

INTERMEDIATE COURSE
GROUP – II

REVISION TEST PAPERS

MAY, 2022



BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(Set up by an Act of Parliament)
New Delhi

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Contents

	<i>Page Nos.</i>
Objective & Approach	<i>i –vii</i>
<i>Objective of Revision Test Paper</i>	<i>i</i>
<i>Planning & Preparing for Examination</i>	<i>ii</i>
<i>Subject-wise Guidance – An Overview</i>	<i>iii</i>
Paper-wise RTPs	
Paper 5: Advanced Accounting.....	1 – 46
<i>Part – I : Announcements Stating Applicability & Non-Applicability</i>	1
<i>Part – II : Questions and Answers</i>	2 – 46
Paper 6: Auditing and Assurance	47 – 79
<i>Part – I : Academic Update</i>	47
<i>Part – II : Questions and Answers</i>	48 – 79
Paper 7: Enterprise Information Systems and Strategic Management	80 – 105
Section A: Enterprise Information Systems	80 – 93
Section B: Strategic Management	94 – 105
Paper 8: Financial Management and Economics for Finance	106 – 135
Section A: Financial Management.....	106 – 126
Section B: Economics for Finance.....	127 – 135
Applicability of Standards/Guidance Notes/Legislative Amendments etc. for May, 2022 – Intermediate Examination	136 – 139

REVISION TEST PAPER, MAY, 2022 – 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 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.

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.icaai.org under the BOS knowledge portal in students section for downloading.

II. Planning and preparing for examination

Ideally, when the RTP reaches your hand, you must have finished reading the relevant Study Materials of all the subjects. Make sure that you have read the Study Materials thoroughly as they cover the syllabus comprehensively. Get a good grasp of the concepts/provisions discussed therein. Solve each and every question/illustration given therein to understand the application of the concepts and provisions.

After reading the Study Materials thoroughly, you should go through the Updates provided in the RTP and then proceed to solve the questions given in the RTP on your own. RTP is an effective tool to revise and refresh the concepts and provisions discussed in the Study Material. RTPs are provided to you to help you assess your level of preparation. Hence you must solve the questions given therein on your own and thereafter compare your answers with the answers given therein.

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 answers 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 Announcement stating Applicability and Non-Applicability for May, 2022 examination and Part II –Questions and Answers.

It may be noted that the September, 2021 edition of the Study Material is relevant for May, 2022 Examination.

Part I of the Revisionary Test Paper consists of the 'Relevant Amendments and Notifications - applicable and not applicable' for May, 2022 examination. The purpose of this information in the RTP is to apprise the students with the latest developments applicable for May, 2022 examination. The brief summary of the same has been given as under:

A. Applicable for May, 2022 examination:

- Amendments in Schedule III (Division I) to the Companies Act, 2013
- Revised Guidance Note on Accounting for Share-based Payments for the topic 'Accounting for ESOPs'.

B. Not applicable for May, 2022 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 eleven questions are based on different topics discussed in the study material. Last nine 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
1a	Dissolution of partnership firm
1b	Limited Liability Partnerships

2	Sale of Partnership firm to a company
3	Accounting for ESOPs
4	Buy Back of Securities
5	Equity Shares with Differential Rights
6	Amalgamation of companies
7	Internal Reconstruction of a Company
8	Liquidation of a Company
9	NBFCs
10	Banking Companies
11	Consolidated Financial Statements
12 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 and other modes of knowledge like student journal, bare acts etc.

The Revisionary Test Paper (RTP) of Auditing and Assurance for May, 2022 carries twenty eight descriptive questions along with Integrated Case Scenarios followed by MCQs and standalone MCQs along with their answers. These questions have been taken from the entire syllabus which is divided into thirteen 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, Objective and Scope of Audit, Audit Strategy, Audit Planning and Audit Programme, Audit Documentation and Audit Evidence, Risk Assessment and Internal Control, Fraud and Responsibilities of Auditor in this Regard, Audit in an Automated Environment, Audit Sampling, Analytical Procedures, Audit of Items of Financial Statements, The Company Audit, Audit Report, Audit of Banks and Audit of Different Types of Entities. 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 May, 2022 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 31st October, 2021 are applicable for May, 2022 Examination. The questions have been answered in this RTP keeping in view latest amendments as per above mentioned date.

PAPER – 7: ENTERPRISE INFORMATION SYSTEMS AND STRATEGIC MANAGEMENT

Section – A: Enterprise Information Systems

The Revision Test Paper on Enterprise Information Systems is a supplementary tool that provides comprehensive coverage 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 May 2022 examination contains total 15 questions out of which first 5 questions are Multiple Choice Questions (MCQ) based on Integrated Case Scenario to test Analysis and Application skillset of the student. Each MCQ has four options out of which students are required to select only one correct option.

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 complete syllabus to check the students' preparedness on answering the questions based on different skill levels "Comprehension & Knowledge" as well as "Analysis & Application". The questions provide an insight to the students to evaluate their understanding of the fundamental concepts of Information Systems and Business Process flows, Financial and Accounting Systems, Core Banking Systems and e-Commerce/m-Commerce transactions. Full answer to each descriptive question is provided so that students would be benefited without searching the answers in the study material.

Section – B: Strategic Management

The Revision Test Paper in the subject of Strategic Management for the May 2022 examination contains twenty-two 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, sixteen different questions have been included to cover all the eight 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 – 8: FINANCIAL MANAGEMENT AND ECONOMICS FOR FINANCE

Section A: Financial Management

The Revision Test Paper (RTP) of Financial Management comprises of ten questions for full coverage of the syllabus. Theoretical questions along with computational problems have also been incorporated so that you can give emphasis to the theoretical portion of the syllabus as well. Since this paper's inclination is more towards numerical-oriented questions which involve mathematical calculations, therefore, it is very important that you have thoroughly studied the theoretical aspects of the subject and are also clear about the concepts and logic behind the mathematical workings and formulae.

A summary of the questions both theoretical and computational has been given for your reference:

Q. No.	Topic	About the Problem
1.	Ratio Analysis	Determination of Sales, Debtors, Closing Stock, Creditors, Fixed Assets using ratios.
2.	Cost of Capital	Determination of WACC.
3.	Capital Structure	Determination of market value, Equity capitalization rate and WACC as per MM Approach.
4.	Leverage	Preparation of Income Statement.
5.	Investment Decisions	Concept of Replacement Decision of old machine.
6.	Risk Analysis in Capital Budgeting	Determination of NPV in different scenarios.

7.	Dividend Decisions	Calculation of dividend pay-out ratio and the price of share.
8.	Management of Cash	Computation of cash from operations to be available after certain period.
9.	Management of working capital	Estimation of working capital.
10 (a)	Scope and objectives of Financial Management	Profit maximization.
10 (b)	Scope and objectives of Financial Management	Agency problem and its cost.

Section B: Economics for Finance

At the intermediate level, students are expected to acquire not only professional knowledge but also the ability to apply such knowledge in problem solving. Therefore, the questions have been framed in such a manner that not only your knowledge and understanding are tested but also how you apply this knowledge in solving problems.

The first question relates to simple calculations of National Income aggregate and Keynesian theory in determination of National income.

Second question is about Keynesian theory in determination of National income and Calculation of Multiplier.

Third question relates to Allocation of resources, information failure, discretionary and non-discretionary fiscal Policy & Money Supply.

The fourth question is about Credit Multiplier, Compound and Mixed tariff & Voluntary export restraint.

Fifth question relates to Functioning of WTO, Income Leakage affecting multiplier, Calculation of National Income & Liquidity preference of behaviour towards risk.

Some answers have been given in detail so as to enable you to understand and comprehend the steps involved in answering/solving the problems; for others only, hints have been provided. Students must attempt the questions themselves under examination conditions and then see the answers. This will help you in knowing your level of preparedness and further strategize your final preparation and presentation.

PAPER – 5: ADVANCED ACCOUNTING

PART – I: ANNOUNCEMENTS STATING APPLICABILITY & NON-APPLICABILITY FOR MAY, 2022 EXAMINATION

A. Applicable for May, 2022 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 (18 of 2013), the Central Government made amendments in Schedule III (Division I) to the said Act, vide MCA Notification dated 24th March, 2021, applicable with effect from 1st day of April, 2021. These amendments have been incorporated in Appendix “Schedule III to the Companies Act” in Module II of September, 2021 Edition. The students are advised to refer the link <https://resource.cdn.icai.org/66657bos53803-mod2-appx.pdf> for the revised content.

- II. The Institute of Chartered Accountants of India revised the Guidance Note on Accounting for Share-based Payments in year 2020. This revised Guidance Note is applicable for the topic “Accounting for Employee Stock Option Plans” for May, 2022 Examination. The provisions of the Guidance Note cover employee stock option plans, the grant date in respect of which falls on or after 1 April 2021. An enterprise is not required to apply this Guidance Note to employee stock option plans to equity instruments that are not fully vested as on 1 April 2021. The chapter on “Employee Stock Option Plans” given in Module II of September, 2021 Edition of the Study Material is revised accordingly. The students are advised to refer link <https://resource.cdn.icai.org/66641bos53803-cp3.pdf> for the revised chapter.

NOTE: September, 2021 Edition of the Study Material on Paper 5 Advanced Accounting is applicable for May 2022 Examination which incorporates the above amendments. The students who have editions prior to September, 2021 may refer the revised content for the amendments.

B. Not applicable for May, 2022 examination

Non-Applicability of Ind AS for May, 2022 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 May 2022 Examination.

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

Dissolution of Partnership Firm

1. (a) The firm of M/s Om has four partners - A,B,C & D and as of 31st March, 2021, its Balance Sheet stood as follows:

Equity and Liabilities	₹	Assets	₹
Capital A/cs:		Land	50,000
A	2,00,000	Building	2,50,000
B	2,00,000	Office equipment	1,25,000
C	1,00,000	Computers	70,000
Current A/cs:		Debtors	4,00,000
A	50,000	Stocks	3,00,000
B	1,50,000	Cash at Bank	75,000
C	1,10,000	Other Current Assets	22,600
Loan from NBFC	5,00,000	Current A/c:	
Current Liabilities	70,000	D	87,400
	13,80,000		13,80,000

The partners have been sharing profits and losses in the ratio of 4:4:1:1. It has been agreed to dissolve the firm on 1.4.2021 on the basis of the following understanding:

- (a) The following assets are to be adjusted to the extent indicated with respect to the book values:
- | | |
|-----------|------|
| Land | 200% |
| Building | 120% |
| Computers | 70% |
| Debtors | 95% |
| Stocks | 90% |
- (b) In the case of the loan, the lenders are to be paid at their insistence a prepayment premium of 1%.
- (c) D is insolvent and no amount is recoverable from him. His father, C, however, agrees to bear 50% of his deficiency. The balance of the deficiency is agreed to be apportioned according to law.

(d) The assets are realized at the agreed (adjusted) values.

Assuming that the realization of the assets and discharge of liabilities is carried out immediately, show the Cash A/c, Realization Account and the Partners' capital accounts (including their current accounts).

Limited Liability Partnerships

(b) Explain the nature of a Limited Liability Partnership. Under what circumstances, an LLP may be wound up voluntarily or by the Tribunal?

Sale of Partnership firm to a company

2. U and V were in partnership with sharing of profit and loss equally. The firm's Balance sheet as at 31/12/2021 (for 9 months) was:

Equity and Liabilities		Assets	
Partners' Capital Accounts:		Plant	1,85,000
U	1,50,000	Building	1,00,000
V	<u>1,80,000</u>	Debtors	85,000
Sundry Creditors	90,000	Stock	56,000
Bank Overdraft	83,000	Profit & Loss A/c (Dr. balance)	60,000
		Partners' Drawings Accounts:	
		U	8,000
		V	<u>9,000</u>
			17,000
Total	5,03,000	Total	5,03,000

The operations of the business were carried on till 31/03/2022. U and V both withdrew in equal amount half the amount of profit made during the current period of three months after charging depreciation of ₹ 5,000 on plant and after writing off 5% of building. During the current period of three months, creditors were reduced by ₹ 50,000 and bank overdraft by ₹ 50,000. The stock was valued at ₹ 24,000 and debtors at ₹ 40,500 on 31st March, 2022. The other items remained the same as at 31/12/2021.

On 31/03/2022, the firm sold its business to UV Limited. The value of goodwill was estimated at ₹ 1,84,000 and the remaining assets were valued on the basis of the balance sheet as on 31/03/2022 except building and stock, which were valued as below:

Building ₹ 1,20,000
 Stock ₹ 36,000

UV Limited paid the purchase consideration in equity shares of ₹ 10 each. You are required to prepare (with necessary working notes):

(i) Balance sheet of the firm as at 31/03/2022.

- (ii) Realization account and
- (iii) Partners' capital accounts showing the final settlement between them.

Accounting for ESOPs

3. (a) Define the following terms:
- (i) Vesting
 - (ii) Grant date
 - (iii) Exercise Price
- (b) Noor Ltd. has its share capital divided into equity shares of ₹ 10 each. On 1.1.2021 it granted 4,000 employee stock options at ₹ 40 per share, when the market price was ₹ 60 per share. Fair value per option was ₹ 20. The options were to be exercised between 15th March, 2021 and 31st March, 2021. The employees exercised their options for 2,500 shares only and the remaining options lapsed. The company closes its books on 31st March every year. You are required to give Journal entries (with narration) as would appear in the books of the company for the year ended 31st March, 2021.

Buy Back of Securities

4. Complicated Ltd. (an unlisted company) gives the following information as on 31.3.2021:

Particulars	Amount (₹)
Equity shares of ₹ 10 each, fully paid up	13,50,000
Share option outstanding Account	4,00,000
Revenue Reserve	15,00,000
Securities Premium	2,50,000
Profit & Loss Account	1,25,000
Capital Reserve	2,00,000
Unpaid dividends	1,00,000
12% Debentures (Secured)	18,75,000
Advance from related parties (Long term - Unsecured)	10,00,000
Current maturities of long term borrowings	16,50,000
Application money received for allotment due for refund	2,00,000
Property, plant and equipment	46,50,000
Current assets	40,00,000

The Company wants to buy back 25,000 equity shares of ₹ 10 each, on 1st April, 2021 at ₹ 15 per share. Buy back of shares is duly authorized by its Articles and necessary resolution has been passed by the Company for this. The buy-back of shares by the Company is also within the provisions of the Companies Act, 2013. The payment for buy back of shares was made by the Company out of sufficient bank balance available shown as part of Current Assets.

You are required to prepare the necessary journal entries towards buy back of shares and prepare the Balance Sheet of the company after buy back of shares.

Equity Shares with Differential Rights

5. (a) Explain the conditions for equity shares with differential rights under the Companies (Share Capital and Debentures) Rules.
- (b) L, M, N and O hold Equity capital in the proportion of 30:30:20:20 in Hill Ltd. X, Y, Z and K hold preference share capital in the proportion of 40:30:20:10. You are required to identify the voting rights of shareholders in case of resolution of winding up of the company if the paid-up capital of the company is ₹ 60 Lakh and preference share capital is ₹ 30 Lakh.

Amalgamation of Companies

6. The following are the Balance Sheets of Aakash Limited and Ganga Limited as at March 31, 2021:

Particulars	Note No.	Aakash Limited (₹)	Ganga Limited (₹)
I. Equity and Liabilities:			
(1) Shareholder's Funds:			
(a) Share Capital	1	80,00,000	20,00,000
(b) Reserves and Surplus	2	(3,24,00,000)	56,00,000
(2) Non-Current Liabilities:			
(a) Secured Loans	3	3,20,00,000	1,60,00,000
(b) Unsecured Loans	4	1,72,00,000	-
(3) Current Liabilities:			
(a) Trade Payables		56,00,000	36,00,000
(b) Other Current Liabilities	5	2,04,00,000	56,00,000
Total		5,08,00,000	3,28,00,000
II. Assets:			
(1) Non-Current Assets:			
Property, Plant & Equipment		68,00,000	1,36,00,000

(2) Current Assets:			
(a) Inventories		3,68,00,000	-
(b) Other Current Assets		72,00,000	1,92,00,000
Total		5,08,00,000	3,28,00,000

Notes to Accounts:

		Aakash Limited (₹)	Ganga Limited (₹)
1.	Share Capital		
	Authorized, Issued, Subscribed & Paid up :		
	6,00,000 Equity Shares of ₹10 each	60,00,000	-
	20,000 Preference Shares of ₹ 100 each	20,00,000	-
	2,00,000 Equity Shares of ₹ 10 each	-	20,00,000
		80,00,000	20,00,000
2.	Reserves and Surplus		
	General Reserve	8,00,000	56,00,000
	Surplus	(3,32,00,000)	-
		(3,24,00,000)	56,00,000
3.	Secured Loans		
	(Secured Loans of Aakash Limited are secured against pledge of Inventories)	3,20,00,000	1,60,00,000
4.	Unsecured Loans	1,72,00,000	-
5.	Other Current Liabilities		
	Statutory Liabilities	1,44,00,000	20,00,000
	Liability to Employees	60,00,000	36,00,000
		2,04,00,000	56,00,000

Both the companies go into liquidation and a new company 'AakashGanga Limited' is formed to take over their business. The following information is given:

- (i) All Current Assets of two companies, except pledged inventory are taken over by Aakash Ganga Limited. The realizable value of all the Current Assets (including pledged inventory) is 80% of book value in case of Aakash Limited and 70% for Ganga Limited.
- (ii) Property, Plant and Equipment of both the companies are taken over at book value by AakashGanga Limited.

- (iii) Secured Loans include ₹ 32,00,000 accrued interest in case of Ganga Limited.
- (iv) 4,00,000 Equity Shares of ₹ 10 each are allotted by AakashGanga Limited at par against cash payment of entire face value to the shareholders of Aakash Limited and Ganga Limited in the ratio of shares held by them in Aakash Limited and Ganga Limited.
- (v) Preference Shareholders in Aakash Limited are issued Equity Shares in AakashGanga Ltd. worth ₹ 4,00,000 in lieu of their present holdings.
- (vi) Secured Loan agree to continue the balance amount of their loans to AakashGanga Limited after adjusting realizable value of pledged asset in case of Aakash Limited and after waiving 50% of interest due in the case of Ganga Limited.
- (vii) Unsecured Loans are taken over by AakashGanga Limited at 25% of loan amounts.
- (viii) Employees are issued fully paid Equity Shares in AakashGanga Limited in full settlement of their dues.
- (ix) Statutory Liabilities are taken over by AakashGanga Limited at full value and Trade Payables are taken over at 80% of the book value.

You are required to prepare the opening Balance Sheet of AakashGanga Limited as at 1.4.2021.

Internal Reconstruction of a Company

7. Z Limited provides the following information as on 31st March, 2021:

Particulars	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 (Dr. balance)	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>Property, plant and Equipment:</u>	
Land & Buildings	30,00,000
Plant & Machinery	12,50,000
Furniture & Fixtures	2,50,000
<u>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 to be written off for Goodwill, Patents and Loss in Profit and Loss account. Also prepare Bank Account and Reconstruction A/c.

Liquidation of Company

8. The Balance Sheet of Cloud Ltd., as at 31st March, 2021, being the date of voluntary winding up is as under:

Particulars		Note	Amount (₹)
I	Equity and Liabilities		
1	Shareholders' Funds:		
	(a) Share Capital	1	21,00,000
	(b) Reserve and Surplus	2	4,00,000
2	Non-Current Liabilities:		
	(a) Long Term Borrowings	3	4,20,000
3	Current Liabilities:		
	(a) Short Term Borrowings	4	9,70,000
	(b) Trade Payables		12,00,000
	(c) Other Current Liabilities	5	<u>2,10,000</u>
	Total		<u>53,00,000</u>
II	Assets		
1	Non-Current Assets:		
	(a) Property, Plant and Equipment	6	26,00,000
2	Current Assets:		
	(a) Inventories		6,50,000
	(b) Trade Receivables		20,50,000
	(c) Cash and Cash Equivalents		<u>-</u>
	Total		<u>53,00,000</u>

Notes to Accounts:

Particulars	Amount (₹)
1. Share Capital	
Authorized:	
10,000 Equity Shares of ₹ 100 each	10,00,000
10,000 Equity Shares of ₹ 100 each	10,00,000
10,000, 10% Cumulative Preference Shares of ₹ 100 each	<u>10,00,000</u>
Issued, Subscribed & Paid up:	
10,000 Equity Shares of ₹ 100 each, ₹ 60 paid up.	6,00,000
10,000 Equity Shares of ₹ 100 each, ₹ 50 paid up.	5,00,000
10,000, 10% Cumulative Preference Shares of ₹ 100 each, fully paid up.	<u>10,00,000</u>
Total	<u>21,00,000</u>
2. Reserve and Surplus	
(a) Securities Premium	15,00,000
(b) Profit & Loss A/c (Dr. balance)	<u>(11,00,000)</u>
	<u>4,00,000</u>
3. Long Term Borrowings	
10% Debentures	4,20,000
4. Short Term borrowings	
Bank Overdraft (unsecured)	9,70,000
5. Other Current Liabilities	
Preferential Creditors	2,10,000
6. Property, Plant and Equipment	
(a) Land and Buildings	10,40,000
(b) Plant and Machinery	<u>15,60,000</u>
	<u>26,00,000</u>

Preference Dividend is in arrears for three years (upto 31st March, 2021). The assets realized as follows:

Land & Building	₹ 12,40,000	Plant & Machinery	₹ 14,20,000
Inventory	₹ 6,20,000	Trade receivables	₹ 13,20,000

Expenses of Liquidation are ₹1,72,000. The Remuneration of the Liquidator is 2% of the realization of assets. Income Tax Payable is ₹1,34,000. Interest on debentures for the

year ended 31st March, 2021 has not been considered in the given balance sheet and is also to be paid.

Prepare the Liquidator's Final Statement of Account.

NBFCs

9. (a) Calculate 'Owned Fund' of an NBFC based on the following information:

Paid up share capital: ₹ 200 lakhs

Free reserves: ₹ 150 lakhs

Compulsory convertible preference shares (CCPS): ₹ 50 lakhs

Revaluation reserve: ₹ 50 lakhs (created by revaluation of assets)

Securities premium: ₹ 25 lakhs

Book value of intangible assets: ₹ 10 lakhs

Capital reserves (surplus arising out of sale proceeds of assets): ₹ 15 lakhs

- (b) While closing its books of account at year end, a Non-Banking Finance Company has its advances classified as follows:

	₹ in lakhs
Standard assets	1,26,000
Sub-standard assets	10,050
Secured portions of doubtful debts:	
– up to one year	2,400
– one year to three years	675
– more than three years	225
Unsecured portions of doubtful debts	727
Loss assets	360

Calculate the amount of provision, which must be made against the advances as per the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016.

Banking Companies

10. The following figures are available from the books of Star Bank Ltd. for the year ended 31st March, 2021.

	Amount in ₹
Interest and Discounts Received	1,52,00,640
Interest Paid on Deposits	91,81,440
Salaries and Allowances	10,00,000

Directors' Fees and Allowances	1,40,000
Rent and Taxes Paid	4,00,000
Postage	2,61,360
Statutory Reserve Fund	32,00,000
Commission, Exchange and Brokerage Earned	7,60,000
Rent Received	2,88,000
Profit on sale of Investments	9,03,200
Depreciation on Assets	1,60,000
Statutory Expenses	1,52,000
Preliminary Expenses	1,20,000
Auditors' Fees	48,000

The following further information is also available:

- (i) Issued and Subscribed Capital of the Bank is ₹ 40,00,000
- (ii) Preliminary Expenses to be fully written off during the year.
- (iii) Rebate on Bills Discounted was ₹ 60,000 as on 31st March, 2020 and was ₹ 80,000 on 31st March, 2021.
- (iv) Transfer 25% of the profits to statutory reserves.
- (v) Income Tax of ₹ 8,00,000 is to be provided.
- (vi) Mr. G, a customer of the bank, who had taken an advance of ₹ 40,00,000 from the bank became insolvent and only 25% was expected to be recovered from his estate.
- (vii) A provision of ₹ 8,00,000 was also necessary on other debts.
- (viii) There was no opening balance of Profit and Loss Account.

You are required to prepare the Profit and Loss Account and the Schedules of Profit and Loss Account of Star bank for the year ended 31st March, 2021. Also show how the Profit and Loss Account will appear in the Balance Sheet.

Consolidated Financial Statements

11. From the following information of Beta Ltd. and its subsidiary Gamma Ltd. drawn up at 31st March, 2021, prepare a consolidated balance sheet as at that date:

	Beta Ltd.	Gamma Ltd.
	₹	₹
Share Capital:		
Shares of ₹ 100 each	15,00,000	2,50,000
Reserves	5,00,000	1,87,500

Profit and Loss Account	2,50,000	62,500
Trade Payables	3,75,000	1,42,500
Property, plant and Equipment:		
Machinery	7,50,000	2,25,000
Furniture	3,75,000	42,500
Other non-current assets	11,00,000	3,75,000
Non-current Investments:		
Shares in Gamma Ltd.: 2,000 shares at ₹ 200 each	4,00,000	

Other information:

Reserves and Profit and Loss Account of Gamma Ltd. stood at ₹ 62,500 and ₹ 37,500 respectively on the date of acquisition of its 80% shares by Beta Ltd. on 1st April, 2020.

Machinery (Book-value ₹ 2,50,000) and Furniture (Book value ₹ 50,000) of Gamma Ltd. were revalued at ₹ 3,75,000 and ₹ 37,500 respectively on 1st April, 2020 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

AS 4 Contingencies and Events occurring after the Balance Sheet Date

12. Tee Ltd. closes its books of accounts every year on 31st March. The financial statements for the year ended 31st March 2020 are to be approved by the approving authority on 30th June 2020. During the first quarter of 2020-2021, the following events / transactions has taken place. The accountant of the company seeks your guidance for the following:
- (i) Tee Ltd. has an inventory of 50 stitching machines costing at ₹ 5,500 per machine as on 31st March 2020. The company is expecting a heavy decline in the demand in next year. The inventories are valued at cost or net realizable value, whichever is lower. During the month of April 2020, due to fall in demand, the prices have gone down drastically. The company has sold 5 machines during April, 2020 at a price of ₹ 4,000 per machine.
 - (ii) A fire has broken out in the company's godown on 15th April 2020. The company has estimated a loss of ₹ 25 lakhs of which 75% is recoverable from the Insurance company.
 - (iii) A suit against the company's advertisement was filed by a party on 10th April, 2020 10 days after the year end claiming damages of ₹ 20 lakhs.

You are required to state with reasons, how the above transactions will be dealt with in the financial statements for the year ended 31 March 2020.

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

13. (a) The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended 31st March, 2021. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;
- (i) Provision for doubtful debts was created @ 2% till 31st March, 2020. From the Financial year 2020-2021, the rate of provision has been changed to 3%.
 - (ii) During the year ended 31st March, 2021, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.
 - (iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.
 - (iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.
 - (v) During the year ended 31st March, 2021, there was change in cost formula in measuring the cost of inventories.

AS 7 Construction Contracts

- (b) B Ltd. undertook a construction contract for ₹ 50 crores in April, 2020. The cost of construction was initially estimated at ₹ 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated that the cost of completion of the contract would be ₹ 53 crores.

Can the company provide for the expected loss in the financial Statements for the year ended 31st March, 2021? Explain.

AS 9 Revenue Recognition

14. (a) An infrastructure company has constructed a mall and entered into agreement with tenants towards license fee (monthly rental) and variable license fee, a percentage on the turnover of the tenant (on an annual basis). Chief Financial Officer of the company wants to account/recognize license fee as income for 12 months during current year and variable license fee as income during next year, since invoice is raised in the subsequent year. Comment whether the treatment desired by the CFO is correct or not.

- (b) Indicate in each case whether revenue can be recognized and when it will be recognized as per AS 9.
- (1) Trade discount and volume rebate received.
 - (2) Where goods are sold to distributors or others for resale.
 - (3) Where seller concurrently agrees to repurchase the same goods at a later date.
 - (4) Insurance agency commission for rendering services.

AS 17 Segment Reporting

15. (a) Company A is engaged in the manufacture and sale of products, which constitute two distinct business segments. The products of the Company are sold in the domestic market only. The management information system of the Company is organized to reflect operating information by two broad market segments, rural and urban. Besides the two business segments, how should Company A identify geographical segments? Do geographical segments exist within the same country? Explain in line with the provisions of AS 17.
- (b) A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 20% above cost. You are required to examine whether the policy adopted by the company is correct or not?

AS 18 Related Party Disclosures

16. (a) In respect of a key supplier who is dependent on the company for its existence and the company enjoys influence over the prices of this supplier (which may not be formally demonstrable), can the supplier and the company be considered as related parties?
- (b) Define "Key management personnel" in the context of AS 18.

AS 19 Leases

17. (a) Classify the following into either operating or finance lease:
- (i) If Present value (PV) of Minimum lease payment (MLP) = "X"; Fair value of the asset is "Y" and $X=Y$.
 - (ii) Economic life of the asset is 7 years, lease term is 6.5 years, but asset is not acquired at the end of the lease term;
 - (iii) Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee.
- (b) 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 –

- (i) Fair value is ₹ 45 lakhs and sale price is ₹ 39 lakhs.
- (ii) Fair value is ₹ 40 lakhs and sale price is ₹ 49 lakhs.
- (iii) Fair value is ₹ 46 lakhs and sale price is ₹ 50 lakhs

AS 20 Earnings Per Share

18. (a) Stock options have been granted by AB Limited to its employees and they vest equally over 5 years, i.e., 20 per cent at the end of each year from the date of grant. The options will vest only if the employee is still employed with the company at the end of the year. If the employee leaves the company during the vesting period, the options that have vested can be exercised, while the others would lapse. Currently, AB Limited includes only the vested options for calculating Diluted EPS. Should only completely vested options be included for computation of Diluted EPS? Is this in accordance with the provisions of AS 20? Explain.
- (b) X Limited, as at March 31, 2021, has income from continuing ordinary operations of ₹ 2,40,000, a loss from discontinuing operations of ₹ 3,60,000 and accordingly a net loss of ₹ 1,20,000. The Company has 1,000 equity shares and 200 potential equity shares outstanding as at March 31, 2021. You are required to compute Basic and Diluted EPS?

AS 22 Accounting for Taxes on Income

19. (a) The following transactions were reported by PQR Ltd. during the year 2020-2021:

i.	Tax Rate	30% (₹ in lakh)
ii.	Items disallowed in 2019-2020 and allowed for tax purposes in 2020-2021.	20.00
iii.	Interest to Financial Institutions accounted in the books on accrual basis, but actual payment was made before the due date of filing return and allowed for tax purpose also.	20.00
iv.	Donations to Private Trust made in 2020-2021 (not allowed under Income Tax Laws).	10.00

You are required to show impact of the above items in terms of Deferred Tax Assets/Deferred Tax Liability for the year ended 31.03.2021.

AS 24 Discontinuing Operations

- (b) (i) What are the disclosure and presentation requirements of AS 24 for discontinuing operations?
- (ii) Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

AS 26 Intangible Assets

20. (a) PQR Ltd. has acquired a Brand from another company for ₹ 100 lakhs. PQR Ltd. contends that since the said brand is a very popular and famous brand, no amortization needs to be provided. Comment on this in line with the Accounting Standards.
- (b) X Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During the year ended 31st March, 2021, it incurred substantial amount on business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefit by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the accountant of the company do you concur with these views? You are required to explain in line with provisions of Accounting Standards.

AS 29 Provisions, Contingent Liabilities and Contingent Assets

- (c) Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2020. It seeks your advice in the following cases:
- (i) Chaos Limited has filed a court case in 2014-2015 against its competitors. It became evident to its lawyers during the year ended 31st March, 2020 that Chaos Limited may lose the case and would have to pay ₹ 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.
- (ii) A new regulation has been passed in 2019-2020 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2021. The company estimates an expenditure of ₹ 10,00,000 for the said upgrade.
- (iii) The company gives one year warranty for its healthcare equipment under the contract of sale that it will make good any manufacturing defect by repair or replacement. As per past experience, it is probable that there will be 1% such cases and estimated cost of repair / replacement is estimated at 10% of such sale value. During the year, the company has made a sale of ₹ 5 crores.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

SUGGESTED ANSWERS

1. (a) In the books of M/s Om
Cash Account (Bank Column)

	₹				₹
To Balance b/d	75,000	By	Realisation A/c-		
To Realization A/c	12,46,600		(Payment of		
			sundry liabilities)		5,75,000
(Realization of Sundry assets)		By	Partners' Capital A/cs:		
			A	2,42,600	
			B	3,42,600	
			C	<u>1,61,400</u>	<u>7,46,600</u>
	<u>13,21,600</u>				<u>13,21,600</u>

Realization Account

To Land		50,000	By Current Liabilities		70,000
To Building		2,50,000	By Loan from NBFC		5,00,000
To Office equipment		1,25,000	By Cash A/c:		
To Computers		70,000	Land	1,00,000	
To Debtors		4,00,000	Building	3,00,000	
To Stocks		3,00,000	Office Equip.	1,25,000	
To Other Current Assets		22,600	Computers	49,000	
To Cash A/c:			Debtors	3,80,000	
Current liabilities	70,000		Stocks	2,70,000	
Loan from NBFC	<u>5,05,000</u>	5,75,000	Other Current Assets	<u>22,600</u>	12,46,600
To Partners' Current A/cs:					
Profit on realisation:					
A	9,600				
B	9,600				
C	2,400				
D	<u>2,400</u>	<u>24,000</u>			
		18,16,600			<u>18,16,600</u>

Partners' Capital Accounts

	A	B	C	D		A	B	C	D
	₹	₹	₹	₹		₹	₹	₹	₹
To Partners' Current A/cs Transfer	-	-	-	85,000	By Balance b/d	2,00,000	2,00,000	1,00,000	-
To D A/c 50% of deficiency	-	-	42,500	-	By Partners' Current A/cs transfer	59,600	1,59,600	1,12,400	-
To D A/c - balance of deficiency borne in capital ratio of other partners (2:2:1)	17,000	17,000	8,500	-	By C A/c - 50% of deficiency	-	-	-	42,500
To Cash A/c - final Settlement	2,42,600	3,42,600	1,61,400	-	By A A/c	-	-	-	17,000
					By B A/c	-	-	-	17,000
					By C A/c	-	-	-	8,500
	2,59,600	3,59,600	2,12,400	85,000		2,59,600	3,59,600	2,12,400	85,000

Partners' Current Accounts

	A	B	C	D		A	B	C	D
	₹	₹	₹	₹		₹	₹	₹	₹
To Balance b/d	-	-	-	87,400	By Balance b/d	50,000	1,50,000	1,10,000	-
To Partners' Capital A/cs (transfer)	59,600	1,59,600	1,12,400	-	By Realisation A/c	9,600	9,600	2,400	2,400
					By Partners' Capital A/cs (transfer)	-	-	-	85,000
	59,600	1,59,600	1,12,400	87,400		59,600	1,59,600	1,12,400	87,400

- (b) A limited liability partnership is a body corporate formed and incorporated under the LLP Act, 2008 and is a legal entity separate from that of its partners. A limited liability partnership shall have perpetual succession and any change in the partners of a limited liability partnership shall not affect the existence, rights, or liabilities of the limited liability partnership.

Under the LLP Act, 2008 an LLP may be wound up voluntarily or by the Tribunal and such LLP so wound up may be dissolved. LLP may be wound up by the Tribunal in the following circumstances:

- 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;
- If the Tribunal is of the opinion that it is just and equitable that the LLP be wound up.

2. (i) **Balance Sheet of the Firm as at 31.3.2022**

Liabilities	₹	Assets	₹	₹
Capital Accounts:		Plant	1,85,000	
U's capital	1,18,750	Less: Depreciation	<u>(5,000)</u>	1,80,000
V's capital	1,47,750	Building	1,00,000	
Sundry Creditors (90,000 – 50,000)	40,000	Less: Written off	<u>(5,000)</u>	95,000
Bank overdraft (83,000 – 50,000)	33,000	Stock		24,000
		Sundry Debtors		<u>40,500</u>
	<u>3,39,500</u>			<u>3,39,500</u>

(ii) **Realization Account**

Particulars	₹	Particulars	₹
To Plant A/c	1,80,000	By Sundry Creditors A/c	40,000
To Building A/c	95,000	By Bank Overdraft A/c	33,000
To Stock A/c	24,000	By UV Ltd. A/c	4,87,500
To Sundry Debtors A/c	40,500	(W.N.2)	
To U's Capital A/c	1,10,500		
To V's Capital A/c	1,10,500		
	<u>5,60,500</u>		<u>5,60,500</u>

(iii) **Partners' Capital Accounts**

Date	Particulars	U	V	Date	Particulars	U	V
		₹	₹			₹	₹
1.1.22	To Profit & Loss A/c	30,000	30,000	1.1.22	By Balance b/d	1,50,000	1,80,000

	To Drawings A/c	8,000	9,000	31.3.22	By Profit (W.N.1)	13,500	13,500
31.3.22	To Drawings (W.N.1)	6,750	6,750				
	To Balance c/d						
		<u>1,18,750</u>	<u>1,47,750</u>				
		<u>1,63,500</u>	<u>1,93,500</u>			<u>1,63,500</u>	<u>1,93,500</u>
30.3.22	To Shares in UV Ltd. A/c			31.3.22	By Balance b/d	1,18,750	1,47,750
		<u>2,29,250</u>	<u>2,58,250</u>	31.3.22	By Realization A/c	<u>1,10,500</u>	<u>1,10,500</u>
		<u>2,29,250</u>	<u>2,58,250</u>			<u>2,29,250</u>	<u>2,58,250</u>

Working Notes:

(1) Ascertainment of profit for the 3 months ended 31st March,2022

	₹	₹
Assets:		
Stock		24,000
Sundry Debtors		40,500
Plant less depreciation		1,80,000
Building		<u>95,000</u>
		3,39,500
Less: Liabilities:		
Sundry Creditors	40,000	
Bank overdraft	<u>33,000</u>	<u>(73,000)</u>
Closing net assets		2,66,500
Less: Opening adjusted capitals		
U (1,50,000 – 30,000 – 8,000)	1,12,000	
V (1,80,000 – 30,000 – 9,000)	<u>1,41,000</u>	<u>2,53,000</u>
Profit net of drawings		<u>13,500</u>
Add: Combined drawings during the 3 months (equal to half of profit) = 13,500 X 2		27,000
Combined drawings for 3 months		13,500

(2) Ascertainment of purchase consideration

	₹	₹
Assets:		
Stock		36,000
Sundry Debtors		40,500
Plant less depreciation		1,80,000
Building		<u>1,20,000</u>
		3,76,500
Less: Liabilities:		
Sundry Creditors	40,000	
Bank overdraft	<u>33,000</u>	<u>(73,000)</u>
Net Assets value taken by UV Ltd.		3,03,500
Add: Goodwill		<u>1,84,000</u>
Purchase Consideration paid by equity shares in UV Ltd. at ₹ 10 each		<u>4,87,500</u>

3. (a) (i) **Vesting** means to become an entitlement. Under an employee stock option plan, a counterparty's right to receive cash, other assets or equity instruments of the enterprise vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting conditions.
- (ii) **Grant Date** is the date at which the enterprise and another party (i.e. an employee) agree to an employee stock option plan, being when the enterprise and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date, the enterprise confers on the counterparty the right to cash, other assets, or equity instruments of the enterprise, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.
- (iii) **Exercise Price** is the price payable by the counterparty for exercising the option granted to him/her/it in pursuance of the employee stock option plan.

(b) Journal Entries in the books of Noor Ltd.

		₹	₹
15.03.2021	Bank A/c (2,500 shares x ₹ 40) Dr.	1,00,000	
to	Employee compensation expense A/c Dr.	50,000	
31.3.2021	(2,500 shares x ₹ 20)		
	To Equity share capital A/c		25,000
	(2,500 shares x ₹ 10)		

	To Securities premium A/c (2,500 shares x ₹ 50) (Being shares issued to the employees against the options vested to them in pursuance of Employee Stock Option Plan)		1,25,000
31.3.2021	Profit and Loss A/c	Dr.	50,000
	To Employee compensation expenses A/c (Being transfer of employee compensation expenses transfer to Profit and Loss Account)		50,000

Working Notes:

- No entry is passed when stock options are granted to employees. Hence no entry will be passed on 1 January 2021.
 - Fair value per option i.e. ₹ 20 per option is the employee cost or employee compensation expense and will be charged to P&L Account for the number of options exercised.
4. As per the information given in the question, buy-back of 25,000 shares @ ₹ 15, as desired by the company, is within the provisions of the Companies Act, 2013.

Journal Entries for buy-back of shares

			Debit (₹)	Credit (₹)
(a)	Equity shares buy-back account	Dr.	3,75,000	
	To Bank account (Being buy back of 25,000 equity shares of ₹ 10 each @ ₹ 15 per share)			3,75,000
(b)	Equity share capital account	Dr.	2,50,000	
	Premium payable on buyback account	Dr.	1,25,000	
	To Equity shares buy-back account (Being cancellation of shares bought back)			3,75,000
(c)	Securities premium account	Dr.	1,25,000	
	To Premium payable on buyback account (Being Premium payable on buyback adjusted against securities premium account)			1,25,000

(d)	Revenue reserve account	Dr.	2,50,000	
	To Capital redemption reserve account			2,50,000
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of capital bought back through free reserves)			

Balance Sheet of Complicated Ltd. as at 1st April, 2021

Particulars	Note No	Amount ₹
EQUITY AND LIABILITIES		
1 Shareholders' funds		
(a) Share capital	1	11,00,000
(b) Reserves and Surplus	2	23,50,000
2 Non-current liabilities		
(a) Long-term borrowings	3	28,75,000
3 Current liabilities		
(a) Short-term borrowings	4	16,50,000
(b) Other current liabilities	5	<u>3,00,000</u>
Total		<u>82,75,000</u>
ASSETS		
1 Non-current assets		
(a) Property, Plant and Equipment		46,50,000
2 Current assets (₹ 40,00,000 – ₹ 3,75,000)		<u>36,25,000</u>
Total		<u>82,75,000</u>

Notes to Accounts

		₹	₹
1.	Share Capital		
	Equity share capital		
	1,10,000 Equity shares of ₹10 each		11,00,000
2.	Reserves and Surplus		
	Capital Reserve	2,00,000	
	Capital Redemption Reserve	2,50,000	
	Securities premium	2,50,000	

	Less: Utilization for share buy-back	<u>(1,25,000)</u>	1,25,000	
	Share Option Outstanding Account		4,00,000	
	Revenue reserves	15,00,000		
	Less: Transfer to CRR	<u>(2,50,000)</u>	12,50,000	
	Surplus i.e. Profit and Loss A/c		<u>1,25,000</u>	23,50,000
3.	Long-term borrowings			
	Secured			
	12% Debentures		18,75,000	
	Unsecured loans		<u>10,00,000</u>	28,75,000
4.	Short-term borrowings			
	Current maturities of long-term borrowings			16,50,000
5.	Other Current Liabilities			
	Unpaid dividend		1,00,000	
	Application money received for allotment due for refund		<u>2,00,000</u>	3,00,000

5. (a) Companies (Share Capital and Debentures) Rules deal with equity shares with differential rights. The rules lay down the following conditions to be compulsorily complied with:
- The articles of association of the company authorizes the issue of shares with differential rights;
 - The issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders: Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot;
 - The voting power in respect of shares with differential rights shall not exceed seventy four percent of the total voting power including voting power in respect of equity shares with differential rights issued at any point of time;
 - The company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
 - The company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;

- The company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

Provided that a company may issue equity shares with differential rights upon expiry of five years from the end of financial year in which such default was made good.

- The company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.
- (b) L, M, N and O hold Equity capital is held by in the proportion of 30:30:20:20 and X, Y, Z and K hold preference share capital in the proportion of 40:30:20:10. As the paid-up equity share capital of the company is ₹ 60 Lakhs and Preference share capital is ₹ 30 Lakh (2:1), then relative weights in the voting right of equity shareholders and preference shareholders will be $\frac{2}{3}$ and $\frac{1}{3}$. The respective voting right of various shareholders will be

$$L = \frac{2}{3} \times \frac{30}{100} = \frac{3}{15}$$

$$M = \frac{2}{3} \times \frac{30}{100} = \frac{3}{15}$$

$$N = \frac{2}{3} \times \frac{20}{100} = \frac{2}{15}$$

$$O = \frac{2}{3} \times \frac{20}{100} = \frac{2}{15}$$

$$X = \frac{1}{3} \times \frac{40}{100} = \frac{2}{15}$$

$$Y = \frac{1}{3} \times \frac{30}{100} = \frac{1}{10}$$

$$Z = \frac{1}{3} \times \frac{20}{100} = \frac{1}{15}$$

$$K = \frac{1}{3} \times \frac{10}{100} = \frac{1}{30}$$

6. **Balance sheet of AakashGanga Ltd. as at 1st April, 2021**

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholders' Funds		
(a) Share Capital	1	1,40,00,000
(2) Non-Current Liabilities		
(a) Long term borrowings	2	2,12,60,000

(3) Current Liabilities		
(a) Trade Payables	3	73,60,000
(b) Other current liabilities	4	1,64,00,000
Total		5,90,20,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant & Equipment	5	2,04,00,000
(b) Intangible assets	6	1,54,20,000
(2) Current assets		
(a) Cash and cash equivalents		40,00,000
(b) Other current assets	7	1,92,00,000
Total		5,90,20,000

Notes to Accounts

		(₹)
1.	Share Capital Issued, subscribed & Paid up: 14,00,000 equity shares of ₹ 10 each, fully paid up (W.N.4) (of the above 10,00,000 shares have been issued for consideration other than cash)	1,40,00,000
2.	Long Term borrowings Secured Loans Aakash Limited 25,60,000 Ganga Limited <u>1,44,00,000</u> 1,69,60,000 Unsecured Loans <u>43,00,000</u> 2,12,60,000	
3.	Trade Payables (W.N.1) Aakash Limited 44,80,000 Ganga Limited <u>28,80,000</u> 73,60,000	
4.	Other current liabilities Statutory Liabilities Aakash Limited 1,44,00,000 Ganga Limited <u>20,00,000</u> 1,64,00,000	

5.	Property, Plant & Equipment		
	Aakash Limited	68,00,000	
	Ganga Limited	<u>1,36,00,000</u>	2,04,00,000
6.	Intangible assets		
	Goodwill (W.N.3)		1,54,20,000
7.	Other Current Assets		
	Aakash Limited	57,60,000	
	Ganga Limited	<u>1,34,40,000</u>	1,92,00,000

Working Notes:**1. Value of total liabilities taken over by AakashGanga Ltd.**

(₹)

	Aakash Limited		Ganga Limited	
<i>Current liabilities</i>				
Statutory liabilities	1,44,00,000		20,00,000	
Liability to employees	60,00,000		36,00,000	
Trade payables @ 80%	<u>44,80,000</u>	2,48,80,000	<u>28,80,000</u>	84,80,000
<i>Secured loans</i>				
Given in Balance Sheet	3,20,00,000		1,60,00,000	
Interest waived	-		<u>16,00,000</u>	1,44,00,000
Value of Inventory (80% of ₹ 3,68,00,000)	<u>2,94,40,000</u>	25,60,000		
Unsecured Loans (25% of ₹1,72,00,000)		<u>43,00,000</u>		-
		<u>3,17,40,000</u>		<u>2,28,80,000</u>

2. Assets taken over by AakashGanga Ltd.

(₹)

	Aakash Limited	Ganga Limited
	₹	₹
Property, Plant & Equipment	68,00,000	1,36,00,000
Current Assets (80% and 70% respectively of book value)	<u>57,60,000</u>	<u>1,34,40,000</u>
	<u>1,25,60,000</u>	<u>2,70,40,000</u>

3. Goodwill / Capital Reserve on amalgamation (₹)

Liabilities taken over (W.N. 1)	3,17,40,000	2,28,80,000
Equity shares to be issued to Preference Shareholders	<u>4,00,000</u>	<u>-</u>
A	3,21,40,000	2,28,80,000
Less: Total assets taken over (W.N. 2)	B <u>(1,25,60,000)</u>	<u>(2,70,40,000)</u>
A-B	1,95,80,000	(41,60,000)
	Goodwill	Capital Reserve
Net Goodwill (1,95,80,000- 41,60,000)	1,54,20,000	

4. Equity shares issued by AakashGanga Ltd.

(i)	For Cash		40,00,000
	For consideration other than cash		
(ii)	In Discharge of Liabilities to Employees	96,00,000	
(iii)	To Preference shareholders	<u>4,00,000</u>	<u>1,00,00,000</u>
			<u>1,40,00,000</u>
	No. of shares @ ₹ 10		14,00,000

7. Journal Entries in the Books of Z Ltd.

		₹	₹
(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 payable A/c	Dr.	96,000	
	Bank A/c	Dr.	1,00,000	
	To 12% Debentures A/c			6,78,000
	To Reconstruction A/c			5,78,000
	(Being ₹ 11,56,000 due to Y (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(iv)	10% Secured Debentures A/c	Dr.	6,40,000	
	Trade Payables		60,000	
	Interest on debentures payable A/c		64,000	
	Bank A/c		60,000	
	To 12% debentures A/c			4,42,000
	To Reconstruction A/c			3,82,000
	(Being ₹ 7,64,000 due to Z (including trade payables) cancelled and 12% debentures allotted for the amount after waving 50% as per scheme of reconstruction.)			
(v)	Trade payables A/c	Dr.	1,70,000	
	To Reconstruction A/c			1,70,000
	(Being remaining trade payables sacrificed 50% of their claim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (₹ 5) A/c			40,000
	To Reconstruction A/c			60,000
	(Being Directors' loan claim settled by issuing 8,000 equity shares of ₹ 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made towards penalty of 5% for cancellation of capital commitments of ₹ 3 Lakhs.)			
(viii)	Bank A/c	Dr.	1,00,000	
	To Reconstruction A/c			1,00,000

	(Being refund of fees by directors credited to reconstruction A/c.)			
(ix)	Reconstruction A/c To Bank A/c	Dr.	15,000	15,000
	(Being payment of reconstruction expenses.)			
(x)	Provision for Tax A/c To Bank A/c To Reconstruction A/c	Dr.	1,00,000	75,000 25,000
	(Being payment of tax liability in full settlement against provision for tax)			
(xi)	Land and Building A/c To Reconstruction A/c	Dr.	2,00,000	2,00,000
	(Being appreciation in value of Land & Building recorded)			
(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.)	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
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction, balance of reconstruction A/c transfer to Capital Reserve.)			

Bank Account

	₹		₹
To Reconstruction (Y)	1,00,000	By Balance b/d (overdraft)	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	
To Bank (reconstruction expenses)	15,000	Capital A/c	25,00,000
To Goodwill	11,00,000	By 9% Pref. Share	
To Patent	5,00,000	Capital A/c	10,00,000
To P & L A/c	14,60,000	By Mr. Y (Settlement)	5,78,000
To P & M	6,50,000	By Mr. Z (Settlement)	3,82,000
To Furniture and Fixtures	1,00,000	By Trade Payables A/c	1,70,000
To Trade investment	50,000	By Director's loan	60,000
To Inventory	2,50,000	By Bank	1,00,000
To Trade Receivables	1,00,000	By Provision for tax	25,000
To Capital Reserve (bal. fig.)	<u>7,75,000</u>	By Land and Building	<u>2,00,000</u>
	<u>50,15,000</u>		<u>50,15,000</u>

8.

Liquidator's Final Statement of Account

Receipts	₹	Payments	₹
To Sundry Assets Realized:		By Liquidator's Remuneration	92,000
Trade receivable 13,20,000		(46,00,000 × 2%)	
Inventory 6,20,000		By Liquidation Expenses	1,72,000
Land & Building 12,40,000		By Preferential Creditors:	
Plant & Machinery <u>14,20,000</u>	46,00,000	As given in Balance Sheet	2,10,000
To Calls from shareholders:		Income Tax Liability (given)	1,34,000
Call money on 10,000 Equity		By Debenture holders:	
shares, ₹ 50 paid up	20,000	Face Value of Debentures	4,20,000
at ₹ 2 per Share		Debenture Interest	42,000

		(for 1 year at 10%)	
		By Unsecured Creditors:	
		Bank Overdraft	9,70,000
		Trade payables	12,00,000
		By Preference Shareholders:	
		Preference Capital	10,00,000
		Arrears of Dividend	
		(10,00,000 × 10% × 3 years)	3,00,000
		By Equity Shareholders:	
		refund on 10,000 Shares ₹60	
		paid up, at ₹8 per Share	<u>80,000</u>
Total	46,20,000	Total	<u>46,20,000</u>

Working Note:

Calls from Holders of Partly Paid Shares

Particulars	₹
(a) Total of Receipts before considering Call Money (from the above account Dr. Side)	46,00,000
(b) Total Payments before final payments to Equity Shares (92,000 + 1,72,000 + 4,20,000 + 42,000 + 2,10,000 + 1,34,000 + 9,70,000 + 12,00,000 + 10,00,000 + 3,00,000)	45,40,000
(c) Surplus from above Calls made on Equity Shares (a-b)	60,000
(d) Notional Call on 10,000 Partly Paid Shares at ₹ 10 each (to make all Shares ₹ 60 Paid up)	1,00,000
(e) Surplus Cash Balance after Notional Call (c + d)	1,60,000
(f) Number of Shares deemed to be paid at ₹ 60 per Share (10,000 + 10,000)	20,000
(g) Hence, Refund on every ₹ 60 Paid up Share (e ÷ f) = ₹ 1,60,000 ÷ 20,000 Shares	₹ 8.00
(h) So, Required Call on ₹ 50 Paid up Share (₹ 10 Notional Call – ₹ 8 Refund)	₹ 2

9. (a) Owned fund calculation:

Paid up share capital: ₹ 200 lakhs

Free reserves: ₹ 150 lakhs

Compulsory convertible preference shares (CCPS): ₹ 50 lakhs

Securities premium: ₹ 25 lakhs

Capital Reserves : 15 lakhs

Total of all above items : ₹ 440 lakhs reduced by the value of intangible assets ₹ 10 lakhs ie. owned fund is computed as ₹ 430 lakhs.

Note: Revaluation reserve to be excluded while computing owned fund.

- (b) Calculation of provision required on advances as at year end, as per the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016

	Amount ₹ in lakhs	Percentage of provision	Provision ₹ in lakhs
Standard assets	1,26,000	0.25	315.00
Sub-standard assets	10,050	10	1,050.00
Secured portions of doubtful debts–			
– upto one year	2,400	20	480.00
– one year to three years	675	30	202.50
– more than three years	225	50	112.50
Unsecured portions of doubtful debts	727	100	727.00
Loss assets	360	100	<u>360.00</u>
			<u>3,247.00</u>

10.

Star Bank Limited

Profit and Loss Account for the year ended 31st March, 2021

		<i>Schedule</i>	<i>Year ended 31.03.2021</i>
			₹
I.	Income:		
	Interest earned	13	1,51,80,640
	Other income	14	<u>19,51,200</u>
	Total		<u>1,71,31,840</u>
II.	Expenditure		
	Interest expended	15	91,81,440
	Operating expenses	16	22,81,360

	Provisions and contingencies (W.N.1)	<u>46,00,000</u>
	Total	<u>160,62,800</u>
III.	Profits/Losses	
	Net profit for the year	10,69,040
	Profit brought forward	Nil
		<u>10,69,040</u>
IV.	Appropriations	
	Transfer to statutory reserve (25% of 10,69,040)	2,67,260
	Balance carried over to balance sheet	<u>8,01,780</u>
		<u>10,69,040</u>

Profit & Loss Account balance of ₹ 8,01,780 will appear under the head 'Reserves and Surplus' in Schedule 2 of the Balance Sheet.

Year ended 31.3.2021 (₹)		
	Schedule 13 – Interest Earned	
I.	Interest/discount on advances/bills (Refer W.N. 2)	<u>1,51,80,640</u>
		<u>1,51,80,640</u>
	Schedule 14 – Other Income	
I.	Commission, exchange and brokerage	7,60,000
II.	Profit on sale of investment	9,03,200
III.	Rent received	<u>2,88,000</u>
		<u>19,51,200</u>
	Schedule 15 – Interest Expended	
I.	Interests paid on deposits	<u>91,81,440</u>
		<u>91,81,440</u>
	Schedule 16 – Operating Expenses	
I.	Payment to and provisions for employees (salaries & allowances)	10,00,000
II.	Rent, taxes paid	4,00,000
III.	Depreciation on assets	1,60,000
IV.	Director's fee, allowances and expenses	1,40,000
V.	Auditor's fee	48,000
VI.	Statutory expenses	1,52,000

VII.	Postage	2,61,360
VIII.	Preliminary expenses	<u>1,20,000</u>
		<u>22,81,360</u>

Working Notes:1. **Provisions and contingencies**

	₹
Provision on advance to Mr. G	30,00,000
Provision on other debts	8,00,000
Provision for Income tax	<u>8,00,000</u>
	<u>46,00,000</u>

2. **Interest and discount earned**

	₹
Interest and discount received	1,52,00,640
Add: Rebate on bills discounted on 31.3. 2020	60,000
Less: Rebate on bills discounted on 31.3. 2021	<u>(80,000)</u>
	<u>1,51,80,640</u>

11. **Consolidated Balance Sheet of Beta Ltd. and its Subsidiary Gamma Ltd.**
as at 31st March, 2021

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		15,00,000
(b) Reserves and Surplus	1	8,61,500
(2) Minority Interest (W.N.5)		1,20,375
(3) Current Liabilities		
(a) Trade Payables	2	<u>5,17,500</u>
Total		<u>29,99,375</u>
II. Assets		
(1) Non-current assets		
(a) (i) Property, Plant & Equipment	3	14,94,375
(ii) Intangible assets	4	30,000
(b) Other non-current assets	5	<u>14,75,000</u>
Total		<u>29,99,375</u>

Notes to Accounts

		₹	
1. Reserves and Surplus			
Reserves		5,00,000	
<i>Add: 4/5th share of Gamma Ltd.'s post-acquisition reserves (W.N.3)</i>		<u>1,00,000</u>	6,00,000
Profit and Loss Account		2,50,000	
<i>Add: 4/5th share of Gamma Ltd.'s post-acquisition profits (W.N.4)</i>		<u>11,500</u>	<u>2,61,500</u>
			<u>8,61,500</u>
2. Trade Payables			
Beta Ltd.		3,75,000	
Gamma Ltd.		<u>1,42,500</u>	5,17,500
3. Property, Plant & Equipment			
Machinery			
Beta Ltd.		7,50,000	
Gamma Ltd.	2,50,000		
<i>Add: Appreciation</i>	<u>1,25,000</u>		
	3,75,000		
<i>Less: Depreciation</i>	<u>(37,500)</u>	3,37,500	
Furniture			
Beta Ltd.		3,75,000	
Gamma Ltd.	50,000		
<i>Less: Decrease in value</i>	<u>(12,500)</u>		
	37,500		
<i>Less: Depreciation</i>	<u>(5,625)</u>	<u>31,875</u>	14,94,37
4. Intangible assets			
Goodwill [WN 6]			30,000
5. Other non-current assets			
Beta Ltd.		11,00,000	
Gamma Ltd.		<u>3,75,000</u>	14,75,00

Working Notes:

1. Pre-acquisition profits and reserves of Gamma Ltd.	₹
Reserves	62,500
Profit and Loss Account	<u>37,500</u>
	<u>1,00,000</u>
Beta Ltd.'s = $4/5 \times 1,00,000$	80,000
Minority Interest = $1/5 \times 1,00,000$	20,000
2. Profit on revaluation of assets of Gamma Ltd.	
Profit on Machinery ₹ (3,75,000 – 2,50,000)	1,25,000
Less: Loss on Furniture ₹ (50,000 – 37,500)	<u>12,500</u>
Net Profit on revaluation	<u>1,12,500</u>
Beta Ltd.'s share $4/5 \times 1,12,500$	90,000
Minority Interest $1/5 \times 1,12,500$	22,500
3. Post-acquisition reserves of Gamma Ltd.	
Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 1,87,500 – 62,500)	<u>1,25,000</u>
Beta Ltd.'s share $4/5 \times 1,25,000$	1,00,000
Minority interest $1/5 \times 25,000$	<u>25,000</u>
4. Post -acquisition profits of Gamma Ltd.	
Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 62,500 – 37,500)	25,000
Add: Excess depreciation charged on furniture @ 15% on ₹ 12,500 i.e. (50,000 – 37,500)	<u>1,875</u>
	26,875
Less: Under depreciation on machinery @ 10% on ₹ 1,25,000 i.e. (3,75,000 – 2,50,000)	<u>(12,500)</u>
Adjusted post-acquisition profits	<u>14,375</u>
Beta Ltd.'s share $4/5 \times 14,375$	11,500
Minority Interest $1/5 \times 14,375$	<u>2,875</u>
5. Minority Interest	
Paid-up value of (2,500 – 2,000) = 500 shares held by outsiders i.e. $500 \times ₹ 100$	50,000
Add: $1/5^{\text{th}}$ share of pre-acquisition profits and reserves	20,000
$1/5^{\text{th}}$ share of profit on revaluation	22,500
$1/5^{\text{th}}$ share of post-acquisition reserves	25,000

1/5 th share of post-acquisition profit	<u>2,875</u>
	<u>1,20,375</u>
6. Cost of Control or Goodwill	
Paid-up value of 2,000 shares held by Beta Ltd. i.e. 2,000 × ₹ 100	2,00,000
Add: 4/5 th share of pre-acquisition profits and reserves	80,000
4/5 th share of profit on the revaluation	<u>90,000</u>
Intrinsic value of shares on the date of acquisition	<u>3,70,000</u>
Price paid by Beta Ltd. for 2,000 shares	4,00,000
Less: Intrinsic value of the shares	<u>(3,70,000)</u>
Cost of control or Goodwill	30,000

12. Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity. Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate. In the given case, financial statements are approved by the approving authority on 30 June 2020. On the basis of above principles, following will be the accounting treatment in the financial statements for the year ended at 31 March 2020:
- (i) Since on 31 March 2020, Tee Ltd. was expecting a heavy decline in the demand of the stitching machine. Therefore, decline in the value during April, 2020 will be considered as an adjusting event. Hence, Tee Ltd. needs to adjust the amounts recognized in its financial statements w.r.t. net realizable value at the end of the reporting period. Accordingly, inventory should be written down to ₹ 4,000 per machine. Total value of inventory in the books will be 50 machines × ₹ 4,000 = ₹ 2,00,000.
 - (ii) A fire took place after the balance sheet date i.e. during 2020-2021 financial year. Hence, the financial statements for the year 2019-2020 should not be adjusted for loss occurred due to fire. However, in this circumstance, the going concern assumption will be evaluated. In case the going concern assumption is considered to be appropriate even after the occurrence of fire, no disclosure of the same is required in the financial statements.
 - (iii) The contingency is restricted to conditions existing at the balance sheet date. However, in the given case, suit was filed against the company's advertisement by a party on 10th April for amount of ₹ 20 lakhs. Therefore, it does not fit into the definition of a contingency and hence is a non-adjusting event.

13. (a) (i) In the given case, Mobile limited created 2% provision for doubtful debts till 31st March, 2020. Subsequently in 2020-21, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in accounting estimate and is not a change in accounting policy. This change will affect only current year.
- (ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction which is substantially different from the previous policy, will not be treated as change in accounting policy.
- (iii) Change in useful life of furniture from 5 years to 3 years is a change in accounting estimate and is not a change in accounting policy.
- (iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.
- (v) Change in cost formula used in measurement of cost of inventories is a change in accounting policy.
- (b) As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately. Therefore, the foreseeable loss of ₹ 3 crores (₹ 53 crores less ₹ 50 crores) should be recognized as an expense immediately in the year ended 31st March, 2021. The amount of loss is determined irrespective of
- (i) Whether or not work has commenced on the contract;
- (ii) Stage of completion of contract activity; or
- (iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance provisions of AS 7.
14. (a) AS 9 on Revenue Recognition, is mainly concerned with the timing of recognition of revenue in the Statement of Profit and Loss of an enterprise. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition. Further, as per accrual concept, revenue should be recognized as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate. In the present case, monthly rental towards license fee and variable license fee as a percentage on the turnover of the tenant (though on annual basis) is the income related to common financial year.

Therefore, recognizing the fee as revenue cannot be deferred simply because the invoice is raised in subsequent period. Hence it should be recognized in the financial year of accrual. Therefore, the contention of the Chief Financial Officer is not in accordance with AS 9.

- (b) (1) Trade discounts and volume rebates received are not encompassed within the definition of revenue, since they represent a reduction of cost. Trade discounts and volume rebates given should be deducted in determining revenue.
 - (2) When goods are sold to distributor or others, revenue from such sales can be recognized if significant risks of ownership have passed; however, in some situations the buyer may in substance be an agent and in such cases the sale should be treated as a consignment sale.
 - (3) For transactions, where seller concurrently agrees to repurchase the same goods at a later date that are in substance a financing agreement, the resulting cash inflow is not revenue as defined and should not be recognized as revenue.
 - (4) Insurance agency commissions should be recognized on the effective commencement or renewal dates of the related policies.
15. (a) AS 17 explains that, “a single geographical segment does not include operations in economic environments with significantly differing risks and returns. A geographical segment may be a single country, a group of two or more countries, or a region within a country”. Accordingly, to identify geographical segments, Company A needs to evaluate whether the segments reflected in the management information system function in environments that are subject to significantly differing risks and returns irrespective of the fact whether they are within the same country.

The Standard recognizes that, “Determining the composition of a business or geographical segment involves a certain amount of judgement...”. Accordingly, while the management information system of the Company provides segment information for rural and urban geographical segments for the purpose of internal reporting, judgement is required to determine whether these segments are subject to significantly differing risks and returns based on the definition of geographical segment. In making such a judgement, aspect like different pricing and other policies, e.g., credit policies, deployment of resources between different regions etc., may be considered for the purpose identifying ‘urban and ‘rural’ as separate geographical segment.

Company A, in making judgment for identifying geographical segments, should also consider the relevance, reliability and comparability over time of segment information that will be reported. The Standard, explains that, “In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in the standard and the qualitative characteristics of financial statements. The qualitative characteristics include the relevance, reliability and comparability over time of financial information that is reported about

the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise.”

- (b) AS 17 ‘Segment Reporting’ requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if followed consistently.
16. (a) The supplier and the company cannot be considered to be related parties merely because the latter is able to influence the transaction price between the parties. Paragraph 3 of AS 18 states that “enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise” are considered to be related party relationships. However, the conditions which define the existence of control, as follows, are not satisfied in the given example.
- ‘ownership, directly or indirectly, of more than one-half of the voting power of an enterprise, or
 - Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
 - a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise”.

Paragraph 10 of the standard defines significant influence as “participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies”. In the given example, although the supplier and the company have entered into a commercial transaction, the terms of which are influenced by the latter because of its better bargaining power in the specific market for such goods, it cannot be concluded that there is participation in the financial and/or operating policy decisions. Therefore, as the conditions specified by the Standard for being classified as a related party are not satisfied in the given example, the company cannot be said to be related to the supplier. This view is supported by paragraph 4 (b) of the Standard which states that “a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence” would not be deemed to be related parties.

- (b) In context of AS 18, “Key management personnel” are those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. For example, in the case of a company, the managing director(s), whole time director(s), manager and any person in accordance with whose directions or instructions the board of directors of the company is accustomed to act, are usually considered key management personnel.
17. (a) (i) The lease is a finance lease if $X = Y$, or if X substantially equals Y .
- (ii) The lease will be classified as a finance lease, since a substantial portion of the life of the asset is covered by the lease term.
- (iii) Since the asset is procured only for the use of lessee, it is a finance lease.
- (b) 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 & sale price is ₹ 39 lakhs, then loss of ₹ 1 lakh (40 – 39) 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 & sale price is ₹ 49 lakhs then, profit of ₹ 9 lakhs is to be deferred and amortized over the lease period.
- (iii) When fair value is ₹ 46 lakhs & sale 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.
18. (a) The current method of calculating Diluted EPS adopted by AB limited is not in accordance with AS 20. The calculation of Diluted EPS should include all potential equity shares, i.e., all the stock options granted at the balance sheet date, which are dilutive in nature, irrespective of the vesting pattern. The options that have lapsed during the year should be included for the portion of the period the same were

outstanding, pursuant to the requirement of the standard.

AS 20 states that "A potential equity share is a financial instrument or other contract that entitles, or may entitle, its holder to equity shares". Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans are examples of potential equity shares. Further, for the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.

- (b) As per AS 20 "Potential equity shares should be treated as dilutive when, and only when, their conversion to equity shares would decrease net profit per share from continuing ordinary operations". As income from continuing ordinary operations, ₹ 2,40,000 would be considered and not ₹ (1,20,000), for ascertaining whether 200 potential equity shares are dilutive or anti-dilutive. Accordingly, 200 potential equity shares would be dilutive potential equity shares since their inclusion would decrease the net profit per share from continuing ordinary operations from ₹ 240 to ₹ 200. Thus the basic E.P.S would be ₹ (120) and diluted E.P.S. would be ₹ (100).

19. (a) **Impact of various items in terms of deferred tax liability/deferred tax asset as per AS 22**

<i>Transactions</i>	<i>Analysis</i>	<i>Nature of difference</i>	<i>Effect</i>	<i>Amount</i>
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Timing difference	Reversal of DTA	₹ 20 lakh × 30% = ₹ 6 lakh
Interest to financial institutions	It is allowed as deduction under IT Act, if the payment is made before the due date of filing the return of income	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

- (b) (i) An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:
- a description of the discontinuing operation(s);
 - the business or geographical segment(s) in which it is reported as per AS 17 'Segment Reporting';
 - the date and nature of the initial disclosure event;

- (d) the date or period in which the discontinuance is expected to be completed if known or determinable;
 - (e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
 - (f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
 - (g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and
 - (h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.
- (ii) Para 3 of AS 24 “Discontinuing Operations” explains the criteria for determination of discontinuing operations. According to AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:
- (i) Gradual or evolutionary phasing out of a product line or class of service;
 - (ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
 - (iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and
 - (iv) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

20. (a) AS 26 ‘Intangible Assets’ provides that an intangible asset should be measured initially at cost. After initial recognition, an intangible asset should be carried at cost less any accumulated amortization and any accumulated impairment losses. The amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life for computing amortization. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date when the asset is available for use. It must be ensured that the value of brand is amortized in accordance with AS 26, as brand is considered to be intangible asset. The contention of PQR Ltd. that Brand is very popular and famous, hence no amortization needs to be provided is not correct as there is no persuasive evidence that the useful life of the intangible asset will exceed 10 years.

- (b) As per AS 26 on Intangible Assets, expenditure on an intangible item should be recognized as an expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria. An intangible asset should be recognized if, and only if: (i) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (ii) the cost of the asset can be measured reliably. In the given case, no intangible assets or other asset is acquired or created that can be recognized, the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the profit and loss statement during the year ended 31st March, 2021.
- (c) **Principles for recognition of provisions:** As per AS 29, "a provision shall be recognised when:
- (i) an entity has a present obligation (legal or constructive) as a result of a past event;
 - (ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
 - (iii) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Accounting treatment under the given scenarios:

- (i) On 31st March, 2020, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as ₹ 3,00,000, there is a present obligation. Hence, provision should be recognised for ₹ 3,00,000 for the amount which may be required to settle the obligation.
- (ii) Under new regulation, an entity is required to upgrade its facilities by 31st March, 2021. However, on 31st March, 2020, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognized on 31st March, 2020 for upgrading the facilities by 31st March, 2021.
- (iii) The obligating event is the sale of health care equipment with a warranty, which gives rise to a legal obligation. Here, an outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole. Hence, a provision is recognized for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period as follows:

Probability of warranty cases for the entity where repair/replacement may be required as per past experience = 1% of ₹ 5,00,00,000 = ₹ 5,00,000

Estimated cost of repair / replacement = ₹ 5,00,000 x 10% = ₹ 50,000.

PAPER – 6: AUDITING AND ASSURANCE

PART – I : ACADEMIC UPDATE

In Chapter 9 of the Printed Copy, the topic at Page number 10 - “Shares issued at a discount” is revised and being given hereunder. Students are advised to study this topic from here and not from printed copy of the study material.

Shares issued at a discount

According to Section 53 of the Companies Act, 2013,

- (1) a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.
- (2) any share issued by a company at a discounted price shall be void.
- (2A) Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.
- (3) Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

The auditor needs to check

- (i) the movement in share capital during the year and wherever there is any issue,
- (ii) he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.
- (iii) Further, auditor should also verify that whether the company has issued shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

This topic has also been revised at page no. 10 of chapter 9 and students can refer at the link given below:

<https://resource.cdn.icai.org/66605bos53774-cp9.pdf>

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

SaveLives Limited is a listed Company which deals in the manufacture of Sanitizers, floor cleaners, dish and fabric cleaners etc. In spite of spread of covid 19 in the country, the company's sales have been very high in the last financial year due to essential products it deals in. The Company is highly automated and is driven by IT systems and applications that are used in the preparation of the financial statements of the Company. The Company uses an integrated enterprise resource planning system since last five years.

KRAN & Associates has been appointed to conduct the statutory audit of the Company. The firm consists of eight partners, and CA N has been appointed as engagement partner for the audit of SaveLives Limited.

CA N briefed the team about the audit and also how IT would be relevant to the audit of SaveLives Limited. The team obtained an understanding of the entity and its automated environment which involved an understanding of how the IT department was organised, IT activities, IT dependence and the relevant risks and controls.

One of the team members wanted to understand the importance of different types of controls in an automated environment viz., General IT Controls, Application Controls and IT- Dependent Controls. Same was discussed in detail along with the relationship between different controls.

The Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on the internal controls for a company. So, CA N decided to himself evaluate and validate the design and operating effectiveness of Internal Financial Controls over Financial Reporting (IFC-FR) of the company as at the Balance Sheet date. Internal Financial Controls (IFC) refers to the policies and procedures put in place by SaveLives Limited for ensuring adequacy and also the operating effectiveness of such controls.

The audit team decided to use the tools and techniques that auditors use in applying the principles of data analytics which are known as CAATs. Data analytics could also be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform various functions.

1.1 Under which situation is IT not relevant to an audit?

- (a) Increased complexity of transactions
- (b) Hi-tech nature of business
- (c) Volume of transactions is low
- (d) Company Policy (Compliance).

- 1.2 Which of the following is a risk that arises from the use of IT systems?
- (a) Direct data changes (backend changes).
 - (b) Limited/Monitored access.
 - (c) Adequate segregation of duties.
 - (d) Authorized access to data.
- 1.3 The relationship between two controls is such that _____ are needed to support the functioning of _____, and both are needed to ensure complete and accurate information processing through IT systems.
- (a) IT Dependent Controls, General Controls
 - (b) Application Controls, General Controls.
 - (c) General Controls, IT Dependent Controls.
 - (d) General IT Controls, Application Controls.
- 1.4 The term Internal Financial Controls (IFC) refers to the policies and procedures put in place by companies for ensuring which of the following:
- (a) reliability of financial transactions.
 - (b) effectiveness and efficiency of operations.
 - (c) safeguarding of human resources.
 - (d) prevention and detection of errors.
- 1.5 Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialized audit tools viz., IDEA and ACL to perform which of the following:
- (a) Evaluating impact of control deficiencies.
 - (b) Compliance with applicable laws and regulations.
 - (c) Authorized changes to system or programs.
 - (d) Providing latest information.

Case Scenario - 2

You are a partner in ABC & Company, a Chartered Accountant firm based in New Delhi. ABC & Company has been appointed as the statutory auditor of onetime Limited, a public limited company which manufactures and sells wall and table clocks and has many branches all over India. onetime Limited has been exporting the clocks since past two years. However, the domestic sales have contributed towards major source of revenue for the Company.

You being the engagement partner have started the audit for the year ended 31.03.2021 along with your five team members. One of the team members, CA B started verification of inventory. In addition to other procedures, he also checked that valuation of Inventory had been recognised

in accordance with AS -2. During detailed checking, he noticed that the amount spent on salary of administrative employees and normal wastage on production of the clocks, had not been added to the valuation of Inventory. The contention of XYZ Limited was that since the cost was not directly related to the production cost and so not added to the cost of inventory.

CA B also noticed that one of the suppliers of onetime Limited, Mr AM had sent some raw material to the Company for storage in their warehouse in March 2021. Due to renovation going on at his warehouse, his stock could be damaged and so he had requested Onetime Limited to keep the same in their warehouse. onetime Limited contended that since the raw material was anyway billed to the Company the next month, so the same had been included in the valuation of stock, since physically the stock was present in the warehouse of Onetime Limited as on 31.03.2021.

The Company had issued shares at premium, and the premium received on the shares had been transferred to a "securities premium account". The same was then applied in writing off the expenses of selling the clocks, writing off the preliminary expenses of the Company and also writing off the commission paid to the sales agents. You have verified the same in detail.

While verifying debtors, team member C noticed that there were a few trade receivables pertaining to export sales mainly to England. Mr. C verified the same with respect to the invoices issued and other supporting documents. The amount booked as on 31.03.2021 was based on the exchange rate as on the date of the invoice.

Mr. T, another team member verified the fixed assets of the Company. onetime Limited had purchased few cars for its directors during the year of audit. The same were appearing in the fixed assets schedule of the Company. Mr T verified the same with respect to the invoices as well as physically verified the assets in the Company's premises. Since the cars were for the official use of the Directors, they were purchased in the name of the Directors of the Company. Mr. T verified the amount with the Invoice and checked the registration and insurance documents.

One of the article clerks was assigned the work of verification of "Provisions" appearing in the Balance sheet. He wanted to understand from you the circumstances in which a provision is recognised in the books of account. You explained him the situations in which an entity recognises Provisions in its books.

Onetime Limited has invested in the shares of other companies. One of the Companies has declared dividend on its shares. Onetime Limited has not recognised the same in the profit & loss account. Team Member R has asked you to look into the matter since she is unable to understand the reasons for the same.

The Company had spent a huge amount on repair and maintenance of the machinery used for the production of the clocks. The amount was accounted for in two parts: repairs were booked as a revenue expenditure and annual maintenance charges were capitalised and added to the machinery cost. Ms. R has verified the same in detail and raised her observations.

- 2.1 Is the raw material lying in the warehouse of onetime Limited accounted for correctly in its books of account?
- (a) No, since the same belongs to Mr. AM and should appear in his books.
 - (b) Yes, since the same is in possession of onetime Limited and was billed to it the following month.
 - (c) It should be shown in the books of both onetime Limited and Mr. AM.
 - (d) It should not appear in the books of onetime Limited or Mr. AM and the raw material should be disclosed as a note in the final accounts of both the entities.
- 2.2 Which exchange rate is considered for accounting of foreign debtors at the year end?
- (a) Exchange Rate on the date of the invoice.
 - (b) Exchange Rate on the last day of the financial year.
 - (c) Exchange Rate on the date of shipment of the products to the customer.
 - (d) Exchange Rate on the date of delivery of the products to the customer.
- 2.3 Which of the following assertions with respect to fixed assets has not been complied with by the Company?
- (a) Existence
 - (b) Valuation
 - (c) Cut-Off
 - (d) Rights and Obligations
- 2.4 Which of the following condition is not required to be met for recognizing a provision?
- (a) When a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
 - (b) When an entity has a present obligation (legal or constructive) as a result of a past event.
 - (c) A reliable estimate can be made of the amount of the obligation.
 - (d) When it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

- 2.5 Dividends are recognized in the statement of profit and loss only on fulfilment of which condition:
- (a) the entity's right to receive payment of the dividend is established.
 - (b) it is probable that the economic benefits associated with the dividend will flow to the entity.
 - (c) the amount of the dividend can be measured reliably.
 - (d) All of the above

General MCQs

1. A type of super user access to information systems that enforces less or no limits on using that system is known as:
 - (a) Super access.
 - (b) Super user access.
 - (c) Unlimited access.
 - (d) Privileged access.
2. Which of the following is not an example of inflation of payments:
 - (a) Making payments against fictitious vouchers.
 - (b) Adjusting unauthorized or fictitious rebates, allowances, discounts, etc. to customer' accounts and misappropriating amount paid by them.
 - (c) Making payments against vouchers, the amounts whereof have been inflated.
 - (d) Manipulating totals of wage rolls either by including therein names of dummy workers or by inflating them in any other manner.
3. _____ requires firms to establish policies and procedures for the retention of _____. The retention period for audit engagements ordinarily is no shorter than _____ from the date of the auditor's report, or, if later, the date of the group auditor's report
 - (a) SA 220, audit evidence, six years
 - (b) SA 200, audit documentation, seven years
 - (c) SQC 1, engagement documentation, seven years
 - (d) SA 230, documentation, six years
4. is the threat which occurs when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised
 - (a) Familiarity threat

- (b) Advocacy threat
 - (c) Self Review threat
 - (d) Intimidation threat
5. _____ refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
- (a) Internal control assessment procedures
 - (b) Risk assessment procedures
 - (c) substantive procedures
 - (d) analytical procedures

PART II B – DESCRIPTIVE QUESTIONS

1. State with reason (in short) whether the following statements are true or false:
- (i) No entry is passed for cheques received by the auditee on the last day of the year and not yet deposited with the Bank.
 - (ii) Written representation from management can be a substitute for other evidence that the auditor could expect to be reasonably available.
 - (iii) According to Para 3(1)(d) of CARO, 2020, an auditor needs to report whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 5% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets
 - (iv) Communicating key audit matters in the auditor's report is 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
 - (v) A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.
 - (vi) It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the RBI and agreed upon by the concerned statutory auditors. Special consideration need not be given to proper reporting of sundry creditors for the purposes of calculating drawing power.
 - (vii) The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him

in accordance with the provisions of the The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971

- (viii) Before holding inquiry by the Central Registrar thirty days' notice must be given to the Multi-State co-operative society.

Chapter 1 - Nature, Objective and Scope of Audit

2. (a) The IESBA Code establishes the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements. Discuss and also explain the meaning of ethics.
(b) Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples.
3. The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. Explain those threats in detail giving examples.

Chapter 2 - Audit Strategy, Audit Planning and Audit Programme

4. (a) Engagement Partner CA Hitesh Kapur of Kapur and Associates wanted to develop an audit plan of Sampurna Fabrics Ltd. Discuss the matters to be described in such an audit plan.
(b) Without adequate knowledge of client's business, a proper audit is not possible. The auditor shall obtain an understanding of the entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. Explain giving examples.
5. You are being appointed as the auditor of Track Ltd. for the first time. You want to determine the materiality level and for that you have applied percentage to choose benchmark as a starting point in determining materiality for the financial statements as a whole. What are the factors that may affect the identification of an appropriate benchmark?

Chapter 3 - Audit Documentation and Audit Evidence

6. While conducting the audit of Pummy Limited, the statutory auditors collected written representations from the Management. The audit was finalized in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, state the importance of inquiry as one of the methods of collecting Audit Evidence.
7. (a) GPS & Co, Chartered Accountants, conducting the audit of Pratibha Ltd., a listed company for the year ended 31.03.2022 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GPS & Co wanted to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial

reporting framework. Guide GPS & Co with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing.

- (b) Pachranga International Ltd is manufacturer of pickles, ginger garlic paste, jams etc having its plant at Jaipur. Being in food industry, the company is facing many litigations in various courts across India. Auditors SPV & Co. wants to identify such litigations and claims involving the company which may give rise to risk of material misstatement. Guide the auditor as to how they should proceed for the purpose.
8. TRS & Associates, Chartered Accountants, having completed the audit of Genuine Leathers Ltd has started the assembling of final audit file. TRS & Associates has established policies and procedures for the timely completion of the assembly of audit files. Explain the various aspects related to final audit file discussed in SA 230 giving specific reference to SQC 1, wherever required.

Chapter 4 - Risk Assessment and Internal Control

9. (a) Generally, IT benefits an entity's internal control by enabling an entity to enhance the timeliness, availability, and accuracy of information. Discuss explaining the other relevant points in the above context.
- (b) While conducting the audit of Smart TV Ltd, engagement team of HTR& Co, has considered materiality and audit risk throughout the audit. Discuss explaining the meaning of audit risk.
10. Saburi Textile Ltd is an established player in the textile manufacturing sector. It has developed strong internal controls in almost every area. It has appointed you as an Internal Audit team head. Internal audit has a very strong relation with internal control of the company. Internal Audit analyses the effectiveness with which the internal control of the company is operating and also makes suggestions for improvement in that internal control. Explain stating clearly activities relating to Internal Control.

Chapter 5 - Fraud and Responsibilities of the Auditor in this Regard.

11. CA Dev of D R Sanduja & Co., statutory auditor of company, Girija Fabs Ltd, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud to the tune of Rs 1.25 Crores has been committed in the company by its employees. CA Dev, the auditor wanted to report the matter to the Central Government as per Law. He refers to Rule 13 of the Companies (Audit and Auditors) Rules, 2014. Sub-rule (1) of the said rule states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

In the above context, explain the manner of reporting the matter to the Central Government.

12. While conducting audit of Always Best Company Ltd, auditor B of B L Kapur & Co. observes lot of intentional misstatements, e.g. fake invoices etc., and considers these encounters as exceptional circumstances and this brings into question his ability to continue performing the audit. Advise B as to what should he do?

Chapter 6 - Audit in an Automated Environment

13. With respect to audit in an automated environment, explain the following:
- (i) Applications
 - (ii) Automated
 - (iii) CAATs
 - (iv) Data Processing
 - (v) General (IT) Controls
14. Explain the meaning of Internal Financial Controls clearly stating reporting requirement (with reference to audit) on adequacy of internal financial controls. Also discuss about its (reporting requirement on adequacy of internal financial controls) applicability on various types of Companies.

Chapter 7- Audit Sampling

15. What are the advantages of Statistical sampling technique in auditing
16. Sampling risk can lead to two types of erroneous conclusions. Explain clearly stating the meaning of sampling risk

Chapter 8 - Analytical Procedures

17. If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, how would the auditor investigate such differences.
18. Discuss the matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated.

Chapter 9 - Audit of Items of Financial Statements

19. Explain how you will verify the items given while conducting an audit of an entity:
- (a) Recovery of Bad debts written off
 - (b) Receipt of Insurance claims
 - (c) Payment of Taxes
 - (d) Sale proceeds of scrap material

20. While conducting audit of Air Space Ltd, the auditor observes that it has issued shares at discount to its creditors when its debt is converted into shares in pursuance of debt restructuring scheme in accordance with any guidelines specified by the Reserve Bank of India. Discuss explaining clearly the provisions relating to discount on issue of shares and its verification by the auditor.

Chapter 10 - The Company Audit

21. Before appointment is made under **Section 139(1)** of the Companies Act, 2013, 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. Explain stating clearly provisions of Section 139(1) along with **Rule 4** of The Companies (Audit and Auditors) Rules, 2014.
22. Harry Limited appointed CA Lakshman as an auditor of the company for a term of 5 years. Further, the company offered him the services of actuarial which were also approved by the board of directors. As an auditor, how would you deal with such situation?
23. Explain the Reporting requirements the auditor should ensure under CARO 2020 related to PPE and Intangible assets.

Chapter 11 - Audit Report

24. The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. Explain stating clearly specific evaluations made by the auditor.
25. When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700. Explain

Chapter 12 - Bank Audit

26. There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets. Explain in detail.
27. Explain the following in the context of Bank audit:
- (a) For audit of operating expenses, the auditor should study and evaluate the system of internal control relating to expenses.
 - (b) For audit of Provisions and contingencies, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.

Chapter 13- Audit of Different Types of Entities

28. (a) Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. Explain.

- (b) No inspection under Section 79 of Multi-State Co-operative Societies Act, 2002 shall be made unless a notice has been given to the multi-state co-operative society. Explain stating clearly when and how such inspection can be made. Also state the powers available with the Central Registrar in this regard along with provisions relating to communication of the inspection report under the said section.

SUGGESTED ANSWERS

Answer Key- Case Scenario - 1

Question No.	Answer
1.1	(c) Volume of transactions is low
1.2	(a) Direct data changes (backend changes).
1.3	(d) General IT Controls, Application Controls.
1.4	(b) effectiveness and efficiency of operations.
1.5	(a) Evaluating impact of control deficiencies.

Answer Key- Case Scenario - 2

Question No.	Answer
2.1	(a) No, since the same belongs to Mr. AM and should appear in his books.
2.2	(b) Exchange Rate on the last day of the financial year.
2.3	(d) Rights and Obligations
2.4	(a) When a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
2.5	(d) All of the above

Answer Key- General MCQ's

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

Descriptive Answers

1. (i) **Incorrect:** The person who is controlling the trade receivables should ensure that proper accounting entries have been passed by crediting respective trade receivables account. The balance of cheque in hand should be disclosed along with the cash and bank balances in the financial statements.
 - (ii) **Incorrect:** One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation. So it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.
 - (iii) **Incorrect:** According to Para 3(1)(d) of CARO, 2020, an auditor needs to report whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets
 - (iv) **Incorrect:** Communicating key audit matters in the auditor's report is not 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
 - (v) **Incorrect:** A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons.
A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.
 - (vi) **Incorrect:** It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.
 - (vii) **Incorrect:** The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013
 - (viii) **Incorrect:** Before holding inquiry by the Central Registrar fifteen days' notice must be given to the Multi-State co-operative society.
2. (a) The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements.

First, broadly understand what are ethics? "Ethics" are the principles of conduct governing an individual or group. Professions like law, medicine have their code of ethics. Auditing profession is no exception. Rather, in profession of auditing, importance of ethics is manifold.

The IESBA Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements. We shall understand broad meaning and intent of these fundamental principles as under:-

(a) Integrity

Integrity requires auditor to be straight forward and honest in all professional and business relationships. It implies fair dealing and truthfulness. It effectively means that he shall not be associated with reports, returns, communications or other information which he believes contains a materially false or misleading statement; contains statements or information provided recklessly or omits required information where such omission could be misleading.

(b) Objectivity

The principle of objectivity requires an auditor not to compromise professional judgment because of bias, conflict of interest or undue influence of others.

(c) Professional competence and due care

It requires that auditor attains and maintains professional knowledge and skill at the level required to render competent professional service based on current technical and professional standards and legislation and also to act diligently and in accordance with technical and professional standards. Diligence includes responsibility to act carefully, thoroughly and on a timely basis in accordance with requirements of an assignment.

(d) Confidentiality

Confidentiality principle requires an auditor to respect the confidentiality of information acquired as a result of professional or business relationships.

and

(e) Professional behaviour

It requires an auditor to comply with relevant laws and regulations and avoid any conduct that he knows or should know might discredit the profession.

- (b) It is to be understood that Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information". Remember that Standards on auditing apply in "audit" of historical financial information which is a reasonable assurance

engagement whereas Standards on Review Engagements apply in “review” of historical financial information which is a limited assurance engagement only.

“Historical financial information means” information expressed in financial terms in relation to a particular entity, derived primarily from that entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Here, we have to broadly understand that “audit” and “review” are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, “review” is a limited assurance engagement, and its objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement,

Standards on Auditing have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements.

Some examples of Standards on Auditing are :

- (i) SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
- (ii) SA 230 Audit Documentation
- (iii) SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
- (iv) SA 500 Audit Evidence
- (v) Revised SA 700 Forming an Opinion and Reporting on Financial Statements

Examples of Standards on Review engagements are

- (i) SRE 2400 (Revised) Engagements to Review Historical Financial Statements
- (ii) SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

3. The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are:
 1. **Self-interest threats**, which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include (i) direct financial interest or materially significant indirect financial interest in a client, (ii) loan or guarantee to or from the concerned client, (iii) undue dependence on a client’s fees and, hence, concerns about losing the engagement, (iv) close business relationship with an audit client, (v) potential employment with the client, and (vi) contingent fees

for the audit engagement. ***Like, in case an audit firm unduly relies on fees from a client, it may result in threat to self interest of auditor and he may not work objectively for the fear of losing client.***

2. **Self-review threats**, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are (i) when an auditor having recently been a director or senior officer of the company, and (ii) when auditors perform services that are themselves subject matters of audit.
 3. **Advocacy threats**, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes. ***In such situations, auditor can be perceived as backing and championing causes of auditee client and it may lead to belief that auditor is not acting and working objectively. Remember that auditor has not only to be independent but also appear to be acting so.***
 4. **Familiarity threats** are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways: (i) close relative of the audit team working in a senior position in the client company, (ii) former partner of the audit firm being a director or senior employee of the client, (iii) long association between specific auditors and their specific client counterparts, and (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees. ***Provisions in Companies Act, 2013 regarding rotation of auditors mainly address these very familiarity threats. Such provisions prescribe that auditor is rotated after a certain number of years so that auditors do not become too familiar with their clients.***
 5. **Intimidation threats**, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees ***or being threatened with litigation. Such threats attempt to intimidate auditors to deter them from acting objectively.***
4. (a) **The auditor shall develop an audit plan that shall include a description of :**
- (i) The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material

Misstatement through Understanding the Entity and Its Environment”.

- (ii) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 “The Auditor’s Responses to Assessed Risks”.
- (iii) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.

Example

Planning of the auditor’s risk assessment procedures occurs early in the audit process.

However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

- (b) Knowledge of the client’s business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client’s business, a proper audit is not possible. As per SA-315, “Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment”, the auditor shall obtain an understanding of the entity’s objectives and strategies, and those related business risks that may result in risks of material misstatement.

Example

1. If one of management’s objectives is to grow the business, management may develop a strategy of steady but regular growth through specific marketing campaigns and development of new markets. Alternatively, management may develop a more aggressive, complex strategy of acquiring competitors. Each of these strategies gives rise to differing business risks and potentially differing risks of material misstatement.
2. Examples of potential business risks include:
 - (i) Failure to keep up to date with new products, technologies or services.
 - (ii) Excessive reliance on a key supplier, product or individual, such as the owner.
 - (iii) Lack of personnel with expertise to react to changes in the industry.
 - (iv) Insufficient or excessive production capacity caused by inaccurate estimation of demand.

- Loss of financing due to the entity's inability to meet financial covenants

5. **SA 320 “Materiality in Planning and Performing an Audit”** prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole.

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

Factors that may affect the identification of an appropriate benchmark include the following:

- i. The **elements of the financial statements** (for example, assets, liabilities, equity, revenue, expenses);
- ii. Whether there are items on which the **attention of the users** of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance, users may tend to focus on profit, revenue or net assets);
- iii. The **nature of the entity**, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates.
- iv. The **entity's ownership structure and the way it is financed** (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- v. The **relative volatility** of the bench.

6. **Inquiry: As per SA 500 Audit Evidence: -**

- (i) Inquiry consists of seeking information of knowledgeable persons, financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
- (ii) Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.
- (iii) Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and

management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

- (iv) In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.
7. (a) **The auditors, GPS & Co** wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information. SA 501 guides in this regard. As per SA 501- "Audit Evidence—Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:
- (i) Sales, transfers and charges between segments, and elimination of inter-segment amounts.
 - (ii) Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
 - (iii) The allocation of assets and costs among segments.
 - (iv) Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.
- (b) The auditor SPV & Co. shall design and perform audit procedures in order to identify litigation and claims involving the entity (Pachranga International Ltd) which may give rise to a risk of material misstatement, including:
- (i) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.
 - (ii) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
 - (iii) Reviewing legal expense accounts.
8. The auditor TRS & Associates, Chartered Accountants shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.
- (i) SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.

- (ii) An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.
- (iii) Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature.

Examples of such changes include:

- (i) Deleting or discarding superseded documentation.
- (ii) Sorting, collating and cross-referencing working papers.
- (iii) Signing off on completion checklists relating to the file assembly process.
- (iv) Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.
- (v) After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.
- (vi) SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

9. (a) Generally, IT benefits an entity's internal control by enabling an entity to:

- (i) Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;
- (ii) Enhance the timeliness, availability, and accuracy of information;
- (iii) Facilitate the additional analysis of information;
- (iv) Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;
- (v) Reduce the risk that controls will be circumvented; and
- (vi) Enhance the ability to achieve effective segregation of duties by implementing security controls in applications, databases, and operating systems.

- (b)** Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk. Materiality and audit risk are considered throughout the audit, in particular, when:

- (a) Identifying and assessing the risks of material misstatement;

- (b) Determining the nature, timing and extent of further audit procedures; and
 - (c) Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.
10. The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the **activities Relating to Internal Control:**
- (i) **Evaluation of internal control:** The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit.
 - (ii) **Examination of financial and operating information:** The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
 - (iii) **Review of operating activities:** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including nonfinancial activities of an entity.
 - (vi) **Review of compliance with laws and regulations:** The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

Internal audit has a very strong relation with internal control of a company. Internal Audit analyzes the effectiveness with which the internal control of a company is operating and also makes suggestions for improvement in that internal control.

11. **The manner of reporting the matter to the Central Government is as follows:**
- (a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;
 - (b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;
 - (c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the

Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

- (d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
 - (e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
 - (f) the report shall be in the form of a statement as specified in Form ADT-4.
12. 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.
13. (i) **Applications:** These are computer software programs that provide a medium for recording, storage and retrieval of business operations or transactions in electronic format.
- (ii) **Automated:** A task or activity that is routinely performed by a computer system and does not require manual effort
- (iii) **CAATs:** Short form for Computer Assisted Audit Techniques, are a collection of computer-based tools and techniques that are used in an audit for analysing data in electronic form to obtain audit evidence.
- (iv) **Data Processing:** Refers to the systematic recording, storage, retrieval, modification and transformation of electronic data using information systems.

(v) **General (IT) Controls:** Are a type of internal controls that help in mitigating risks that arise due to use of information technology and information systems in a business.

14. **Explanation given in Clause (e) of Sub-section 5 of Section 134 explains the meaning of internal financial controls as,** “the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.”

From the above definition, it is clear that **internal financial controls are** the policies and procedures adopted by the company for:

1. ensuring the orderly and efficient conduct of its business, including adherence to company’s policies,
2. the safeguarding of its assets,
3. the prevention and detection of frauds and errors,
4. the accuracy and completeness of the accounting records, and
5. the timely preparation of reliable financial information.”

Section 143(3)(i) of the Act requires an auditor to report 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 anybody corporate at any point of time during the financial year less than ₹ 25 crore.

15. **Advantages of Statistical Sampling in Auditing: The advantages of statistical sampling may be summarized as follows -**

- (i) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
- (ii) The sample selection is more objective and thereby more defensible.
- (iii) The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
- (iv) It provides a means for deriving a “calculated risk” and corresponding precision (sampling error) *i.e.* the probable difference in result due to the use of a sample in

lieu of examining all the records in the group (universe), using the same audit procedures.

- (v) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.

- 16. 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. This risk will always be in existence when auditor uses sampling technique in conducting his audit.

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. This is because of over reliance on the internal controls.
 - (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. This is because of under reliance on the test of controls and detailed substantive procedures performed by the auditor. Here risk of giving wrong opinion is minimum but it will lead to more detailed checking which is time consuming.
- 17.** If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:
- (i) **Inquiring of management and obtaining appropriate audit evidence relevant to management's responses:** Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.
 - (ii) **Performing other audit procedures as necessary in the circumstances:** The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.
- 18.** Matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include:

- (i) **The accuracy with which the expected results of substantive analytical procedures can be predicted.**

For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.

- (ii) **The degree to which information can be disaggregated.**

For example, substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole.

- (iii) **The availability of the information, both financial and non-financial.**

For example, the auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures. If the information is available, the auditor may also consider the reliability of the information.

19. (a) **Recovery of Bad Debts written off:** Recovery of bad debts written off is verified with reference to relevant correspondence and proper authorisation.

- (i) Ascertain the total amount lying as bad debts and verify the relevant correspondence with the trade receivables whose accounts were written off as bad debt.
- (ii) Ensure that all recoveries of bad debts have been properly recorded in the books of account.
- (iii) Examine notification from the Court or from bankruptcy trustee. Letters from collecting agencies or from account receivables should also be seen.
- (iv) Check Credit Manager's file for the amount received and see that the said amount has been deposited into the bank promptly.
- (v) Vouch acknowledgement receipts issued to account receivables or trustees.
- (vi) Review the internal control system regarding writing off and recovery of bad debts

- (b) **Receipt of Insurance Claims:** Insurance claims may be in respect of fixed assets or current assets. While vouching the receipts of insurance claims-

- (i) The auditor should examine a copy of the insurance claim lodged with the insurance company correspondence with the insurance company and with the insurance agent should also be seen. Counterfoils of the receipts issued to the insurance company should also be seen.

- (ii) The auditor should also determine the adjustment of the amount received in excess or short of the value of the actual loss as per the insurance policy.
- (iii) The copy of certificate/report containing full particulars of the amount of loss should also be verified.
- (iv) The accounting treatment of the amount received should be seen particularly to ensure that revenue is credited with the appropriate amount and that in respect of claim against asset, the Statement of Profit and Loss is debited with the short fall of the claim admitted against book value, if the claim was lodged in the previous year but no entries were passed, entries in the Statement of Profit and Loss should be appropriately described.

(c) Payment of Taxes:

- (i) Obtain the computation of taxes prepared by the auditee and verify whether it is as per the Income Tax Act/GST Act/ Rules/ Notifications/ Circulars etc.
- (ii) Examine relevant records and documents pertaining to payment of advance income tax and self assessment tax.
- (iii) Payment on account of income-tax and other taxes like GST consequent upon a regular assessment should be verified by reference to the copy of the assessment order, notice of demand and the receipted challan acknowledging the amount paid.
- (iv) The penal interest charged for non-payment should be debited to the interest account.
- (v) Nowadays, electronic payment of taxes is also in trend. Such electronic payment of taxes by way of internet banking facility or credit or debit cards shall also be verified.
- (vi) The assessee can make electronic payment of taxes also from the account of any other person. Therefore, it should be verified that the challan for making such payment is clearly indicating the PAN No./TAN No./TIN No./GSTIN etc. of the assessee on whose behalf the payment is made.

(d) Sale Proceeds of Scrap Material:

- (i) Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.
- (ii) Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of scrap materials.
- (iii) Review the production and cost records for determination of the extent of scrap materials that may arise in a given period.
- (iv) Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years.

- (v) Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.
- (vi) See that scrap materials sold have been billed and check the calculations on the invoices.
- (vii) Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it and sold as scrap
- (viii) Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness.

20. Shares issued at a discount

According to Section 53 of the Companies Act, 2013,

- (1) a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.
- (2) any share issued by a company at a discounted price shall be void.
- (2A) Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.
- (3) Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

The auditor needs to check

- (i) the movement in share capital during the year and wherever there is any issue,
- (ii) he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.
- (iii) Further, auditor should also verify that in case a company has issued shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

In the given case of Air Space Ltd, it is clear that it can issue shares to its creditors when its debt is converted into shares in accordance with approved restructuring scheme.

21. **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) **Under Rule 4** of The Companies (Audit and Auditors) Rules, 2014, the said certificate shall state the following:-
 - (a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;
 - (b) the proposed appointment is as per the term provided under the Act;
 - (c) the proposed appointment is within the limits laid down by or under the authority of the Act;
 - (d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.
 - (iii) 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.
22. Section 141(3)(i) of the Companies Act, 2013 disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

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

*Actuarial services broadly pertain to services relating to evaluation of financial impact of risks using range of mathematical and statistical methods

In the given situation, CA. Lakshman was appointed as an auditor of Harry Ltd for a term of 5 years. He was offered additional services of actuarial which was also approved by the Board of Directors. CA. Lakshman is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

23. Reporting for PPE and Intangible assets - Clause (i) of Para 3 of CARO ,2020, requires the auditor to include a statement in the auditor’s report on the following matters, namely-

- (i) (a) (A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;
- (B) whether the company is maintaining proper records showing full particulars of intangible assets;
- (b) whether these Property, Plant and Equipment 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 all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below:-

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held –indicate range, where appropriate	Reason for not being held in name of company*
					*also indicate if in dispute

- (d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;
- (e) whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements.

24. 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 judgements.

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.

Further, when the financial statements are prepared in accordance with a fair presentation framework, the evaluation mentioned above shall also include an evaluation by the auditor as to whether the financial statements achieve fair presentation which shall include consideration of:

- (a) The overall presentation, structure and content of the financial statements; and
- (b) Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.

25. When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:
- A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;
 - A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
 - The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).
26. **Classification as NPA** should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise. Further, asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets which are given below:

Categories of Non-Performing Assets:	Provision required	
(i) Substandard Assets: Would be one, which has remained NPA for a period less than or equal to 12 months.	15%	
(ii) Doubtful Assets: Would be one, which has remained in the substandard category for a period of 12 months.	Secured+ Unsecured	
(i) Sub-categories:		
Doubtful up to 1 Year (D1)	25%	+ 100%
Doubtful 1 to 3 Years (D2)	40%	+ 100%
Doubtful more than 3 Years (D3)	100%	+ 100%
(ii) Loss Assets: Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.	100%	

27. (a) **For audit of operating expenses**, the auditor should study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures. The auditor should examine whether there are any divergent trends in respect of major items of expenses. The auditor should perform substantive analytical procedures in respect of these expenses. e.g. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years. The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required.
- (b) **For audit of Provisions and contingencies**, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled. The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets. The auditor may verify the loan classification on a sample basis.

The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger. The auditor should obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation. The other provisions for expenses should be examined vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

28. (a) Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. It is the responsibility of management to introduce controls which will minimise the leakage as far as possible. Evidence of their success is provided by the preparation of regular perhaps weekly, trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated. The auditor should obtain these regular trading accounts for the period under review, examine them and obtain explanations for any apparent deviations.

The auditor should verify a few restaurant bills by reference to K.O.T.s (Kitchen Order Tickets) or basic record. This would enable the auditor to ensure that controls regarding revenue cycle are in order.

The auditor should satisfy himself that all taxes collected from occupants on food and occupation have been paid over to the proper authorities. If the internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor. As a result of the transient nature of many of his clients' records, the auditor must rely to a very large extent on the gross margin shown by the accounts. As a

result, the scope of his audit tests will necessarily be increased and, in the event of a material margin discrepancy being unexplained, he will have to consider qualifying his audit report.

(b) Inspection of Multi-State Co-operative societies under Section 79

1. **When:** The Central Registrar may, on a request from
 - (i) federal co-operative to which a Multi-State Co-operative society is affiliated or a creditor or
 - (ii) not less than one-third of the members of the board or
 - (iii) not less than one-fifth of the total number of members of a Multi-State co-operative society
2. **How:** By general or special order in writing in this behalf inspect or direct any person authorized by him by order in writing in this behalf to make an inspection into the constitution, working and financial condition of a Multi-State co-operative society.
3. **Opportunity of Being heard:** No inspection shall be made unless a notice of not less than fifteen days has been given to the multi-state co-operative society.
4. **Powers available:** The Central Registrar or the person authorized by him shall have the following powers:
 - (a) He shall at all times have access to all books, accounts, papers, vouchers, securities, stock and other property of that society and may, in the event of serious irregularities discovered during inspection, take them into custody and shall have power to verify the cash balance of the society and subject to the general or special order of the central registrar to call a meeting of the society where such general meeting is, in his opinion necessary.
 - (b) Every officer or member of a Multi-State Co-operative society shall furnish such information with regard to the working of the society as the central registrar or the person making such inspection may require.
5. **Inspection Report:** A copy of the report of inspection under this section shall be communicated to the Multi-State Co-operative society within a period of three months from the date of completion of such inspection.

PAPER – 7: ENTERPRISE INFORMATION SYSTEMS AND STRATEGIC MANAGEMENT

SECTION – A: ENTERPRISE INFORMATION SYSTEMS

QUESTIONS

Multiple Choice Questions

The Printage Ltd. is the printing press that deals with printing of the notepads and calendars and supplying it to various vendors, schools, and offices. With an aim of expansion of their business and to enter into the competitive market with variety of high-designed products, they purchased several state-of-art printing equipment in the year 2019 costing approximately ₹ 5 lakhs. The distinguishing feature of these printing equipment, if used optimally, enables the users to prepare any customized designs as per customers' choice on various daily use products like Mugs, T-shirts, and pillows etc. However, due to lack of proper training, the employees in the factory of the company were not able to operate the equipment properly thereby causing the delay in supply of the products against the orders placed by the customers. Few instances were registered where customers returned the products due to defects in designing and misprinting and also due to delay in the delivery of their ordered products.

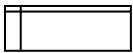
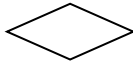


The company being aware about enormous benefits of E-Commerce environment has its own online platform where the customers can place their orders. To place the orders for their customized products, the new customers are required to fill an online registration form that captures the payment related information like Account details or Credit Card details etc. and upload the design and photograph of their choice at the time of placing the order.

Though Printage Ltd. has made huge Capital investment in the new equipment, however there was a regular fall in sales and market share due to unsatisfied customers. On Management's request, an expert Mr. Amit was assigned to assess the reasons for steady fall in sales, market share and furthermore to suggest the improvements for overall business processes to increase the productivity and quality of the end-products. He prepared a pictorial representation of operations and processing of these equipment to understand their working. After completion of his assignment, he suggested the following:

- To enhance the output and reduce the costs and generate a positive Return on Investment (RoI), he suggested the management to begin regular periodic training sessions for its employees to operate and handle the equipment efficiently and use them optimally.
- He recommended to have dedicated Inspection Officer(s) for regular review of products before packing and delivery of products to customer, against the present process of clearing the products by the Production In-charge itself for packing and delivery.

Based on the above case scenario, answer the Question No(s) 1 to 5.

1. In purview of case scenario, the new customers are required to fill an online form that captures the information of their credit cards for payment at the time of placing any order, whereas the details like Credit Card get prefilled in the form of already registered customers. From which category of data of Financial and Accounting systems, does the prefilled data for registered customers get fetched in the online form?
 - (a) Master data
 - (b) Non-Master data
 - (c) Accounting data
 - (d) Customer's data

2. Mr. Amit used flowchart for diagrammatic representation to describe various business processes and operations. Identify the flowchart symbol used by him to represent the internal storage.
 - (a) 
 - (b) 
 - (c) 
 - (d) 

3. In purview of above case scenario, the customers may pay for his/her order using Credit Card. The following are the controls applied by Credit Card Issuing Authority except one. Choose the odd statement regarding Credit Cards.
 - (a) Batch processing of the reconciliations for the balances received from the credit card network with the transactions updated in the credit card system or card network level.
 - (b) Interest on fund-based credit cards is automatically calculated in credit card system.
 - (c) Access rights to authorize credit limit should be restricted to authorized personnel.
 - (d) No transaction can happen if the aggregate limit of outstanding amount exceeds the assigned credit limit.

4. The Printage Ltd. has its own online platform to promote and avail the benefits of e-Commerce transactions. However, many risks are also associated with online business. Which of the following does not fall under the category of risk of online business?
 - (a) Denial of Service

- (b) Problem of piracy
 - (c) Repudiation of Contract
 - (d) Elimination of time delays
5. In purview of above case scenario, a control is well implemented in the payment gateway of Prinatge Ltd. that checks for the authorized limit of the Credit Card of any customer when s/he places any online order. Identify the control from the following that has been executed in this case.
- (a) Detective Control
 - (b) Preventive Control
 - (c) Corrective Control
 - (d) Environmental Control

Descriptive Questions

Chapter 1: Automated Business Process

6. Mr. Rajesh and his team have been given the task to develop Internal controls policies and procedures for ABC Ltd. to safeguard the company's assets and to ensure the reliability of internal and external financial reporting. Elaborate the components of Internal Control System that Mr. Rajesh and his team must take care to make the system effective.
7. Information Technology has touched every sector of business and has been instrumental in accelerating their growth. However, many crimes are also associated with computers henceforth Information Technology Act, 2000 came into existence. Explain few computer-related offences prescribed in IT Act, 2000.

Chapter 2: Financial and Accounting Systems

8. Unlike non-integrated systems in an organization, where all the departments work independent to each other and use their own set of data; ERP systems use single database and contains data for various software modules. This distinct feature of ERP Systems enables them to provide enormous benefits to an organization. Discuss these benefits.
9. XBRL (eXtensible Business Reporting Language) is a freely available and global standard for digital business reporting. Discuss key features of XBRL that makes it an international standard way to communicate and exchange of business information.

Chapter 3: Information Systems and its Components

10. Information System's Control affects the working environment of an organization and are classified based on various factors like the objective of controls, the physical and logical security of resources etc. Describe the category of IS controls based on their objectives with examples.

11. In an organization, the Database Controls are used within an application software to maintain the integrity of data and prevent any data integrity violations. Discuss various controls under Database Controls to achieve this objective.

Chapter 4: E-Commerce, M-Commerce and Emerging Technologies

12. The businesses with the vision to anticipate change generally grab the trend before their competitors does and certainly opt for online mode for their businesses, therefore e-commerce is a happening trend in businesses nowadays. Briefly explain the forces underpinning the revolution of e-commerce.
13. Ms. Swati has been directed by her Reporting officer to prepare a short report on Blockchain technology and several risks associated with it. Elaborate in brief the factors that would form part of her report.

Chapter 5: Core Banking Systems

14. In Core Banking Systems, Information security has become critical to mitigate the risks associated with Information Technology. Elaborate the sub-processes that comprise Information security in this case.
15. BNC Financial is a well renowned Mortgage Broker company that is engaged in providing mortgage loans to potential businessmen for expansion/establishing their businesses. Write down various risks and their associated controls around the Mortgage Process.

SUGGESTED ANSWERS

Multiple Choice Questions

1. (a) Master data
2. (a)

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3. (a) Batch processing of the reconciliations for the balances received from the credit card network with the transactions updated in the credit card system or card network level.
4. (d) Elimination of time delays
5. (a) Detective Control

Descriptive Questions

6. The components of Internal Control System are as follows:
 - (i) **Control Environment:** It is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. The Board of Directors and Senior Management establish the tone at the top regarding the importance of internal control, including expected standards of conduct. Management reinforces expectations at the various levels of the organization. The

control environment comprises the integrity and ethical values of the organization; the parameters enabling the board of directors to carry out its governance responsibilities; the organizational structure and assignment of authority and responsibility; the process for attracting, developing, and retaining competent individuals; and the rigor around performance measures, incentives, and rewards to drive accountability for performance. The resulting control environment has a pervasive impact on the overall system of internal control.

- (ii) **Risk Assessment:** Every entity faces a variety of risks from external and internal resources. Risk may be defined as the possibility that an event will occur and adversely affect the achievement of objectives. Risk Assessment involves a dynamic and iterative process for identifying and assessing risks to the achievement of objectives. Risks to the achievement of these objectives from across the entity are considered relative to established risk tolerances. Thus, Risk Assessment forms the basis for determining how risks will be managed. A precondition to risk assessment is the establishment of objectives linked at different levels of the entity. Management specifies objectives within categories of operations, reporting, and compliance with sufficient clarity to be able to identify and assess risks to those objectives. Because economic, industry, regulatory and operating conditions will continue to change; risk assessment also requires management to consider the impact of possible changes in the external environment and within its own business model that may render internal control ineffective. Risk Assessment includes the Identification of threats and vulnerabilities in the system; and Potential impact or magnitude of harm that a loss of CIA would have on enterprise operations or enterprise assets, should an identified vulnerability be exploited by a threat.
- (iii) **Control Activities:** These are the actions established through policies and procedures that help ensure that management's directives to mitigate risks to the achievement of objectives are carried out. Control activities are performed at all levels of the entity, at various stages within business processes, and over the technology environment. They may be preventive or detective in nature and may encompass a range of manual and automated activities such as authorizations and approvals, verifications, reconciliations and business performance reviews.

Broadly, the control activities include the elements that operate to ensure transactions are authorized, duties are segregated, adequate documents and records are maintained, assets and records are safeguarded, and independent checks on performance and valuation of records. Internal auditors are also concerned with administrative controls to achieve effectiveness and efficiency objectives. Control activities must be developed to manage, mitigate, and reduce the risks associated with each business process. It is unrealistic to expect to eliminate risks completely.

- (iv) **Information and Communication:** Information is necessary for the entity to carry out internal control responsibilities in support of the achievement of its objectives. Management obtains or generates and uses relevant and quality information from both internal and external sources to support the functioning of other components of internal control. Pertinent information must be identified, captured, and communicated in a form and time frame that enable people to carry out their responsibilities.

Communication is the continual, iterative process of providing, sharing, and obtaining necessary information. Internal communication is how information is disseminated throughout the enterprise, flowing up, down, and across the entity. It enables personnel to receive a clear message from senior management that control responsibilities should be taken seriously. External communication is two-fold: it enables inbound communication of relevant external information and provides information to external parties in response to requirements and expectations.

- (v) **Monitoring of Controls:** It is an ongoing cyclical process. Ongoing evaluations, separate evaluations, or some combination of the two are used to ascertain whether each of the five components of internal control including controls to affect the principles within each component is present and functioning. Ongoing evaluations built into business processes at different levels of the entity, provide timely information. Separate evaluations conducted periodically will vary in scope and frequency depending on assessment of risks, effectiveness of ongoing evaluations, and other management considerations. Findings are evaluated against management's criteria and deficiencies are communicated to management and the Board of Directors as appropriate.

7. Some computer related scenarios which can attract prosecution as per the penalties and offences prescribed in Information Technology Act, 2000 are as follows:

- ◆ **Harassment via fake public profile on social networking site:** A fake profile of a person is created on a social networking site with the correct address, residential information or contact details but he/she is labelled as 'prostitute' or a person of 'loose character'. This leads to harassment of the victim.
- ◆ **Email Account Hacking:** If victim's email account is hacked and obscene emails are sent to people in victim's address book.
- ◆ **Credit Card Fraud:** Unsuspecting victims would use infected computers to make online transactions.
- ◆ **Web Defacement:** The homepage of a website is replaced with a pornographic or defamatory page. Government sites generally face the wrath of hackers on symbolic days.

- ◆ **Introducing Viruses, Worms, Backdoors, Rootkits, Trojans, and Bugs:** All these are some sort of malicious programs which are used to destroy or gain access to some electronic information.
 - ◆ **Cyber Terrorism:** Cyber terrorism is the terrorism conducted in cyberspace, where the criminals attempt to damage or disrupt computer systems or telecommunication services. Examples are hacking into computer systems, introducing viruses to vulnerable networks, web site defacing, denial-of-service attacks, or terroristic threats made via electronic communication. Many terrorists use virtual (Drive, FTP sites) and physical storage media (USB's, hard drives) for hiding information and records of their illicit business.
 - ◆ **Online sale of illegal Articles:** Where sale of narcotics, drugs, weapons and wildlife is facilitated by the Internet.
 - ◆ **Cyber Pornography:** Among the largest businesses on Internet, pornography may not be illegal in many countries, but child pornography is.
 - ◆ **Phishing and Email Scams:** Phishing involves fraudulently acquiring sensitive information through masquerading oneself as a trusted entity (e.g. usernames, Passwords, credit card information).
 - ◆ **Theft of Confidential Information:** Many business organizations store their confidential information in computer systems. This information is targeted by rivals, criminals and disgruntled employees.
 - ◆ **Source Code Theft:** A Source code generally is the most coveted and important "crown jewel" asset of a company.
8. The benefits of Enterprise Resource Planning (ERP) systems to an organization are as follows:
- **Information integration:** The reason ERP systems are called integrated is because they possess the ability to automatically update data between related business functions and components. For example - one needs to only update the status of an order at one place in the order-processing system; and all the other components will automatically get updated.
 - **Reduction of Lead-time:** The elapsed time between placing an order and receiving it is known as the Lead-time. The ERP Systems by virtue of their integrated nature with many modules like Finance, Manufacturing, Material Management Module etc.; the use of the latest technologies like EFT (Electronic Fund Transfer), EDI (Electronic Data Interchange) reduce the lead times and make it possible for the organizations to have the items at the time they are required.
 - **On-time Shipment:** Since the different functions involved in the timely delivery of the finished goods to the customers- purchasing, material management production, production planning, plant maintenance, sales, and distribution are integrated and

the procedures automated; the chances of errors are minimal, and the production efficiency is high. Thus, by integrating the various business functions and automating the procedures and tasks the ERP system ensures on-time delivery of goods to the customers.

- **Reduction in Cycle Time:** Cycle time is the time between placement of the order and delivery of the product. In an ERP System; all the data, updated to the minute, is available in the centralized database and all the procedures are automated, almost all these activities are done without human intervention. This efficiency of the ERP systems helps in reducing the cycle time.
- **Improved Resource utilization:** The efficient functioning of the different modules in the ERP system like manufacturing, material management, plant maintenance, sales and distribution ensures that the inventory is kept to a minimum level, the machine down time is minimum and the goods are produced only as per the demand and the finished goods are delivered to the customer in the most efficient way. Thus, the ERP systems help the organization in drastically improving the capacity and resource utilization.
- **Better Customer Satisfaction:** Customer satisfaction means meeting or exceeding customers' requirement for a product or service. With the help of web-enabled ERP systems, customers can place the order, track the status of the order and make the payment sitting at home. Since all the details of the product and the customer are available to the person at the technical support department also, the company will be able to better support the customer.
- **Improved Supplier Performance:** ERP systems provide vendor management and procurement support tools designed to coordinate all aspect of the procurement process. They support the organization in its efforts to effectively negotiate, monitor and control procurement costs and schedules while assuring superior product quality. The supplier management and control processes are comprised of features that will help the organization in managing supplier relations, monitoring vendor activities and managing supplier quality.
- **Increased Flexibility:** ERP Systems help the companies to remain flexible by making the company information available across the departmental barriers and automating most of the processes and procedures, thus enabling the company to react quickly to the changing market conditions.
- **Reduced Quality Costs:** Quality is defined in many different ways- excellence, conformance to specifications, fitness for use, value for the price and so on. The ERP System's central database eliminates redundant specifications and ensures that a single change to standard procedures takes effect immediately throughout the organization. The ERP systems also provide tools for implementing total quality management programs within an organization.

- **Better Analysis and Planning Capabilities:** Another advantage provided by ERP Systems is the boost to the planning functions. By enabling the comprehensive and unified management of related business functions such as production, finance, inventory management etc. and their data; it becomes possible to utilize fully many types of Decision Support Systems (DSS) and simulation functions, what-if analysis and so on; thus, enabling the decision-makers to make better and informed decisions.
 - **Improved information accuracy and decision-making capability:** The three fundamental characteristics of information are accuracy, relevancy, and timeliness. The information needs to be accurate, relevant for the decision-maker and available to the decision-makers when he requires it. The strength of ERP Systems-integration and automation help in improving the information accuracy and help in better decision-making.
 - **Use of Latest Technology:** ERP packages are adapted to utilize the latest developments in Information Technology such as open systems, client/server technology, Cloud Computing, Mobile computing etc. It is this adaptation of ERP packages to the latest changes in IT that makes the flexible adaptation to changes in future development environments possible.
9. The key features of eXtensible Business Reporting Language (XBRL) that makes it an international standard way to communicate and exchange of business information are as follows:
- **Clear Definitions:** XBRL allows the creation of reusable, authoritative definitions, called taxonomies that capture the meaning contained in all the reporting terms used in a business report, as well as the relationships between all the terms. Taxonomies are developed by regulators, accounting standards setters, government agencies and other groups that need to clearly define information that needs to be reported upon. XBRL doesn't limit what kind of information is defined: it's a language that can be used and extended as needed.
 - **Testable Business Rules:** XBRL allows the creation of business rules that constrain what can be reported. Business rules can be logical or mathematical, or both and can be used, for example, these business rules can be used to:
 - stop poor quality information being sent to a regulator or third party, by being run by the preparer while the report is in draft.
 - stop poor quality information being accepted by a regulator or third party, by being run at the point that the information is being received. Business reports that fail critical rules can be bounced back to the preparer for review and resubmission.
 - flagging or highlighting questionable information, allowing prompt follow up, correction or explanation.

- create ratios, aggregations, and other kinds of value-added information, based on the fundamental data provided.
 - **Multi-lingual Support:** XBRL allows concept definitions to be prepared in as many languages as necessary. Translations of definitions can also be added by third parties. This means that it's possible to display a range of reports in a different language to the one that they were prepared in, without any additional work. The XBRL community makes extensive use of this capability as it can automatically open up reports to different communities.
 - **Strong Software Support:** XBRL is supported by a very wide range of software from vendors large and small, allowing a very wide range of stakeholders to work with the standard.
10. The classification of controls of Information System based on their objectives is as under:
- (i) **Preventive Controls:** These controls prevent errors, omissions, or security incidents from occurring. They are basically proactive in nature. Examples include simple data-entry edits that block alphabetic characters from being entered in numeric fields, access controls that protect sensitive data/ system resources from unauthorized people, and complex and dynamic technical controls such as anti-virus software, firewalls, and intrusion prevention systems. In other words, Preventive Controls are those inputs, which are designed to prevent an error, omission or malicious act occurring. Any control can be implemented in both manual and computerized environment for the same purpose. Only, the implementation methodology may differ from one environment to the other.
 - (ii) **Detective Controls:** These controls are designed to detect errors, omissions or malicious acts that occur and report the occurrence. Detective Controls detect errors or incidents that elude preventive controls. They are basically investigative in nature. For example, a detective control may identify account numbers of inactive accounts or accounts that have been flagged for monitoring of suspicious activities. Detective controls can also include monitoring and analysis to uncover activities or events that exceed authorized limits or violate known patterns in data that may indicate improper manipulation. For sensitive electronic communications, detective controls can indicate that a message has been corrupted or the sender's secure identification cannot be authenticated.
 - (iii) **Corrective Controls:** It is desirable to correct errors, omissions, or incidents once they have been detected. They are reactive in nature. They vary from simple correction of data-entry errors, to identifying and removing unauthorized users or software from systems or networks to recovery from incidents, disruptions, or disasters. Generally, it is most efficient to prevent errors or detect them as close as possible to their source to simplify correction. These corrective processes also should be subject to preventive and detective controls because they represent

another opportunity for errors, omissions, or falsification. Corrective controls are designed to reduce the impact or correct an error once it has been detected.

11. Various controls under Database Controls of an application software are as follows:
- (a) **Access Controls:** These controls in database subsystem seek to prevent unauthorized access to and use of the data. A security policy has to be specified followed by choosing an access control mechanism that will enforce the policy chosen. If database is replicated, the same access control rules must be enforced by access control mechanism at each site.
 - (b) **Integrity Controls:** These are required to ensure that the accuracy, completeness, and uniqueness of instances used within the data or conceptual modeling are maintained. Integrity Constraints are established to specify the type of relationship and consistency among rows (tuple) in relationship.
 - (c) **Application Software Controls:** When application software acts as an interface to interact between the user and the database, the DBMS depends on application software to pass across a correct sequence of commands and update parameters so that appropriate actions can be taken when certain types of exception condition arise. This is achieved through Update Controls that ensure that changes to the database reflect changes to the real-world entities and associations between entities that data in the database is supposed to represent and Report Controls that identify errors or irregularities that may have occurred when the database has been updated.
 - (d) **Concurrency Controls:** These are required to address the situation that arises either due to simultaneous access to the same database or due to deadlock.
 - (e) **Cryptographic Controls:** These controls can be well used for protecting the integrity of data stored in the database using block encryption.
 - (f) **File Handling Controls:** These controls are used to prevent accidental destruction of data contained on a storage medium. These are exercised by hardware, software, and the operators or users who load/unload storage media.
 - (g) **Audit Trail Controls:** The audit trail maintains the chronology of events that occur either to the database definition or the database itself.
12. The forces underpinning the revolution of e-Commerce are as follows:
- **Proliferation of Mobile Device:** The user is moving from desktop to mobile computing. 55% of the online traffic is generated from mobile devices and still it is on the increase. The most spectacular growth in mobile phone ownership contributes to the growth of e-commerce through mobile app. The creation of mobile application for e-commerce site is the latest trend to drive many online shoppers who use mobile apps for online shopping. The latest trend is using videos for product to attract customers. Shoppable videos for customers instead of using images and content would enable them to shop for products and services directly

from videos. The product content and recommendation increase the sales conversion through competitive analysis and identifying the basic style, studying, and using trending keywords and trying new trends.

- **Convergence of Mobile Telecommunication Network and the Internet:** The mobile internet is also about a very different user experience. It is characterized by goal-oriented activities reserving movie tickets or looking for directions. These activities are often conducted when time pressure, such as knowing that movie starts at 8 PM and are subject to distraction. The transition from 3G to 5G and faster data rate along with many new applications and services makes the success of e-commerce possible.
- **Social Network:** Social media these days is an integral part of almost every consumer's online habits. The latest trend is the inclusion of e-commerce in social networks, such as Facebook, Twitter, YouTube, etc. This allows the consumer to buy the product without even leaving the social media platform. The concept of commerce using social media tool box will help the e-marketer to become more familiar with their clients and at the same time will also enable the customers to develop deep relationships with the merchants they buy from. Promotion of products on social media platforms is another trend.
- **Artificial Intelligence (AI):** Another trend in e-commerce is the use of Chatbot, a fully automated chat agent that will answer all the questions of consumers and act as a first point of contact. Chatbots commonly known as messenger bots is a piece of software that can be used by a retailer to chat with customers via text or voice. Well-designed chatbots can offer personalized assistances, enhance the user experience, process orders, track shipments, provide product suggestion, automates processes, and lot more. A chatbot can offer guided, interactive browsing to the consumers and provide personalized answers to customers' questions at all times.
- **Predictive Analysis:** The use of predictive analysis tools is increasing to predict the online customers' behaviour, their buying habits, their tastes, and preferences, both quantitative and qualitative. By segmenting the customers in different categories, the company can optimize its e-mail communication in order to increase conversions by offering the right customer; the right product; in the right way; and at the right time. The analytical approach would lead to an increase in the number of new customers, as well as tools can determine the probability of a customer purchasing certain products in certain situations. Based on this information, marketer can create unique, personalized promotions for each customer.
- **Support of IT governing Laws:** Various provisions of IT Act, 2000 and laws now govern E-commerce which has proven to be a game-changer for the Indian economy and the future of "Digital India". The availability of jurisprudence in India on the various issues related to e-commerce sector is in abundance. These laws

empower the e-businesses and lower the chances of any upsetting legal conflicts or lost business.

13. Blockchain sometimes referred to as Distributed Ledger Technology (DLT) is a shared, peer-to-peer, and decentralized open ledger of transactions system with no trusted third parties in between. This ledger database has every entry as permanent as it is an append-only database which cannot be changed or altered. All transactions are fully irreversible with any change in the transaction being recorded as new transaction. The decentralized network refers to the network which is not controlled by any bank, corporation, or government. A blockchain generally uses a chain of blocks, with each block representing the digital information stored in public database (“the chain”).

The risks associated with Blockchain are as follows:

- With the use of blockchain, organizations need to consider risks with a wider perspective as different members of a particular blockchain may have different risk appetite/risk tolerances that may further lead to conflict when monitoring controls are designed for a blockchain. There may be questions about who is responsible for managing risks if no one party is in-charge and how proper accountability is to be achieved in a blockchain.
 - The reliability of financial transactions is dependent on the underlying technology and if this underlying consensus mechanism has been tampered with, it could render the financial information stored in the ledger to be inaccurate and unreliable.
 - In the absence of any central authority to administer and enforce protocol amendments, there could be a challenge in the establishment of development and maintenance of process control activities and in such case, users of public blockchains find difficult to obtain an understanding of the general IT controls implemented and the effectiveness of these controls.
 - As blockchain involves humongous data getting updated frequently, risk related to information overload could potentially challenge the level of monitoring required. Furthermore, to find competent people to design and perform effective monitoring controls may again prove to be difficult.
14. The sub-processes that comprise Information security to mitigate the risks associated with Information Technology are as follows:
- **Information Security Policies, Procedures and practices:** This refers to the processes relating to approval and implementation of information security. The security policy is basis on which detailed procedures and practices are developed and implemented at various units/department and layers of technology, as relevant. These cover all key areas of securing information at various layers of information processing and ensure that information is made available safely and securely. For example: Non-disclosure agreement with employees, vendors etc., KYC procedures for security.

- **User Security Administration:** This refers to security for various users of information systems. The security administration policy documents define how users are created and granted access as per organization structure and access matrix. It also covers the complete administration of users right from creation to disabling of users is defined as part of security policy.
- **Application Security:** This refers to how security is implemented at various aspects of application right from configuration, setting of parameters and security for transactions through various application controls. For example: Event Logging.
- **Database Security:** This refers to various aspects of implementing security for the database software. For example - Role based access privileges given to employees.
- **Operating System Security:** This refers to security for operating system software which is installed in the servers and systems which are connected to the servers.
- **Network Security:** This refers to how security is provided at various layers of network and connectivity to the servers. For example: Use of virtual private networks for employees, implementation of firewalls etc.
- **Physical Security:** This refers to security implemented through physical access controls. For example: Disabling the USB ports.

15. The risks and their associated controls around the Mortgage process are as follows:

Risks	Key Controls
Incorrect customer and loan details are captured which will affect the overall downstream process.	There is secondary review performed by an independent team member who will verify loan details captured in core banking application with offer letter.
Incorrect loan amount disbursed.	There is secondary review performed by an independent team member who will verify loan amount to be disbursed with the core banking application to the signed offer letter.
Interest amount is incorrectly calculated and charged.	Interest amount is auto calculated by the core banking application basis loan amount, RoI and tenure.
Unauthorized changes made to loan master data or customer data.	System enforced Segregation of Duties exist in the core banking application where the person putting in the transaction cannot approve its own transaction and reviewer cannot edit any details submitted by person putting data.

SECTION – B: STRATEGIC MANAGEMENT**Multiple Choice Questions**

1. Since its inception in 1910, the family business of Indian ethnic wear firm Shanti Prasad & Sons, run by Mr. Mukesh Gupta and his three sons has seen major transformation in supply chain, product development and management. The inheritance over generations hasn't been easy, as it was subject to family brawls, but the company stood strong to its core principles.

Since 2011, major foreign brands have been eyeing the segment with world class designers opening up their boutiques in plush areas around the country. JMM, a French design house, recently branded its Indian wear with leading film personalities, to attract masses. This damaged existing supply chains, attracted new age buyers and has been profitable from the very beginning.

The three sons reach out to you for management consultancy, to help them meet the competition, if not beat it. You study the business inside out and come up with three options.

First, to exit Indian Market, and start exporting their designs to European markets. This would ensure bigger revenue and forex gains, and also the distribution chains were well built there.

Second, to become the major manufacturer of JMM and other big foreign brands. This would ensure they stay relevant in the market as all the promotional spend would be taken care of by JMM and the volumes they would rope in would actually mean growth for Shanti Prasad & Sons too.

Third, to sell their designs to the global brands with patent protection. This would ensure a perpetual flow of revenue and a new market altogether, with global business exposure.

The family after considering your proposals, knowing the intricacies of business, and its environment, decided to blend options two and three. The success or failure could only be gauged in three quarters, when they sit down for an internal post implementation review.

Based on the above Case Scenario, answer the Multiple Choice Questions.

- (i) What can be said about the attitude of the owners with regards to their strategy mindset when they reached out for consultancy?
- (a) Expansion Oriented
 - (b) Stability Oriented
 - (c) Retrenchment Oriented
 - (d) Combination Oriented

- (ii) If the owners went with option two, which of the following components of marketing strategy would be irrelevant for them?
 - (a) Product and Promotion
 - (b) Price and Product
 - (c) Promotion only
 - (d) Place only
 - (iii) Option three if opted, would help in sustainability of which of the following, and would ensure so because of what major characteristic of sustainability?
 - (a) Sustainability of Competitive Advantage by ensuring Transferability
 - (b) Sustainability of Value Creation by ensuring Appropriability
 - (c) Sustainability of Value Creation by restricting Imitability
 - (d) Sustainability of Competitive Advantage by ensuring Durability
 - (iv) For Shanti Prasad & Sons well as JJM, globalisation has been a key area of consideration. As times change, and new players enter a market, the existing firms need to be careful about their survival. Which of the following statements about Globalisation is false for JJM?
 - (a) It unifies the trade and such trade barriers become irrelevant
 - (b) It needs ability to compete in domestic market with foreign competitors
 - (c) It includes commitment to invest heavily in other countries
 - (d) It brings in foreign investment in the form of FDI
 - (v) For JMM, which of the following structures would be best suited, in case all major Indian family run businesses start producing designs for them, while JMM simply takes care of distribution and marketing?
 - (a) Simple Structure
 - (b) Network Structure
 - (c) Matrix Structure
 - (d) Divisional Structure
2. Nom-Nom is a fast-food brand and has been facing a lot of competition from American brands and has decided to NOT go very aggressive but to just preserve market share? Which of the strategy Nom-Nom is following?
- (a) Build
 - (b) Hold
 - (c) Harvest

- (d) Divest
3. A tea farm owners plan to open tea cafes in tourist spots and to sell their own premium tea to build a brand. Which of the following can this be termed as?
- (a) Backward Integration
 - (b) Forward Integration
 - (c) Diversification
 - (d) Horizontal Integration
4. Airlines providing special lounge access to loyal customers is a type of which marketing?
- (a) Augmented Marketing
 - (b) Direct Marketing
 - (c) Relationship Marketing
 - (d) Services Marketing
5. Maadhyan, a hearing aid manufacturer recently introduced an AI based management tool that has the capabilities of managing teams across functions. What could be their new organisational structure post this implementation?
- (a) Divisional Structure
 - (b) Matrix Structure
 - (c) Hourglass Structure
 - (d) Network Structure
6. Halder & Sons have invested in latest technology in terms of latest printing machines from Germany and Israel. But recent advent of internet has posed a big threat to their printing business as majority of their clients have now turned to more environment friendly options. They are not able to sell off their machines which are now redundant. What condition are they facing right now?
- (a) Improper market analysis
 - (b) Exit Barriers
 - (c) Paralysis of Strategic Vision
 - (d) Weak SWOT Analysis

Descriptive Questions

Chapter 1-Introduction to Strategic Management

7. ABC Ltd. currently sells its product in two major markets – Europe and Asia. While it is a market leader in Europe, ABC Ltd. has struggled to penetrate the more competitive Asian market. ABC Ltd. hired a strategic consultant to analyze the situation and submit his

report to them. After the report received from the strategic consultant, it has therefore decided to pull out of Asia entirely and focus on its European markets only. This decision relates to which level in ABC Ltd. and explain the role of managers at this level in the organization.

8. Discuss the challenges faced by public sector units while designing for their organisations.

Chapter 2-Dynamics of Competitive Strategy

9. Explain the strategic implications of each of the following types of business in a corporate portfolio:
(a) Stars (b) Question Marks (c) Cash Cows (d) Dogs
10. Explain the role of ADL Matrix in assessing competitive position of a firm.

Chapter 3-Strategic Management Process

11. Differentiation between Strategic Planning and Operational Planning.
12. What are 'objectives'? What characteristics it must possess to be meaningful?

Chapter 4-Corporate Level Strategies

13. *Racers Ltd.* manufactures bicycles. Until recently it has adopted a differentiation strategy, offering high quality bicycles which *Racers Ltd.* sells at a high profit margin.

In recent years, *Racers Ltd.* has entered a period of decline due to the market becoming flooded with cheaper, high quality bicycles from abroad, where labour costs are lower.

Racers Ltd. has therefore decided to adjust its strategy and adopt a focus approach, targeting its bicycles towards professional athletes. This will allow *Racers Ltd.* to continue earning high margins, though the size of its potential market will likely fall.

Identify and explain the need of adopting this strategy by *Racers Ltd.* to manage decline?
14. Diversification endeavours can be categorized into four broad classifications. State the basis for this classification and name the four categories. How is concentric diversification different from vertically diversification? Explain.

Chapter 5-Business Level Strategies

15. A business consultancy firm specializes in environment management consultancy. It advises client companies on how to set up environmental management accounting systems. For measuring recording and analyzing environmental costs. A large part of its business involves performing environmental audits to check whether companies have achieved an international assurance standard in environmental management; this is something that rival consultancy firms do not do. The firm also carries out other management consultancy projects for client, but these make up only a small proportion of its total annual fee income.

Identify the strategy categories by Michael Porter which best describes the strategy of this firm.

16. What are the five competitive forces in an industry as identified by Michael Porter?

Chapter 6-Functional Level Strategies

17. You are the Human Resource Manager of a Company. What are the prominent areas where you can play strategic role?
18. You are a manager of a firm, and you have to raise funds for a business project. From which sources can you raise the funds for your company?

Chapter 7-Organisation and Strategic Leadership

19. How the 'Strategic Business Unit (SBU), structure becomes imperative in an organization with increase in number, size and diversity of divisions?
20. "A network structure is suited to unstable environment." Elucidate this statement.

Chapter 8-Strategy Implementation and Control

21. *Glassware Ltd.* is about to go through a significant restructuring. The strategic change involves moving from a decentralized to a centralized structure. This will help *Glassware* avoid duplication of support activities and lower its costs.

The management have held the first staff briefing in which they went to great lengths to explain that the change was necessary to equip the company to face future competitive challenges. Identify and explain the current stage of *Glassware Ltd.* from the Lewin's three-stage model of change?

22. Explain the various categories in which generic business process of a firm requires redesigning.

SUGGESTED ANSWERS

1. (i) (b) (ii) (c) (iii) (d) (iv) (b) (v) (b)
2. (b)
3. (b)
4. (c)
5. (c)
6. (b)
7. Corporate level strategy relates to the markets and industries that the organization chooses to operate in, as well as other decisions that affect the organization as a whole. The role of corporate-level managers is to oversee the development of strategies for the whole organization. This role includes defining the mission and goals of the organization,

determining what businesses it should be in, allocating resources among the different businesses, formulating and implementing strategies that span individual businesses, and providing leadership for the organization.

8. Central, state, municipal agencies, Public Sector Units, departments are responsible for formulating, implementing, and evaluating strategies that use taxpayers' money in the most cost-effective way to provide services and programs. The Challenges faced by the public sector units while designing their organizations are on account of basic nature of such organizations.

Public sector units face the following challenges while designing strategies for their organizations:

- Operating with less strategic autonomy.
 - Cannot diversify into unrelated businesses or merge with other firms.
 - Strategists usually enjoy little freedom while altering the organization's mission or redirecting objectives when needed.
 - Legislators and politicians control over major decisions and resources.
 - Fear of media debate over the strategic issues.
 - Chances of politicization of issues resulting fewer strategic choice.
9. In the BCG growth-share matrix portfolio of investments are represented in two-dimensional space. The vertical axis represents market growth rate, and the horizontal axis represents relative market share. The strategic implications for various business types under BCG in the corporate portfolio are:

Stars are products or businesses that are growing rapidly and are best opportunity for expansion. *Stars may follow build strategy.* They need heavy investments to maintain their position and finance their rapid growth potential.

Cash Cows are low-growth, high market share businesses or products. They generate cash and have low costs. They are established, successful, and need less investment to maintain their market share. *Strategic alternative advocated for cash cows is harvest.*

Question Marks are low market share business in high-growth markets. *Strategic option for them is hold for which they need heavy investments.* Question marks if left unattended are capable of becoming cash traps.

Dogs are low-growth, low-share businesses and products. *Relevant strategy is divest.* Dogs may generate enough cash to maintain themselves, but do not have much future. Dogs should be minimized by means of divestment or liquidation.

10. 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 h
- ◆ **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.

11.

Strategic planning	Operational planning
Strategic planning shapes the organisation and its resources.	Operational planning deals with current deployment of resources.
Strategic planning assesses the impact of environmental variables.	Operational planning develops tactics rather than strategy.
Strategic planning takes a holistic view of the organisation.	Operational planning projects current operations into the future.
Strategic planning develops overall objectives and strategies.	Operational planning makes modifications to the business functions but not fundamental changes.
Strategic planning is concerned with the long-term success of the organisation.	Operational planning is concerned with the short-term success of the organisation.
Strategic planning is a senior management responsibility.	Operational planning is the responsibility of functional managers.

12. Objectives are organizations performance targets – the results and outcomes it wants to achieve. They function as yardstick for tracking an organization’s performance and progress.

Objectives with strategic focus relate to outcomes that strengthen an organization's overall business position and competitive vitality. Objectives, to be meaningful to serve the intended role, must possess the following characteristics:

- ◆ Objectives should define the organization's relationship with its environment.
- ◆ Objectives should be facilitative towards achievement of mission and purpose.
- ◆ Objectives should provide the basis for strategic decision-making.
- ◆ Objectives should provide standards for performance appraisal.
- ◆ Objectives should be understandable.
- ◆ Objectives should be concrete and specific.
- ◆ Objectives should be related to a time frame.
- ◆ Objectives should be measurable and controllable.
- ◆ Objectives should be challenging.
- ◆ Different objectives should correlate with each other.
- ◆ Objectives should be set within constraints.

13. *Racers Ltd.* has adopted Turnaround strategy. This involves *Racers Ltd.* repositioning itself in the market in an attempt to once again gain competitive advantage.

Turnaround is needed when an enterprise's performance deteriorates to a point that it needs a radical change of direction in strategy, and possibly in structure and culture as well. It is a highly targeted effort to return an organization to profitability and increase positive cash flows to a sufficient level. It is used when both threats and weaknesses adversely affect the health of an organization so much that its basic survival is difficult.

The overall goal of turnaround strategy is to return an underperforming or distressed company to normalcy in terms of acceptable levels of profitability, solvency, liquidity and cash flow. To achieve its objectives, turnaround strategy must reverse causes of distress, resolve the financial crisis, achieve a rapid improvement in financial performance, regain stakeholder support, and overcome internal constraints and unfavourable industry characteristics.

14. Diversification strategy involves expansion into new businesses that are outside the current business and markets of an organisation. Based on the nature and extent of their relationship to existing businesses, diversification can be classified into four broad categories:

- (i) Vertically integrated diversification
- (ii) Horizontally integrated diversification
- (iii) Concentric diversification

(iv) Conglomerate diversification

Concentric diversification takes place when the products are related. The new product is a spin-off from the existing facilities and products/processes. This means that in concentric diversification too, there are benefits of synergy with the current operations. However, concentric diversification differs from vertically integrated diversification in the nature of the linkage the new product has with the existing ones.

In vertically integrated diversification, firms opt to engage in businesses that are related to the existing business of the firm. The firm remains vertically within the same process. Sequence moves forward or backward in the chain and enters specific product/process steps with the intention of making them into new businesses for the firm. The new product falls within the firm's current process-product chain. In concentric diversification, there is a departure from this vertical linkage, a new related product is added to the existing business. The new product is only connected in a loop-like manner at one or more points in the firm's existing process/technology/product chain.

15. By concentrating mainly on the 'market' for consultancy services in environmental management, the firm is pursuing a focus strategy. By offering audit services, which rival firms do not, this indicates a differentiation strategy within this chosen market niche. Hence, the firm is following Focus differentiation strategy.

A focused differentiation strategy requires offering unique features that fulfil the demands of a narrow market. Similar to focused low-cost strategy, narrow markets are defined in different ways in different settings. Some firms using a focused differentiation strategy concentrate their efforts on a particular sales channel, such as selling over the internet only. Others target particular demographic groups. Firms that compete based on uniqueness and target a narrow market are following a focused differentiations strategy.

16. Five forces model of Michael Porter is a popular tool for systematically diagnosing the significant competitive pressures in the market and assessing their strength and importance. The model holds that the state of competition in an industry is a composite of competitive pressures operating in five forces as follows:
1. **Threat of new entrants:** New entrants place a limit on prices and affect the profitability of existing players. The new capacity and product range the new entrants bring increases competitive pressure.
 2. **Bargaining power of customers:** The bargaining power of the buyers influences not only the prices that the producer can charge but also influence costs and investments of the producer. This force will become heavier depending on the possibilities of the buyers forming groups or cartels, particularly in case of industrial products.
 3. **Bargaining power of suppliers:** Often suppliers can exercise considerable bargaining power. The bargaining power of suppliers determines the cost of raw

materials and other inputs of the industry and, therefore, can affect industry attractiveness and profitability.

4. **Rivalry among current players:** The impact is evident more at functional level in the prices being charged, advertising, and pressures on costs, product and so on.
 5. **Threats from substitutes:** Substitute products are a latent source of competition in an industry. Substitute products offering a price advantage and/or performance improvement to the consumer can have significant impact.
17. Prominent areas where the Human Resource Manager can play strategic role are as follows:
1. **Providing purposeful direction:** The human resource manager leads people and the organization towards the desired direction involving people. He can ensure harmony between organisational objectives and individual objectives.
 2. **Creating competitive atmosphere:** In the present business environment, maintaining competitive position or gains is an important objective of any business. Having a highly committed and competent workforce is very important for getting a competitively advantageous position.
 3. **Facilitation of change:** The human resource manager will be more concerned about furthering the organization not just maintaining it. He can devote more time to promote acceptance of change rather than maintaining the status quo.
 4. **Managing diversity of workforce:** In a modern organization, management of diverse workforce is a great challenge. Workforce diversity can be observed in terms of male and female, young and old, educated and uneducated, unskilled and professional employee and so on. Motivation, maintaining morale and commitment are some of the key tasks that a HR manager can perform.
 5. **Empowerment of human resources:** Empowerment involves giving more power to those who, at present, have little control on what they do and little ability to influence the decisions being made around them.
 6. **Building core competency:** The human resource manager has an important role to play in developing core competency of the firm. A core competence is a unique strength of an organization which may not be shared by others. Organization of business around core competence implies leveraging the limited resources of a firm.
 7. **Development of works ethics and culture:** A vibrant work culture will have to be developed in the organizations to create an atmosphere of trust among people and to encourage creative ideas by the people.
18. Strategies related to the source of fund are important since they determine how financial resources will be available for the implementation of the financial strategies. Companies may rely on internal and external sources of financing for their short term and long term

requirement of their funds. The funds may be raised from national and international money and capital markets.

Following are some important sources for raising funds:

- i. **Net profit from the operations:** Using retained earnings to reinvest in the business, either in new projects or to scale up existing operations.
 - ii. **Sale of assets:** The purpose of an asset sale is generally to increase cash flow, reduce bad debt risk and liquidation of assets.
 - iii. **Debt:** Debt is an amount of money borrowed by one party from another. It is used by many corporations as a method of making large purchases that they could not afford under normal circumstances. It could be applied to boost organizations return on investment. During low earning periods, too much debt in the capital structure of an organization can endanger stockholders' return and jeopardize company survival. Debt can be in the form of debentures, bonds, loans from financial institutions and deposits from public/fixed deposits.
 - iv. **Issuance of share capital to the public:** Equity can be of two type – ordinary Shares and preference shares.
19. SBU is a part of a large business organization that is treated separately for strategic management purposes. The concept of SBU is helpful in creating an SBU organizational structure. It is separate part of large business serving product markets with readily identifiable competitors. It is created by adding another level of management in a divisional structure after the divisions have been grouped under a divisional top management authority based on the common strategic interests.

Very large organisations, particularly those running into several products, or operating at distant geographical locations that are extremely diverse in terms of environmental factors, can be better managed by creating strategic business units. SBU structure becomes imperative in an organisation with increase in number, size and diversity. SBUs helps such organisations by:

- Establishing coordination between divisions having common strategic interest.
- Facilitate strategic management and control.
- Determine accountability at the level of distinct business units.
- Allow strategic planning to be done at the most relevant level within the total enterprise.
- Make the task of strategic review by top executives more objective and more effective.
- Help to allocate resources to areas with better opportunities.

20. Network structure is a newer and somewhat more radical organizational design. The network structure could be termed a "non-structure" as it virtually eliminates in-house business functions and outsource many of them. An organization organized in this manner is often called a virtual organization because it is composed of a series of project groups or collaborations linked by constantly changing non-hierarchical, cobweb-like networks.

The network structure becomes most useful when the environment of a firm is unstable and is expected to remain so. Under such conditions, there is usually a strong need for innovation and quick response. Instead of having salaried employees, it may contract with people for a specific project or length of time. Long-term contracts with suppliers and distributors replace services that the company could provide for itself through vertical integration. The network structure provides organization with increased flexibility and adaptability to cope with rapid technological change and shifting pattern of international trade and competition.

21. *Glassware Ltd.* is currently in the 'unfreezing' stage, where management is attempting to explain the need for change in an attempt to maximize buy-in by employees and reduce the amount of resistance.

Unfreezing the situation: The process of unfreezing simply makes the individuals aware of the necessity for change and prepares them for such a change. Lewin proposes that the changes should not come as a surprise to the members of the organization. Sudden and unannounced change would be socially destructive and morale lowering. The management must pave the way for the change by first "unfreezing the situation", so that members would be willing and ready to accept the change.

Unfreezing is the process of breaking down the old attitudes and behaviours, customs and traditions so that they start with a clean slate. This can be achieved by making announcements, holding meetings and promoting the new ideas throughout the organization.

22. The generic business processes of a firm that require redesign may be classified into **three broad categories** as follows:

- ◆ **Processes pertaining to development and delivery of product(s) and / or services** - These may include research, design, engineering, manufacturing, and logistics, besides purchasing / procurement and materials management.
- ◆ **Process involving interface(s) with customers** - These usually include marketing, advertising, order fulfilment, and service.
- ◆ **Process comprising management activities** - These include strategy formulation, planning and budgeting, performance measurement and reporting, human resource management, and building infrastructure.

In the context of these generic business processes, BPR may be viewed as a means of solving business problem through IT capabilities.

PAPER – 8: FINANCIAL MANAGEMENT AND ECONOMICS FOR FINANCE

PART A: FINANCIAL MANAGEMENT

QUESTIONS

Ratio Analysis

1. FM Ltd. is in a competitive market where every company offers credit. To maintain the competition, FM Ltd. sold all its goods on credit and simultaneously received the goods on credit. The company provides the following information relating to current financial year:

Debtors Velocity	3 months
Creditors Velocity	2 months
Stock Turnover Ratio (on Cost of Goods Sold)	1.5
Fixed Assets turnover Ratio (on Cost of Goods Sold)	4
Gross Profit Ratio	25%
Bills Receivables	₹ 75,000
Bills Payables	₹ 30,000
Gross Profit	₹ 12,00,000

FM Ltd. has the tendency of maintaining extra stock of ₹ 30,000 at the end of the period than that at the beginning.

DETERMINE:

- (i) Sales and cost of goods sold
- (ii) Sundry Debtors
- (iii) Closing Stock
- (iv) Sundry Creditors
- (v) Fixed Assets

Cost of Capital

2. The information relating to book value (BV) and market value (MV) weights of Ex Limited is given below:

Sources	Book Value (₹)	Market Value (₹)
Equity shares	2,40,00,000	4,00,00,000
Retained earnings	60,00,000	-
Preference shares	72,00,000	67,50,000
Debentures	18,00,000	20,80,000

Additional information:

- I. Equity shares are quoted at ₹ 130 per share and a new issue priced at ₹ 125 per share will be fully subscribed; flotation costs will be ₹ 5 per share on face value.
- II. During the previous 5 years, dividends have steadily increased from ₹ 10 to ₹ 16.105 per share. Dividend at the end of the current year is expected to be ₹ 17.716 per share.
- III. 15% Preference shares with face value of ₹ 100 would realise ₹ 105 per share.
- IV. The company proposes to issue 11-year 15% debentures but the yield on debentures of similar maturity and risk class is 16%; flotation cost is 2% on face value.
- V. Corporate tax rate is 30%.

You are required to DETERMINE the weighted average cost of capital of Ex Limited using both the weights.

Capital Structure

3. The following data relates to two companies belonging to the same risk class:

Particulars	Bee Ltd.	Cee Ltd.
12% Debt	₹ 27,00,000	-
Equity Capitalization Rate	-	18
Expected Net Operating Income	₹ 9,00,000	₹ 9,00,000

You are required to:

- (a) DETERMINE the total market value, Equity capitalization rate and weighted average cost of capital for each company assuming no taxes as per M.M. Approach.
- (b) DETERMINE the total market value, Equity capitalization rate and weighted average cost of capital for each company assuming 40% taxes as per M.M. Approach.

Leverage

4. Company P and Q are having same earnings before tax. However, the margin of safety of Company P is 0.20 and, for Company Q, is 1.25 times than that of Company P. The interest expense of Company P is ₹ 1,50,000 and, for Company Q, is 1/3rd less than that of Company P. Further, the financial leverage of Company P is 4 and, for Company Q, is 75% of Company P.

Other information is given as below:

Particulars	Company P	Company Q
Profit volume ratio	25%	33.33%
Tax rate	45%	45%

You are required to PREPARE Income Statement for both the companies.

Investment Decisions

5. ABC & Co. is considering whether to replace an existing machine or to spend money on revamping it. ABC & Co. currently pays no taxes. The replacement machine costs ₹ 18,00,000 now and requires maintenance of ₹ 2,00,000 at the end of every year for eight years. At the end of eight years, it would have a salvage value of ₹ 4,00,000 and would be sold. The existing machine requires increasing amounts of maintenance each year and its salvage value fall each year as follows:

Year	Maintenance (₹)	Salvage (₹)
Present	0	8,00,000
1	2,00,000	5,00,000
2	4,00,000	3,00,000
3	6,00,000	2,00,000
4	8,00,000	0

The opportunity cost of capital for ABC & Co. is 15%.

REQUIRED:

When should the company replace the machine?

The following present value table is given for you:

Year	Present value of ₹ 1 at 15% discount rate
1	0.8696
2	0.7561
3	0.6575
4	0.5718
5	0.4972
6	0.4323
7	0.3759
8	0.3269

Risk Analysis in Capital Budgeting

6. ASG Ltd. is considering a project "Z" with an initial outlay of ₹ 15,00,000 and life of 5 years. The estimates of project are as follows:

	Lower Estimates	Base	Upper Estimates
Sales (units)	9,000	10,000	11,000
	(₹)	(₹)	(₹)
Selling Price p.u.	175	200	225

Variable cost p.u.	100	125	150
Fixed Cost	1,00,000	1,50,000	2,00,000

Depreciation included in Fixed cost is ₹ 70,000 and corporate tax is 25%.

Assuming the cost of capital as 15%, DETERMINE NPV in three scenarios i.e worst, base and best case scenario.

PV factor for 5 years at 15% are as follows:

Years	1	2	3	4	5
P.V. factor	0.870	0.756	0.658	0.572	0.497

Dividend Decision

7. The following figures have been collected from the annual report of ABC Ltd. for the current financial year:

Net Profit	₹ 75 lakhs
Outstanding 12% preference shares	₹ 250 lakhs
No. of equity shares	7.50 lakhs
Return on Investment	20%
Cost of capital i.e. (K_e)	16%

- (a) COMPUTE the approximate dividend pay-out ratio so as to keep the share price at ₹ 42 by using Walter’s model?
- (b) DETERMINE the optimum dividend pay-out ratio and the price of the share at such pay-out.
- (c) PROVE that the dividend pay-out ratio as determined above in (b) is optimum by using random pay-out ratio.

Management of Cash

8. You are given below the Profit & Loss Accounts for two years for a company:

Profit and Loss Account

	Year 1	Year 2		Year 1	Year 2
	(₹)	(₹)		(₹)	(₹)
To Opening stock	32,00,000	40,00,000	By Sales	3,20,00,000	4,00,00,000
To Raw materials	1,20,00,000	1,60,00,000	By Closing stock	40,00,000	60,00,000
To Stores	38,40,000	48,00,000	By Misc. Income	4,00,000	4,00,000
To Manufacturing Expenses	51,20,000	64,00,000			

To Other Expenses	40,00,000	40,00,000			
To Depreciation	40,00,000	40,00,000			
To Net Profit	42,40,000	72,00,000		-	-
	3,64,00,000	4,64,00,000		3,64,00,000	4,64,00,000

Sales are expected to be ₹ 4,80,00,000 in year 3.

As a result, other expenses will increase by ₹ 20,00,000 besides other charges. Only raw materials are in stock. Assume sales and purchases are in cash terms and the closing stock is expected to go up by the same amount as between year 1 and 2. You may assume that no dividend is being paid. The Company can use 75% of the cash generated to service a loan. COMPUTE how much cash from operations will be available in year 3 for the purpose? Ignore income tax.

Management of Working Capital

9. PQR Ltd., a company newly commencing business in the year 2021-22, provides the following projected Profit and Loss Account:

	(₹)	(₹)
Sales		5,04,000
Cost of goods sold		<u>3,67,200</u>
Gross Profit		1,36,800
Administrative Expenses	33,600	
Selling Expenses	<u>31,200</u>	<u>64,800</u>
Profit before tax		72,000
Provision for taxation		<u>24,000</u>
Profit after tax		<u>48,000</u>
The cost of goods sold has been arrived at as under:		
Materials used	2,01,600	
Wages and manufacturing Expenses	1,50,000	
Depreciation	<u>56,400</u>	
	4,08,000	
Less: Stock of Finished goods (10% of goods produced not yet sold)	<u>40,800</u>	
	<u>3,67,200</u>	

The figure given above relate only to finished goods and not to work-in-progress. Goods equal to 15% of the year's production (in terms of physical units) will be in process on the

average requiring full materials but only 40% of the other expenses. The company believes in keeping materials equal to two months' consumption in stock.

All expenses will be paid one month in advance. Suppliers of materials will extend 1-1/2 months credit. Sales will be 20% for cash and the rest at two months' credit. 70% of the Income tax will be paid in advance in quarterly instalments. The company wishes to keep ₹ 19,200 in cash. 10% must be added to the estimated figure for unforeseen contingencies.

PREPARE an estimate of working capital.

Miscellaneous

10. (a) 'Profit maximisation is not the sole objective of a company. It is at best a limited objective. If profit is given undue importance, a number of problems can arise.' DISCUSS four of such problems.
- (b) DISCUSS Agency problem and its cost. HOW it arises and HOW it can be addressed?

SUGGESTED ANSWERS/HINTS

1. (i) Determination of Sales and Cost of goods sold:

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$\text{Or, } \frac{25}{100} = \frac{\text{₹ } 12,00,000}{\text{Sales}}$$

$$\text{Or, Sales} = \frac{12,00,00,000}{25} = \text{₹ } 48,00,000$$

$$\begin{aligned} \text{Cost of Goods Sold} &= \text{Sales} - \text{Gross Profit} \\ &= \text{₹ } 48,00,000 - \text{₹ } 12,00,000 = \text{₹ } 36,00,000 \end{aligned}$$

(ii) Determination of Sundry Debtors:

Debtors' velocity is 3 months or Debtors' collection period is 3 months,

$$\text{So, Debtors' turnover ratio} = \frac{12\text{months}}{3\text{months}} = 4$$

$$\begin{aligned} \text{Debtors' turnover ratio} &= \frac{\text{Credit Sales}}{\text{Average Accounts Receivable}} \\ &= \frac{\text{₹ } 48,00,000}{\text{Bills Receivable} + \text{Sundry Debtors}} = 4 \end{aligned}$$

$$\text{Or, Sundry Debtors} + \text{Bills receivable} = \text{₹ } 12,00,000$$

$$\text{Sundry Debtors} = ₹ 12,00,000 - ₹ 75,000 = ₹ 11,25,000$$

(iii) Determination of Closing Stock

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock}} = \frac{₹ 36,00,000}{\text{Average Stock}} = 1.5$$

$$\text{So, Average Stock} = ₹ 24,00,000$$

$$\text{Now Average Stock} = \frac{\text{Opening Stock} + \text{Closing Stock}}{2}$$

$$\text{Or } \frac{\text{Opening Stock} + (\text{Opening Stock} + ₹ 30,000)}{2} = ₹ 24,00,000$$

$$\text{Or } 2 \text{ Opening Stock} + ₹ 30,000 = ₹ 48,00,000$$

$$\text{Or } 2 \text{ Opening Stock} = ₹ 47,70,000$$

$$\text{Or, Opening Stock} = ₹ 23,85,000$$

$$\text{So, Closing Stock} = ₹ 23,85,000 + ₹ 30,000 = ₹ 24,15,000$$

(iv) Determination of Sundry Creditors:

Creditors' velocity of 2 months or credit payment period is 2 months.

$$\text{So, Creditors' turnover ratio} = \frac{12 \text{ months}}{2 \text{ months}} = 6$$

$$\text{Creditors turnover ratio} = \frac{\text{Credit Purchases}^*}{\text{Average Accounts Payables}}$$

$$= \frac{₹ 36,30,000}{\text{Sundry Creditors} + \text{Bills Payables}} = 6$$

$$\text{So, Sundry Creditors} + \text{Bills Payable} = ₹ 6,05,000$$

$$\text{Or, Sundry Creditors} + ₹ 30,000 = ₹ 6,05,000$$

$$\text{Or, Sundry Creditors} = ₹ 5,75,000$$

(v) Determination of Fixed Assets

$$\text{Fixed Assets Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Fixed Assets}} = 4$$

$$\text{Or, } \frac{₹ 36,00,000}{\text{Fixed Assets}} = 4$$

$$\text{Or, Fixed Asset} = ₹ 9,00,000$$

Workings:

***Calculation of Credit purchases:**

Cost of goods sold = Opening stock + Purchases – Closing stock

$$₹ 36,00,000 = ₹ 23,85,000 + \text{Purchases} - ₹ 24,15,000$$

$$\text{Purchases (credit)} = ₹ 36,30,000$$

Calculation of credit purchase also can be done as below:

Or Credit Purchases = Cost of goods sold + Difference in Opening Stock

$$\text{Or Credit Purchases} = 36,00,000 + 30,000 = ₹ 36,30,000$$

$$2. \quad (i) \quad \text{Cost of Equity } (K_e) = \frac{D_1}{P_0 - F} + g = \frac{₹ 17.716}{₹ 125 - ₹ 5} + 0.10^*$$

$$K_e = 0.2476$$

*Calculation of g:

$$₹ 10 (1+g)^5 = ₹ 16.105$$

$$\text{Or, } (1+g)^5 = \frac{16.105}{10} = 1.6105$$

Table (FVIF) suggests that ₹ 1 compounds to ₹ 1.6105 in 5 years at the compound rate of 10 percent. Therefore, g is 10 per cent.

$$(ii) \quad \text{Cost of Retained Earnings } (K_r) = \frac{D_1}{P_0} + g = \frac{₹ 17.716}{₹ 130} + 0.10 = 0.2363$$

$$(iii) \quad \text{Cost of Preference Shares } (K_p) = \frac{PD}{P_0} = \frac{₹ 15}{₹ 105} = 0.1429$$

$$(iv) \quad \text{Cost of Debentures } (K_d) = \frac{I(1-t) + \left(\frac{RV - NP}{n} \right)}{\frac{RV + NP}{2}}$$

$$= \frac{₹ 15 (1-0.30) + \left(\frac{₹ 100 - ₹ 91.75^*}{11 \text{ years}} \right)}{\frac{₹ 100 + ₹ 91.75^*}{2}}$$

$$= \frac{₹ 15 \times 0.70 + ₹ 0.75}{₹ 95.875} = \frac{₹ 11.25}{₹ 95.875} = 0.1173$$

*Since yield on similar type of debentures is 16 per cent, the company would be required to offer debentures at discount.

Market price of debentures (approximation method)

$$= ₹ 15 \div 0.16 = ₹ 93.75$$

Sale proceeds from debentures = ₹ 93.75 – ₹ 2 (i.e., flotation cost) = ₹ 91.75

Market value (P_0) of debentures can also be found out using the present value method:

$P_0 = \text{Annual Interest} \times \text{PVIFA (16\%, 11 years)} + \text{Redemption value} \times \text{PVIF (16\%, 11 years)}$

$$P_0 = ₹ 15 \times 5.0287 + ₹ 100 \times 0.1954$$

$$P_0 = ₹ 75.4305 + ₹ 19.54 = ₹ 94.9705$$

Net Proceeds = ₹ 94.9705 – 2% of ₹ 100 = ₹ 92.9705

Accordingly, the cost of debt can be calculated

Total Cost of capital [BV weights and MV weights]

(Amount in (₹) lakh)

Source of capital	Weights		Specific Cost (K)	Total cost	
	BV	MV		(BV × K)	(MV × K)
Equity Shares	240	320**	0.2476	59.4240	79.2320
Retained Earnings	60	80**	0.2363	14.1780	18.9040
Preference Shares	72	67.50	0.1429	10.2888	9.6458
Debentures	18	20.80	0.1173	2.1114	2.4398
Total	390	488.30		86.0022	110.2216

**Market Value of equity has been apportioned in the ratio of Book Value of equity and retained earnings i.e., 240:60 or 4:1.

Weighted Average Cost of Capital (WACC):

$$\text{Using Book Value} = \frac{₹ 86.0022}{₹ 390} = 0.2205 \text{ or } 22.05\%$$

$$\text{Using Market Value} = \frac{₹ 110.2216}{₹ 488.30} = 0.2257 \text{ or } 22.57\%$$

3. (a) Assuming no tax as per MM Approach.

Calculation of Value of Firms ‘Bee Ltd.’ and ‘Cee Ltd’ according to MM Hypothesis

Market Value of ‘Cee Ltd’ [Unlevered(u)]

Total Value of Unlevered Firm (V_u) = $[NOI/k_e] = 9,00,000/0.18 = ₹ 50,00,000$

K_e of Unlevered Firm (given) = 0.18

K_o of Unlevered Firm (Same as above = k_e as there is no debt) = 0.18

Market Value of ‘Bee Ltd’ [Levered Firm (l)]

Total Value of Levered Firm (V_L) = $V_u + (\text{Debt} \times \text{Nil})$
 = ₹ 50,00,000 + (27,00,000 × nil)
 = ₹ 50,00,000

Computation of Equity Capitalization Rate and Weighted Average Cost of Capital (WACC)

Particulars	Bee Ltd.
Net Operating Income (NOI)	9,00,000
Less: Interest on Debt (I)	3,24,000
Earnings of Equity Shareholders (NI)	5,76,000
Overall Capitalization Rate (k_o)	0.18
Total Value of Firm ($V = NOI/k_o$)	50,00,000
Less: Market Value of Debt	27,00,000
Market Value of Equity (S)	23,00,000
Equity Capitalization Rate [$k_e = NI / S$]	0.2504
Weighted Average Cost of Capital (k_o)* $k_o = (k_e \times S/V) + (k_d \times D/V)$	0.18

*Computation of WACC Bee Ltd

Component of Capital	Amount	Weight	Cost of Capital	WACC
Equity	23,00,000	0.46	0.2504	0.1152
Debt	27,00,000	0.54	0.12*	0.0648
Total	50,00,000			0.18

* $K_d = 12\%$ (since there is no tax)

WACC = 18%

(b) Assuming 40% taxes as per MM Approach**Calculation of Value of Firms 'Bee Ltd.' and 'Cee Ltd' according to MM Hypothesis****Market Value of 'Cee Ltd' [Unlevered(u)]**

$$\begin{aligned} \text{Total Value of unlevered Firm (V}_u) &= [\text{NOI} (1 - t)/k_e] = 9,00,000 (1 - 0.40) / 0.18 \\ &= ₹ 30,00,000 \end{aligned}$$

K_e of unlevered Firm (given) = 0.18

K_o of unlevered Firm (Same as above = k_e as there is no debt) = 0.18

Market Value of 'Bee Ltd' [Levered Firm (l)]

$$\begin{aligned} \text{Total Value of Levered Firm (V}_L) &= V_u + (\text{Debt} \times \text{Tax}) \\ &= ₹ 30,00,000 + (27,00,000 \times 0.4) \\ &= ₹ 40,80,000 \end{aligned}$$

Computation of Weighted Average Cost of Capital (WACC) of 'Cee Ltd.'

= 18% (i.e. $K_e = K_o$)

**Computation of Equity Capitalization Rate and
Weighted Average Cost of Capital (WACC) of Bee Ltd**

Particulars	Bee Ltd. (₹)
Net Operating Income (NOI)	9,00,000
Less: Interest on Debt (I)	3,24,000
Earnings Before Tax (EBT)	5,76,000
Less: Tax @ 40%	2,30,400
Earnings for equity shareholders (NI)	3,45,600
Total Value of Firm (V) as calculated above	40,80,000
Less: Market Value of Debt	27,00,000
Market Value of Equity (S)	13,80,000
Equity Capitalization Rate [$k_e = \text{NI}/S$]	0.2504
Weighted Average Cost of Capital (k_o)* $k_o = (k_e \times S/V) + (k_d \times D/V)$	13.23

*Computation of WACC Bee Ltd.

Component of Capital	Amount	Weight	Cost of Capital	WACC
Equity	13,80,000	0.338	0.2504	0.0846

Debt	27,00,000	0.662	0.072*	0.0477
Total	40,80,000			0.1323

* $K_d = 12\% (1 - 0.4) = 12\% \times 0.6 = 7.2\%$

WACC = 13.23%

4.

Income Statement

Particulars	Company P (₹)	Company Q (₹)
Sales	40,00,000	18,00,000
Less: Variable Cost	30,00,000	12,00,000
Contribution	10,00,000	6,00,000
Less: Fixed Cost	8,00,000	4,50,000
EBIT	2,00,000	1,50,000
Less: Interest	1,50,000	1,00,000
EBT	50,000	50,000
Tax (45%)	22,500	22,500
EAT	27,500	27,500

Workings:

(i) Margin of Safety

For Company P = 0.20

For Company Q = 0.20 x 1.25 = 0.25

(ii) Interest Expenses

For Company P = ₹ 1,50,000

For Company Q = ₹ 1,50,000 (1-1/3) = ₹ 1,00,000

(iii) Financial Leverage

For Company P = 4

For Company Q = 4 x 75% = 3

(iv) EBIT

For Company A

Financial Leverage = EBIT/(EBIT - Interest)

4 = EBIT/(EBIT - ₹ 1,50,000)

4EBIT - ₹ 6,00,000 = EBIT

3EBIT = ₹ 6,00,000

EBIT = ₹ 2,00,000

For Company B

Financial Leverage = EBIT/(EBIT - Interest)

3 = EBIT/(EBIT - ₹ 1,00,000)

3EBIT - ₹ 3,00,000 = EBIT

2EBIT = ₹ 3,00,000

EBIT = ₹ 1,50,000

(v) Contribution

For Company A

Operating Leverage = 1/Margin of Safety

= 1/0.20 = 5

Operating Leverage = Contribution/EBIT

5 = Contribution/₹ 2,00,000

Contribution = ₹ 10,00,000

For Company B

Operating Leverage = 1/Margin of Safety

= 1/0.25 = 4

Operating Leverage = Contribution/EBIT

4 = Contribution/₹ 1,50,000

Contribution = ₹ 6,00,000

(vi) Sales

For Company A

Profit Volume Ratio = 25%

Profit Volume Ratio = Contribution/Sales × 100

25% = ₹ 10,00,000/Sales

Sales = ₹ 10,00,000/25%

Sales = ₹ 40,00,000

For Company B

Profit Volume Ratio = 33.33%

Therefore, Sales = ₹ 6,00,000/33.33%

Sales = ₹ 18,00,000

5. ABC & Co.

Equivalent Annual Cost (EAC) of new machine

		(₹)
(i)	Cost of new machine now	18,00,000
	Add: PV of annual repairs @ ₹ 2,00,000 per annum for 8 years (₹ 2,00,000 × 4.4873)	8,97,460
		26,97,460
	Less: PV of salvage value at the end of 8 years (₹ 4,00,000 × 0.3269)	1,30,760
		25,66,700
	Equivalent annual cost (EAC) (₹ 25,66,700/4.4873)	5,71,992

PV of cost of replacing the old machine in each of 4 years with new machine

Scenario	Year	Cash Flow	PV @ 15%	PV
		(₹)		(₹)
Replace Immediately	0	(5,71,992)	1.00	(5,71,992)
	0	8,00,000	1.00	8,00,000
				2,28,008
Replace in one year	1	(5,71,992)	0.8696	(4,97,404)
	1	(2,00,000)	0.8696	(1,73,920)
	1	5,00,000	0.8696	4,34,800
				(2,36,524)
Replace in two years	1	(2,00,000)	0.8696	(1,73,920)
	2	(5,71,992)	0.7561	(4,32,483)
	2	(4,00,000)	0.7561	(3,02,440)
	2	3,00,000	0.7561	2,26,830
				(6,82,013)
Replace in three years	1	(2,00,000)	0.8696	(1,73,920)
	2	(4,00,000)	0.7561	(3,02,440)
	3	(5,71,992)	0.6575	(3,76,085)
	3	(6,00,000)	0.6575	(3,94,500)
	3	2,00,000	0.6575	1,31,500
				(11,15,445)

Replace in four years	1	(2,00,000)	0.8696	(1,73,920)
	2	(4,00,000)	0.7561	(3,02,440)
	3	(6,00,000)	0.6575	(3,94,500)
	4	(5,71,992)	0.5718	(3,27,065)
	4	(8,00,000)	0.5718	(4,57,440)
				(16,55,365)

Advice: The company should replace the old machine immediately because the PV of cost of replacing the old machine with new machine is least.

6. (i) Calculation of Yearly Cash Inflow

In worst case: High costs and Low price (Selling price) and volume (Sales units) are taken.

In best case: Low costs and High price (Selling price) and volume (Sales units) are taken.

	Worst Case	Base	Best Case
Sales (units) (A)	9,000	10,000	11,000
	(₹)	(₹)	(₹)
Selling Price p.u.	175	200	225
Less: Variable cost p.u.	150	125	100
Contribution p.u. (B)	25	75	125
Total Contribution (A x B)	2,25,000	7,50,000	13,75,000
Less: Fixed Cost	2,00,000	1,50,000	1,00,000
EBT	25,000	6,00,000	12,75,000
Less: Tax @ 25%	62,50	1,50,000	3,18,750
EAT	18,750	4,50,000	9,56,250
Add: Depreciation	70,000	70,000	70,000
Cash Inflow	88,750	5,20,000	10,26,250

(ii) Calculation of NPV in different scenarios

	Worst Case	Base	Best Case
Initial outlay (A) (₹)	15,00,000	15,00,000	15,00,000
Cash Inflow (c) (₹)	88,750	5,20,000	10,26,250
Cumulative PVF @ 15% for 5 years (d)	3.353	3.353	3.353

PV of Cash Inflow (B = c x d) (₹)	2,97,578.75	17,43,560.00	34,41,016.25
NPV (B - A) (₹)	(12,02,421.25)	2,43,560.00	19,41,016.25

7. (a)

	₹ in lakhs
Net Profit	75
Less: Preference dividend	30
Earning for equity shareholders	45
Earning per share	= 45/7.5 = ₹ 6.00

Let, the dividend per share be D to get share price of ₹ 42

$$P = \frac{D + \frac{r}{K_e}(E - D)}{K_e}$$

$$₹ 42 = \frac{D + \frac{0.20}{0.16}(6 - D)}{0.16}$$

$$6.72 = \frac{0.16D + 1.2 - 0.20D}{0.16}$$

$$0.04D = 1.2 - 1.0752$$

$$D = 3.12$$

$$D/P \text{ ratio} = \frac{DPS}{EPS} \times 100 = \frac{3.12}{6} \times 100 = 52\%$$

So, the required dividend payout ratio will be = 52%

(b) Since $r > K_e$, the optimum dividend pay-out ratio would 'Zero' (i.e. $D = 0$),

Accordingly, value of a share:

$$P = \frac{D + \frac{r}{K_e}(E - D)}{K_e}$$

$$P = \frac{0 + \frac{0.20}{0.16}(6 - 0)}{0.16} = ₹ 46.875$$

- (c) The optimality of the above pay-out ratio can be proved by using 25%, 50%, 75% and 100% as pay- out ratio:

At 25% pay-out ratio

$$P = \frac{1.5 + \frac{0.20}{0.16}(6-1.5)}{0.16} = ₹ 44.531$$

At 50% pay-out ratio

$$P = \frac{3 + \frac{0.20}{0.16}(6-3)}{0.16} = ₹ 42.188$$

At 75% pay-out ratio

$$P = \frac{4.5 + \frac{0.20}{0.16}(6-4.5)}{0.16} = ₹ 39.844$$

At 100% pay-out ratio

$$P = \frac{6 + \frac{0.20}{0.16}(6-6)}{0.16} = ₹ 37.50$$

From the above it can be seen that price of share is maximum when dividend pay-out ratio is 'zero' as determined in (b) above.

8. Projected Profit and Loss Account for the year 3

Particulars	Year 2 Actual (₹ in lakhs)	Year 3 Projected (₹ in lakhs)	Particulars	Year 2 Actual (₹ in lakhs)	Year 3 Projected (₹ in lakhs)
To Materials consumed	140.00	168.00	By Sales	400.00	480.00
To Stores	48.00	57.60	By Misc. Income	4.00	4.00
To Mfg. Expenses	64.00	76.80			
To Other expenses	40.00	60.00			
To Depreciation	40.00	40.00			
To Net profit	72.00	81.60			
	404.00	484.00		484.00	484.00

Cash Flow:

Particulars	(₹ in lakhs)
Profit	81.60
Add: Depreciation	<u>40.00</u>
	121.60

Less: Cash required for increase in stock	<u>20.00</u>
Net cash inflow	101.60

Available for servicing the loan: 75% of ₹ 1,01,60,000 or ₹ 76,20,000

Working Notes:

- (i) Material consumed in year 1 = $(32 + 120 - 40)/320 = 35\%$
 Material consumed in year 2 = $(40 + 160 - 60)/400 = 35\%$
 Likely consumption in year 3 = $480 \times \frac{35}{100} = ₹ 168$ (lakhs)
- (ii) Stores are 12% of sales & Manufacturing expenses are 16% of sales for both the years.

9. Statement showing the requirements of Working Capital

Particulars	(₹)	(₹)
A. Current Assets:		
Inventory:		
Stock of Raw material (₹ 2,31,840 × 2/12)	38,640	
Stock of Work-in-progress (As per Working Note)	39,240	
Stock of Finished goods (₹ 3,51,600 × 10/100)	35,160	
Receivables (Debtors) (₹3,04,992 × 2/12)	50,832	
Cash in Hand	19,200	
Prepaid Expenses:		
Wages & Mfg. Expenses (₹ 1,59,000 × 1/12)	13,250	
Administrative expenses (₹ 33,600 × 1/12)	2,800	
Selling & Distribution Expenses (₹ 31,200 × 1/12)	2,600	
Advance taxes paid {(70% of ₹ 24,000) × 3/12}	4,200	
Gross Working Capital	2,05,922	2,05,922
B. Current Liabilities:		
Payables for Raw materials (₹ 2,70,480 × 1.5/12)	33,810	
Provision for Taxation (Net of Advance Tax) (₹ 24,000 × 30/100)	7,200	
Total Current Liabilities	41,010	41,010
C. Excess of CA over CL		1,64,912
Add: 10% for unforeseen contingencies		16,491
Net Working Capital requirements		1,81,403

Working Notes:**(i) Calculation of Stock of Work-in-progress**

Particulars	(₹)
Raw Material (₹ 2,01,600 × 15%)	30,240
Wages & Mfg. Expenses (₹ 1,50,000 × 15% × 40%)	9,000
Total	39,240

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

Particulars	(₹)
Direct material Cost [₹ 2,01,600 + ₹ 30,240]	2,31,840
Wages & Mfg. Expenses [₹ 1,50,000 + ₹ 9,000]	1,59,000
Depreciation	0
Gross Factory Cost	3,90,840
Less: Closing W.I.P.	(39,240)
Cost of goods produced	3,51,600
Add: Administrative Expenses	33,600
	3,85,200
Less: Closing stock	(35,160)
Cost of Goods Sold	3,50,040
Add: Selling and Distribution Expenses	31,200
Total Cash Cost of Sales	3,81,240
Debtors (80% of cash cost of sales)	3,04,992

(iii) Calculation of Credit Purchase

Particulars	(₹)
Raw material consumed	2,31,840
Add: Closing Stock	38,640
Less: Opening Stock	-
Purchases	2,70,480

10. (a) **Profit maximisation cannot be the sole objective of a company.** It is at best a limited objective. If profit is given undue importance, a number of problems can arise. Some of these have been discussed below:

- (i) **The term profit is vague. It does not clarify what exactly it means.** It conveys a different meaning to different people. For example, profit may be in short term or long term period; it may be total profit or rate of profit etc.
- (ii) **Profit maximisation has to be attempted with a realisation of risks involved.** There is a direct relationship between risk and profit. Many risky propositions yield high profit. Higher the risk, higher is the possibility of profits. If profit maximisation is the only goal, then risk factor is altogether ignored. This implies that finance manager will accept highly risky proposals also, if they give high profits. In practice, however, risk is very important consideration and has to be balanced with the profit objective.
- (iii) **Profit maximisation as an objective does not take into account the time pattern of returns.** Proposal A may give a higher amount of profits as compared to proposal B, yet if the returns of proposal A begin to flow say 10 years later, proposal B may be preferred which may have lower overall profit but the returns flow is more early and quick.
- (iv) **Profit maximisation as an objective is too narrow.** It fails to take into account the social considerations as also the obligations to various interests of workers, consumers, society, as well as ethical trade practices. If these factors are ignored, a company cannot survive for long. Profit maximization at the cost of social and moral obligations is a short sighted policy.

(b) **Agency Problem:** Though in a sole proprietorship firm, partnership etc., owners participate in management but in corporates, owners are not active in management so, there is a separation between owner/ shareholders and managers. In theory managers should act in the best interest of shareholders however in reality, managers may try to maximise their individual goal like salary, perks etc., so there is a principal agent relationship between managers and owners, which is known as Agency Problem. In a nutshell, **Agency Problem is the chances that managers may place personal goals ahead of the goal of owners.**

Agency Problem leads to Agency Cost. Agency cost is the additional cost borne by the shareholders to monitor the manager and control their behaviour so as to maximise shareholders wealth. Generally, Agency Costs are of four types (i) monitoring (ii) bonding (iii) opportunity (iv) structuring.

The agency problem arises if manager's interests are not aligned to the interests of the debt lender and equity investors. The agency problem of debt lender would be addressed by imposing negative covenants i.e. the managers cannot borrow beyond a point. This is one of the most important concepts of modern-day

finance and the application of this would be applied in the Credit Risk Management of Bank, Fund Raising, Valuing distressed companies.

Agency problem between the managers and shareholders can be addressed if the interests of the managers are aligned to the interests of the shareholders. It is easier said than done.

However, following **efforts** have been made to **address these issues**:

- ◆ Managerial compensation is linked to profit of the company to some extent and also with the long-term objectives of the company.
- ◆ Employee is also designed to address the issue with the underlying assumption that maximisation of the stock price is the objective of the investors.
- ◆ Effecting monitoring can be done.

SECTION: B: ECONOMICS FOR FINANCE

QUESTIONS

1. (a) What are the data requirement and outcome of different method of National Income Calculation?
- (b) Can the GDP of a country be taken as an Index of welfare of people in the country?
- (c) Calculate National Income with the help of Expenditure Method and Income Method:

Item	In Crores
Compensation of employees	1600
Profit	700
Net factor Income from above abroad	40
Indirect Taxes	200
Subsidies	80
Private Final Consumption Expenditure	1800
Net domestic capital formation	900
Depreciation	150
Interest	600
Rent	400
Mixed Income of self employed	800
Export	50
Import	30
Government Final consumption expenditure	1100
Employees contribution to social security scheme	400

2. (a) How is multiplier useful in of functioning of Keynesian theory of determination of National Income?
- (b) Do you agree with the statement “An important element of Keynesian models is that they relate to short period equilibrium and contain no dynamic elements?”
- (c) An Economy is characterized by the following equations:
 $C = 40 + 0.6Y_d$
 $F = 20$
 $G = 40$
 $T_Y = 2$

$$X = 30$$

$$M = 25 + 0.02Y$$

- (a) What is the equilibrium income.
- (b) Calculate trade balance and foreign trade multiplier.
3. (a) What are the various instruments by which governments can influence resource allocation in the economy?
- (b) What are the intervention by government for correcting information failure?
- (c) What is the distinction between discretionary and non-discretionary fiscal policy?
- (d) What is the interrelationship between monetary policy and Money Supply?
4. (a) How is credit multiplier determined?
- (b) What is Compound tariff and how it is different from Mixed Tariff?
- (c) What is Voluntary Export Restraints?
- (d) Explain the situation "where a pharmaceutical Company has full information regarding the risks of a product, but it continues to sell"?
5. (a) What are the major concern in functioning of WTO?
- (b) How does income leakages effect the multiplier?
- (c) Which is the most appropriate method for calculation of National Income in developed countries?
- (d) What is the significance of Liquidity Preference of behavior towards risk?

SUGGESTED ANSWERS

1. (a) The processes of production, distribution and disposition keep going on simultaneously and enable us to look at national income from three different angles namely: as a flow of production or value added, as a flow of income and as a flow of expenditure. Each of these different ways of looking at national income suggests a different method of calculation and requires a different set of data.

Product Method

Data required: The sum of net values added by all the producing enterprises of the country.

What is measured: Contribution of production units.

Income Method

Data required: Total factor incomes generated in the production of goods and services

What is measured: Relative contribution of factor owners.

Expenditure method

Data required: Sum of expenditures of the three spending units in the economy, namely, government, consumer households, and producing enterprises.

What is measured: Flow of consumption and investment expenditures

- (b) There are many reasons to dispute the validity of GDP as a perfect measure of well-being. In fact, GDP measures our ability to obtain many requirements to make our life better; yet leave out many important aspects which ensure good quality of life for all. GDP measures exclude the following which are critical for the overall wellbeing of citizens.
- Countries may have significantly different income distributions and, consequently, different levels of overall well-being for the same level of per capita income.
 - Quality improvements in systems and processes due to technological as well as managerial innovations which reflect true growth in output from year to year.
 - Productions hidden from government authorities, either because those engaged in it are evading taxes or because it is illegal.
 - Nonmarket production (with a few exceptions) and non-economic contributors to well-being for example: health of a country's citizens, education levels, political participation, or other social and political factors that may significantly affect well-being levels.
 - The disutility of loss of leisure time. We know that other things remaining the same, a country's GDP rises if the total hours of work increase.
 - The volunteer work and services rendered without remuneration undertaken in the economy, even though such work can contribute to social well-being as much as paid work.
 - Many things that contribute to our economic welfare such as, leisure time, fairness, gender equality, security of community feeling etc.,
 - Both positive and negative externalities which are external effects that do not form part of market transactions.

(c) Income Method

$$\begin{aligned}
 \text{NNP}_{\text{FC or NI}} &= \text{Compensation of Employees} + \text{Operating Surplus} + \text{Mixed Income of self employed} + \text{Net factor Income from abroad.} \\
 &= 1600 + (\text{Rent} + \text{Interest} + \text{Profit}) + \text{Mixed Income of self-employed} + \text{Net factor Income from Abroad.} \\
 &= 1600 + (400+600+700) + 800+40 \\
 &= 1600+1700+840 \\
 &= 4140 \text{ Cr.}
 \end{aligned}$$

$$\begin{aligned}
 \text{GDP}_{\text{MP}} &= \text{Private final consumption expenditure} + \text{Government final Consumption expenditure} + \text{Gross domestic Capital formation (Net domestic Capital formation} + \text{depreciation)} + \text{Net export} \\
 &= 1800+1100 (900 + 150) + (50 - 30) \\
 &= 2900 + 1050+20 \\
 &= 3970 \text{ Cr.}
 \end{aligned}$$

$$\begin{aligned}
 \text{NNP}_{\text{FC or NI}} &= \text{GDP}_{\text{MP}} - \text{depreciation} + \text{Net factor income from abroad} - \text{Net Indirect taxes} \\
 &= 3970 - 150 + 40 - 120 \\
 &= 3740 \text{ Cr.}
 \end{aligned}$$

2. (a) The multiplier concept is central to Keynes's theory because it explains how shifts in investment caused by changes in business expectations set off a process that causes not only investment but also consumption to vary. The multiplier shows how shocks to one sector are transmitted throughout the economy.

The MPC, on which the multiplier effect of increase in income depends, is high in underdeveloped countries, but ironically the value of multiplier is low. Due to structural inadequacies, increase in consumption expenditure is not generally accompanied by increase in production. Example, increased demand for industrial goods consequent on increased income does not lead to increase in their real output, rather prices tend to rise.

- (b) An important element of Keynesian models is that they relate to short-period equilibrium and contain no dynamic elements. There is nothing like Keynesian macro-economic dynamics. When a shock occurs, for example when there is a change in autonomous investment due to change in some variable, one equilibrium position can be compared with another as a matter of comparative statics. There is no link between one period and the next and no provision is made for an analysis of processes through time.

$$\begin{aligned}
 \text{(c) } Y &= C + I + G + (X - M) \\
 &= 40 + 0.6Y_d + 20 + 40 + (30 - 25 + 0.02Y) \\
 &= 40 + 0.6(Y - T) + 20 + 40 + 30 - 25 - 0.02Y \\
 &= 40 + 0.6(Y - 2) + 65 - 0.02Y \\
 &= 40 + 0.6Y - 1.2 + 65 = 0.02Y
 \end{aligned}$$

$$Y = 103.8 + 0.58Y$$

$$Y - 0.58Y = 103.8$$

$$0.42Y = 103.8$$

$$Y = \frac{103.8}{0.42} = 247.142$$

$$\begin{aligned}
 \text{Trade Balance} &= (X - M) \\
 &= 30 - 25 + 0.02(247.142) \\
 &= 5 + 4.94 \\
 &= 9.94 \text{ Cr.}
 \end{aligned}$$

$$\begin{aligned}
 \text{Foreign Trade multiplier} &= \frac{1}{1 - b + m} \\
 &= \frac{1}{1 - 0.6 + 0.02} \\
 &= \frac{1}{0.42} \\
 &= 2.38
 \end{aligned}$$

3. (a) The allocation responsibility of the governments involves suitable corrective action when private market fail to provide the right and desirable combination of goods and services. A variety of allocation instruments are available by which governments can influence resource allocation in the economy. For example,
- Government may directly produce an economic good.
 - Government may influence private allocation through incentives and disincentives.
 - Government may influence allocation through its competition policies, merger policies etc. which affect the structure of industry and commerce.
 - Governments' regulatory activities such as licensing, controls, minimum wages, and directives on location of industry influence resource allocation.

- Government sets legal and administrative frameworks, and
 - Any mixture of intermediate methods may be adopted by governments.
- (b) For combating the problem of market failure due to information problems and considering the importance of information in making rational choices, the following interventions are resorted to:
- Government makes it mandatory to have accurate labelling and content disclosures by producers. Eg. Labelling of nutritional information in food packages.
 - Mandatory disclosure of information for example: SEBI requires that accurate information be provided to prospective buyers of new stocks.
 - Public dissemination of information to improve knowledge and subsidizing of initiatives in that direction.
 - Regulation of advertising and setting of advertising standards to make advertising more responsible, informative, and less persuasive.
- (c) Discretionary fiscal policy refers to deliberate policy actions on the part of the government to change the levels of expenditure and taxes to influence the level of national output, employment, and prices. Non-discretionary fiscal policy or automatic stabilizers are part of the structure of the economy and are 'built-in' fiscal mechanisms that operate automatically to reduce the expansions and contractions of the business cycle.

In most economies, changes in the level of taxation and level of government spending tend to occur automatically. These are dependent on and are determined by the level of aggregate production and income, such that the instability caused by business cycle is automatically dampened without any need for discretionary policy action.

- (d) If the central bank of a country wants to stimulate economic activity it does so by infusing liquidity into the system. Let us take the example of open market operations (OMO) by central banks. Purchase of government securities injects high powered money (monetary base) into the system. Assuming that banks do not hold excess reserves and people do not hold more currency than before, and also that there is demand for loans from businesses, the credit creation process by the banking system in the country will create money to the tune of

$$\Delta \text{Money Supply} = 1/R \times \Delta \text{Reserves}$$

The effect of an open market sale is very similar to that of open market purchase, but in the opposite direction. In other words, an open market purchase by central bank will reduce the reserves and thereby reduce the money supply.

4. (a) The Credit Multiplier also referred to as the deposit multiplier or the deposit expansion multiplier, describes the amount of additional money created by commercial bank through the process of lending the available money it has in excess of the central bank's reserve requirements. The deposit multiplier is, thus inextricably tied to the bank's reserve requirement. This measure tells us how much new money will be created by the banking system for a given increase in the high-powered money. It reflects a bank's ability to increase the money supply.

The existence of the credit multiplier is the outcome of fractional reserve banking. It explains how increase in money supply is caused by the commercial bank's use of depositors funds to lend money.

Credit Multiplier = $1 / \text{Required Reserve Ratio}$

- (b) Tariffs are aimed at altering the relative prices of goods and services imported, so as to contract the domestic demand and thus regulate the volume of their imports. Tariffs leave the world market price of the goods unaffected; while raising their prices in the domestic market. The main goals of tariffs are to raise revenue for the government, and more importantly to protect the domestic import-competing industries. The distinction between Compound tariff and Mixed tariff is as follows:

Compound Tariff or a Compound Duty is a combination of an ad valorem and a specific tariff. i.e., the tariff is calculated on the basis of both the value of the imported goods (an ad valorem duty) and a unit of measure of the imported goods (a specific duty). It is generally calculated by adding up a specific duty to an ad valorem duty.

Mixed Tariffs: Mixed tariffs are expressed either on the basis of the value of the imported goods (an ad valorem rate) or on the basis of a unit of measure of the imported goods (a specific duty) depending on which generates the most income (or least income at times) for the nation.

- (c) Voluntary Export Restraints (VERs) refer to a type of informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported out of that country during a specified period of time. Such restraints originate primarily from political considerations and are imposed based on negotiations of the importer with the exporter.

The inducement for the exporter to agree to a VER is mostly to appease the importing country and to avoid the effects of possible retaliatory trade restraints that may be imposed by the importer. VERs may arise when the import-competing industries seek protection from a surge of imports from particular exporting countries. VERs cause, as do tariffs and quotas, domestic prices to rise and cause loss of domestic consumer surplus.

- (d) This is a case of Asymmetric Information. Asymmetric information occurs when there is an imbalance in information between buyer and seller i.e. when the buyer knows more than the seller or the seller knows more than the buyer. This can distort choices. With asymmetric information, low-quality goods can drive high-quality goods out of the market. These are situations in which one party to a transaction knows a material fact that the other party does not. This phenomenon, which is sometimes referred to as the 'lemons problem', is an important source of market failure. These are situations in which one party to a transaction knows a material fact that the other party does not. This phenomenon, which is sometimes referred to as the 'lemons problem', is an important source of market failure.
5. (a) In recent years, apprehensions have been raised in respect of the WTO and its ability to maintain and extend a system of liberal world trade. The major issues are:
- The progress of multilateral negotiations on trade liberalization is very slow and the requirement of consensus among all members acts as a constraint and creates rigidity in the system. As a result, countries find regionalism as a plausible alternative.
 - The complex network of regional agreements introduces uncertainties and murkiness in the global trade system.
 - While multilateral efforts have effectively reduced tariffs on industrial goods, the achievement in liberalizing trade in agriculture, textiles, and apparel, and in many other areas of international commerce has been negligible.
 - The negotiations, such as the Doha Development Round, have run into problems, and their definitive success is doubtful.
 - Specific to the developing countries, namely, protectionism and lack of willingness among developed countries to provide market access, difficulties that they face in implementing the present agreements, apparent north-south divide, exceptionally high tariffs, tariff escalation, erosion of preferences and difficulties with regards to adjustments.
- (b) The multiplier concept is central to Keynes's theory because it explains how shifts in investment caused by changes in business expectations set off a process that causes not only investment but also consumption to vary. The multiplier shows how shocks to one sector are transmitted throughout the economy.

Increase in income due to increase in initial investment, does not go on endlessly. The process of income propagation slows down and ultimately comes to a halt. Causes responsible for the decline in income are called leakages. Income that is not spent on currently produced consumption goods and services may be regarded as having leaked out of income stream. If the increased income goes out of the cycle

of consumption expenditure, there is a leakage from income stream which reduces the effect of multiplier. The more powerful these leakages are the smaller will be the value of multiplier

- (c) Ideally, all the three methods of national income computation should arrive at the same figure. Moreover, different ways of measuring total output give us different insights into the structure of our economy.

Income method may be most suitable for developed economies where people properly file their income tax returns. With the growing facility in the use of the commodity flow method of estimating expenditures, an increasing proportion of the national income is being estimated by expenditure method. As a matter of fact, countries like India are unable to estimate their national income wholly by one method. Thus, in agricultural sector, net value added is estimated by the production method, in small scale sector net value added is estimated by the income method and in the construction sector net value added is estimated by the expenditure method.

- (d) In his classic article, 'Liquidity Preference as Behavior towards Risk' (1958), Tobin established that the risk-avoiding behavior of individuals provided the foundation for the liquidity preference and for a negative relationship between the demand for money and the interest rate. The risk-aversion theory is based on the principles of portfolio management.

In his theory which analyzes the individual's portfolio allocation between money and bond holdings, the demand for money is considered as a store of wealth. Tobin hypothesized that an individual would hold a portion of his wealth in the form of money in the portfolio because the rate of return on holding money was more certain than the rate of return on holding interest earning assets and entails no capital gains or losses. It is riskier to hold alternative assets vis-à-vis holding just money alone, because government bonds and equities are subject to market price volatility, while money is not. Thus, bonds pay an expected return of r , but as asset, they are unlike money because they are risky; and their actual return is uncertain. Despite this, the individual will be willing to face this risk because the expected rate of return from the alternative financial assets exceeds that of money.

**Applicability of Standards/Guidance Notes/Legislative Amendments etc. for
May, 2022 Examination**

Intermediate

Paper 5: Advanced Accounting

List of Applicable 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 7: Construction Contracts
- AS 9: Revenue Recognition
- AS 14: Accounting for Amalgamations
- AS 17: Segment Reporting
- AS 18: Related Party Disclosures
- AS 19: Leases
- AS 20: Earnings Per Share
- AS 22: Accounting for Taxes on Income
- AS 24: Discontinuing Operations
- AS 26: Intangible Assets
- AS 29: Provisions, Contingent Liabilities and Contingent Assets.

Applicability of the Companies Act, 2013 and other Legislative Amendments for May, 2022 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 31st October, 2021 (Refer Note*) will be applicable for May, 2022 Examination.

***Note: Applicability of the Amendments to Schedule III to the Companies Act, 2013:** The Central Government made certain amendments in Schedule III to the Companies Act, 2013 (vide Notification dated 24th March, 2021), with effect from 1st day of April, 2021. These amendments to Schedule III are applicable for May, 2022 Examination.

Non-Applicability of Ind AS : 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 do not form part of the syllabus and hence are not applicable.

Paper 6: Auditing and Assurance
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List of topic-wise inclusion in the syllabus**I. List of applicable Engagements and Quality Control Standards on Auditing**

S.No.	SA	<i>Title of Standard on Auditing</i>
1	SQC 1	Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements
2	SA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
3	SA 210	Agreeing the Terms of Audit Engagements
4	SA 220	Quality Control for Audit of Financial Statements
5	SA 230	Audit Documentation
6	SA 240	The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements
7	SA 250	Consideration of Laws and Regulations in An Audit of Financial Statements
8	SA 299	Joint Audit of Financial Statements (Revised)
9	SA 300	Planning an Audit of Financial Statements
10	SA 315	Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
11	SA 320	Materiality in Planning and Performing an Audit
12	SA 500	Audit Evidence
13	SA 501	Audit Evidence - Specific Considerations for Selected Items
14	SA 505	External Confirmations
15	SA 510	Initial Audit Engagements-Opening Balances
16	SA 520	Analytical Procedures
17	SA 530	Audit Sampling
18	SA 550	Related Parties
19	SA 560	Subsequent Events
20	SA 570	Going Concern (Revised)
21	SA 580	Written Representations
22	SA 610	Using the Work of Internal Auditors (Revised)
23	SA 700	Forming an Opinion and Reporting on Financial Statements (Revised)

24	SA 701	Communicating Key Audit Matters in the Independent Auditor's Report (New)
25	SA 705	Modifications to the Opinion in the Independent Auditor's Report (Revised)
26	SA 706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report (Revised)
27	SA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements

II. Applicability of the Companies Act, 2013 and other Legislative Amendments

- (i) The **September, 2021 Edition of the Study Material** on Intermediate Paper 6: Auditing and Assurance [comprising of 2 Modules – Modules 1 – 2] is relevant for May, 2022 Examinations. **This is an integrated Study Material cum Practice Manual.**

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 May, 2022 examination, significant notifications and circulars issued upto 31st October, 2021 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 31st October, 2021 will be applicable for May, 2022 Examination. **It may be noted that the significant notifications and circulars issued up to 31st October, 2021, which are not covered in the September, 2021 Edition of the Study Material, would be given as Academic Update in the Revision Test Paper for May, 2022 Examination.**

NOTE:

Applicability of the Amendments to Schedule III to the Companies Act, 2013

The Central Government made certain amendments in Schedule III to the Companies Act, 2013 (vide Notification dated 24th March, 2021), with effect from 1st day of April, 2021. These amendments to Schedule III are applicable for May, 2022 Examination.

- (ii) Companies (Auditor's Report) Order, 2020 issued by Ministry of Corporate Affairs is applicable for May, 2022 Examination.

List of topic-wise exclusion in the syllabus

- I. Statement on Reporting under Section 227(1A) of the Companies Act, 1956 (Section 143(1) of the Companies Act, 2013) **excluded.**
- II. **Following Engagements and Quality Control Standards on Auditing excluded:**

(1)	(2)	(3)
S. No	SA	Exclusions
1	SA 260	Communication with Those Charged with Governance (Revised)
2	SA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
3	SA 330	The Auditor's Responses to Assessed Risks
4	SA 402	Audit Considerations Relating to an Entity Using a Service Organization
5	SA 450	Evaluation of Misstatements Identified during the Audits
6	SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
7	SA 600	Using the Work of Another Auditor
8	SA 620	Using the Work of an Auditor's Expert
9	SA 720	The Auditor's Responsibilities Relating to Other Information

III. Following Guidance Notes are excluded:

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