flows from top to bottom. Downward communication means communication from superior to subordinate in the hierarchical system of the organization. It includes orders and instructions. In upward communication, message flows from the subordinate to superior in the form of request, reports, instructions complaints and suggestions. Communication between co-workers with different areas of responsibility is called horizontal (lateral) communication. Communication among the functional managers of a company is the best example of horizontal communication. Diagonal communication means communication among the various Department/employees of the organization without any hierarchical system in case of emergency.

5.

Under Section 118 (5) of the Companies Act, 2013 there shall not be included in the Minutes of a meeting, any matter which, in the opinion of the Chairman of the meeting:

(i) is or could reasonably be regarded as defamatory of any person;

(ii) is irrelevant or immaterial to the proceeding; or

(iii) is detrimental to the interests of the company;

Further under section 118 (6) the chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the Minutes on the grounds specified in sub-section (5) above.

Hence, in view of the above, the contention of M, a shareholder of PQR Limited is not valid because the Chairman has absolute discretion on the inclusion or exclusion of any matter in the minutes for aforesaid reasons.

[Note: Ministry Vide Notification G.S.R. 466 (E) dated 5th June 2015, in case of section 8 companies, section 118 shall not apply as a whole except that minutes may be recorded within 30 days of the conclusion of every meeting in case of companies where articles of association provide for confirmation of minutes by circulation]

6.

"Eligible company" means a public company as referred to in sub-section (1) of section 76, having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies before making any invitation to the Public for acceptance of deposits :

However, an eligible company, which is accepting deposits within the limits specified under clause (c) of sub-section (1) of section 180, may accept deposits by means of an ordinary resolution.

An eligible company shall accept or renew any deposit from its members, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members exceeds ten per cent. of the aggregate of the Paid-up share capital, free Reserves and securities premium account of the company.

ABC Limited is having a net worth of 120 crore rupees. Hence, it can fall in the category of eligible company.

Thus, ABC has to ensure that acceptance deposits from members should not exceed 10% of the aggregate of the Paid-up share capital, free Reserves and securities premium account of the company.