

Illustration 1

On 1st May 2021 Superman Ltd. issued 5,000 Equity Shares of ₹100 each payable as follows:

	₹		₹	
On application	20	On 1st Call	20	(Last date fixed for payment 31st July)
On allotment	30	On Final Call	30	(Last date fixed for payment 30th August)

Applications were received on 15th May 2021 for 6,000 shares and allotment was made on 1st June 2021. Applicants for 2,500 shares were allotted in full, those for 3,000 shares were allotted 2,500 shares and applications for 500 shares were rejected.

Balance of amount due on allotment was received on 15th June.

The calls were duly made on 1st July, 2021 and 1st August 2021 respectively. One shareholder did not pay the 1st Call money on 150 shares which he paid with the final call together with interest at 5% p.a. Another shareholder holding 100 shares did not pay the final call money till end of the accounting year which ends on 31st October.

Required: Show the Cash Book and Journal Entries.

Solution:

In the books of Superman Ltd.

Journal

Dr.		Cr.
Date	Particulars	(₹)
1.6.21	Equity Share Application A/c Dr. To Equity Share Capital A/c To Share Allotment A/c (Being the transfer of application money @ ₹ 20 per share on 5,000 shares transferred to Share Capital A/c and @ ₹ 20 on 500 t/f to Share Allotment A/c)	1,10,000 1,00,000 10,000
1.6.21	Equity Share Allotment A/c Dr. To Equity Share Capital A/c (Being allotment money due on 5000 shares @ ₹ 30 per share)	1,50,000 1,50,000
1.7.21	Equity Share First Call A/c Dr. To Equity Share Capital A/c (Being 1st call money due on 5000 shares @ ₹ 20 per share)	1,00,000 1,00,000
1.8.21	Calls-in-Arrear A/c Dr. To Equity Share first call A/c (Being the non-receipt of 1st call money on 150 equity shares @ ₹ 20 each transferred to calls-in-Arrear A/c)	3,000 3,000
1.8.21	Equity Share Final Call A/c Dr. To Equity Share Capital A/c	1,50,000 1,50,000

	(Being final call money due on 5000 shares @ ₹ 30 per share)		
30.8.21	Shareholders A/c Dr. To Interest on calls-in-arrear (Being the interest due on first call on ₹300 @ 5% for two months, assumed payment made on 30.8.12)	25	25
1.09.21	Calls-in-Arrear A/c Dr. To Equity Share Final Call A/c (Being the transfer to calls-in-Arrear A/c final call money on 100 equity shares @ ₹30 per shares)	3,000	3,000
31.10.21	Shareholders A/c Dr. To Interest on Calls-in-Arrears A/c (Being the interest due on ₹ 3,000 @ 5% for two months)	25	25

Cash Book (Bank Column)

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
15.5.21	To Equity Share Application A/c (Application money @ ₹ 20 per share on 6,000 shares)	1,20,000	01.6.21	By Equity Share Application A/c (Refund of application money @ ₹ 20 per share on 500 shares rejected)	10,000
15.6.21	To Equity Share Allotment A/c (Balance of allotment money)	1,40,000			
31.07.21	To Equity Share 1st Call A/c (1st Call money on 4,850 shares)	97,000			
30.08.21	To Equity Share Final A/c (Final call money on 4,900 Shares)	1,47,000			
30.08.21	To Calls-in-Arrear A / c (Arrear of 1st Call money @ ₹ 20 per Share on 1,50 Shares)	3,000			
1.9.21	Shareholders A/c (Interest on ₹ 3,000 for two months @ 5% p.a.)	25	31.10.14	By Balance c/d	4,97,025
		5,07,025			5,07,025

Statement of shares applied, allotted and amounts adjusted

Categories	A	B	C
(a) Applied (No. of shares)	2,500	3,000	500
(b) Allotted (No. of shares)	2,500	2,500	Nil
(c) Application money received [(a) × ₹ 20 per share]	50,000	60,000	10,000

(d) Application money required [(b) × ₹ 20 per share]	50,000	50,000 (refundable)	-
(e) Excess Application money to be adjusted with allotment [(c) - (d)]	Nil	10,000	-
(f) Allotment money due [(b) × ₹ 30 per share]	75,000	75,000	-
(g) Amount received on allotment [(f) - (e)]	75,000	65,000	-

Illustration 2

A Company is planning to raise funds by making rights issue of equity shares to finance its expansion. The existing equity share capital of the company is ₹50,00,000. The market value of its share is ₹42. The company offers to its shareholders the right to buy 2 shares at ₹11 each for every 5 shares held. You are required to calculate:

- Theoretical market price after rights issue;
- The value of rights; and
- Percentage increase in share capital.

Solution:

	₹
Market value of 5 shares already held by a shareholder @ ₹ 42	210
Add: Price to be paid by him for acquiring 2 more shares @ ₹ 11 per share	<u>22</u>
Total price of 7 shares after rights issue	<u>232</u>
(i) Therefore, theoretical market price of one share, (i.e., 232/7) = 33.14	
(ii) Value of Rights = Market Price - Theoretical Market Price = ₹ 42 - ₹ 33.14. = ₹ 8.86	
(iii) Percentage Increase in Share Capital	
Present Capital	50,00,000
Rights Issue ₹ 50,00,000 × 2/5	20,00,000
% Increase in Share Capital (20,00,000/50,00,000) × 100	40%
	or, 2/5 × 100 = 40%

Illustration 3

The following is the balance sheet of RR Company Ltd as on 31.12.2021

Liabilities:	(₹)
Issued and paid up capital:	
225000 equity shares of ₹10 each fully called up	22,50,000
Less: Calls in arrear (25000 shares of ₹2 each)	50,000
100000 equity shares of ₹10 each, ₹4 paid up	4,00,000
P/L A/c	12,50,000
Dividend Equalization Reserve	1,00,000
General Reserve	1,50,000
Development Rebate reserve	2,50,000
Capital reserve	1,50,000
Securities premium	2,50,000

Capital redemption reserve	4,00,000
Current liability	10,00,000
Total	6,15,0000
Assets:	
	(₹)
Non-current assets	
Fixed assets	30,00,000
Current assets	10,00,000
Cash at bank	21,50,000
Total	61,50,000

The board of directors of the company took the following decisions.

- To forfeit the shares on which final call of ₹ 2 each is due.
- To issue fully paid bonus shares @ 1 fully paid up share for every 2 fully paid shares held.
- to pay bonus to the partly paid shares at an equivalent rate as in (b) above without collecting any amount from the related shareholders.
- to reissue the forfeited shares @ ₹ 12 each fully fed up.
- To pay dividend equivalent to 10% on share capital including bonus shares.
- To issue right shares in the ratio of 1 fully paid up share for every four existing fully paid up shares held after bonus issue at ₹15 per share.
- To use minimum balance of profit and loss account.

Note:

- All Capital Reserve are realized in cash.
- One fifth of the development rebate reserve is free.

Pass necessary journal entries in the books of the company including cash transaction after the above decisions are implemented.

Solution:

In The Books of RR Company Ltd. Journal

Date	Particulars		(₹)	Dr.	Cr.
	Equity Share Capital A/c	Dr.	2,50,000		
	To Calls in arrear A/c				50,000
	To Share forfeiture A/c				2,00,000
	Capital Redemption Reserve A/c	Dr.	4,00,000		
	Securities Premium A/c	Dr.	2,50,000		
	Capital Reserve A/c	Dr.	1,50,000		
	Development Rebate Reserve A/c Dr.		50,000		
	General Reserve A/c	Dr.	1,50,000		
	To Bonus to Shareholders A/c				10,00,000
	Bonus to Shareholders A/c To Equity Share Capital A/c	Dr.	10,00,000		10,00,000

	Equity Share Call A/c To Equity Share Capital A/c	Dr.	2,00,000	2,00,000
	Dividend Equalization Reserve A/c Profit and Loss A/c To Bonus to Shareholders A/c	Dr. Dr.	1,00,000 1,00,000	2,00,000
	Bonus to Shareholders A/c To Equity Share Call A/c	Dr.	2,00,000	2,00,000
	Bank (12 × 25000) A/c To Equity Share Capital A/c To Securities Premium A/c	Dr.	3,00,000	2,50,000 50,000
	Share Forfeiture A/c To Capital Reserve A/c	Dr.	2,00,000	2,00,000
	Profit and Loss A/c To Equity Dividend A/c	Dr.	3,85,000	3,85,000
	Equity Dividend A/c To Bank A/c	Dr.	3,85,000	3,85,000
	Bank A/c To Equity Share Capital A/c To Securities Premium A/c	Dr.	12,18,750	8,12,500 4,06,250

Illustration 4

XYZ Ltd. has the following capital structure on of 31st March 2021.

Particulars	₹ in Crores
a. Equity Share capital (Shares of ₹ 10 each)	300
b. Reserves:	
General reserve	270
Security Premium	100
Profit and Loss A/c	50
Export Reserve (Statutory reserve)	80
c. Loan Funds	800

The shareholders have on recommendation of Board of Directors approved vide special resolution at their meeting on 10th April 2021 a proposal to buy back maximum permissible equity shares considering the huge cash surplus following A/c of one of its divisions.

The market price was hovering in the range of ₹25 and in order to induce existing shareholders to offer their shares for buy back, it was decided to offer a price of 20% above market.

Advice the company on maximum number of shares that can be bought back and record journal entries for the same assuming the buyback has been completed in full within the next 3 months.

If borrowed funds were ₹1200 crores, and 1500 crores respectively would your answer change?

Solution:

Maximum shares that can be bought back

	Situation I	Situation II	Situation III
a. Shares outstanding test (WN # 1)	7.5	7.5	7.5
b. Resources test (WN # 2)	6	6	6
c. Debt Equity ratio test (WN # 3)	10.68	3	—
d. Maximum number of shares for buy back - LEAST of the above	6	3	—

	Particulars	Situation I		Situation II	
		Debit	Credit	Debit	Credit
a.	Shares bought back A/c Dr.	180		90	
	To Bank A/c		180		90
b.	[Being purchase of shares from public]	60		30	
	Share capital A/c Dr.	100		60	
	Security premium A/c Dr.	20		—	
	General reserve A/c (balancing figure) Dr.		180		90
c.	To Shares bought back A/c	60		30	
	[Being cancellation of shares bought on buy back]		60		30
	General reserves A/c Dr.				
	To Capital redemption reserve A/c				
	[Being transfer of reserves to capital redemption reserve to the extent capital is redeemed]				

Note: Under situation III, the company does not qualify the debt equity ratio test. Therefore, the company cannot perform the buyback of shares

Working Notes :

WN # 1: Shares outstanding test

Particulars	(₹)
a. No. of shares outstanding	30 crores
b. 25% of shares outstanding	7.5 crores

WN # 2: Resources test

(₹ in Crores)

Particulars	
a. Paid up capital	300
b. Free reserves [270+100+50]	420
c. Shareholders fund (a+b)	720
d. 25% of shareholders fund	180
e. Buyback price per share	₹ 30
f. Number of shares that can be bought back	6 Crores

WN # 3: Debt Equity ratio test:

₹ in Crores)

	Particulars	Situation I	Situation II	Situation III
a.	Borrowed Funds	800	1,200	1,500
b.	Minimum equity to be maintained after buy back in the ratio 2:1	400	600	750
c.	Present equity	720	720	720
d.	Maximum possible dilution in equity	320	120	—
e.	Maximum shares that can be bought back @ ₹ 30/- per share	10.67	4	—

Illustration 5

The share capital of Beta Co. Ltd consists of 1,00,000 equity shares of ₹10 each, and 25,000 preference shares of ₹100 each, fully called up. Its securities premium account shows a balance of ₹40,000 and general reserve of ₹7,00,000. The company decides to buy-back 20,000 equity shares of ₹12 each.

Pass the necessary journal entries.

Solution:

In the Books of Beta Co. Ltd.

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
1	Equity Share Capital A/c Securities Premium A/c To Equity Shareholders A/c (Amount due to equity shareholders for buying-back of 20,000 equity shares)	Dr. Dr.	2,00,000 40,000	2,40,000
2	Equity Shareholders A/c To Bank A/c (Payment to shareholders on account of buy-back)	Dr.	2,40,000	2,40,000
3	General Reserve A/c To Capital Redemption Reserve A/c (Transfer of nominal amount of equity shares Bought back.)	Dr.	2,00,000	2,00,000

Illustration 6

Alpha Ltd issued a prospectus inviting applications for 2,000 shares of ₹10 each at a premium of ₹2 per share, payable as follows:

On Application ₹ 2, On Allotment ₹ 5 (including premium)

On First Call ₹ 3, On Second & Final Call ₹ 2

Applications were received for 3,000 shares and pro rata allotment was made on the applications for 2,400 shares. It was decided to utilize excess application money towards the amount due on allotment.

Mohit, to whom 40 shares allotted, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited.

Jagat, the holder of 60 shares failed to pay the two calls and on his such failure, his shares were forfeited. Of the shares forfeited, 80 shares were sold to Rishav credited as fully paid for ₹ 9 per share, the whole of Mohit's shares being included.

Required: Give Journal Entries to record the above transactions (including cash transactions)

Solution:

In the Books of Alpha Ltd. Journals

Dr. Cr.

Particulars	(₹)	(₹)
Bank A/c Dr. To Share Application A/c [Being the application money received on 3,000 shares]	6,000	6,000
Share Application A/c Dr. To Share Capital A/c To Bank A/c To Share Allotment A/c (2,000@ ₹0.40) [Being the transfer and refund of application money received on 3,000 shares]	6,000	4,000 1,200 800
Share Allotment A/c Dr. To Share Capital A/c To Securities Premium A/c [Being the allotment money due]	10,000	6,000 4,000
Bank A/c Dr. Calls in Arrear A/c Dr. To Share Allotment A/c [Being the remaining allotment money received on 1,960 shares]**	9,016 184	9,200
Share First Call A/c Dr. To Share Capital A/c [Being the first call money due]	6,000	6,000
Bank A/c Dr. Calls in Arrear A/c Dr. To Share First Call A/c [Being the first call money received on 1,900 shares @ ₹ 3 per share]**	5,700 300	6,000
Share Capital A/c (40 × ₹8) Dr. Securities Premium A/c Dr. To Calls in Arrear A/c (184 +120) To Forfeited Share A/c [Being 40 shares forfeited for non-payment of full allotment money and the first call money]	320 80	304 96

Share Second & Final Call A/c	Dr.	3,920	
To Share Capital A/c			3,920
[Being the second and final call due on 1,960 share]			
Bank A/c	Dr.	3,800	
Calls in Arrear A/c	Dr.	120	
To Share Second and Final Call A/c			3,920
[Being the second and final call received on 1,900 shares]			
Share Capital A/c	Dr.	600	
To Calls in Arrear A/c			300
To Forfeited Shares A/c			300
[Being 60 shares forfeited for non-payment on the first call and final call]			
Bank A/c	Dr.	720	
Forfeited Shares A/c	Dr.	80	
To Share Capital A/c			800
[Being the reissued of 80 shares @ ₹ 9 as fully paid up]			
Forfeited Shares A/c	Dr.	216	
To Capital Reserve A/c			216
[Being the transfer of profit on re-issue]			
[On 40 @ ₹(2.40 - 1.00) = 56]			
On 40 @ ₹(5.00 - 1.00) = <u>160</u>			
216]			

Working Notes:

(i) Calculation of the amount due but not paid on allotment in Case of Mohit

	₹
Total No. of shares applied by Mohit (40 × 2,400/2,000)	48
Total money sent on application by Mohit (48 × ₹ 2)	96
Excess application money [₹ 96 - (40 × ₹ 2)]	16
Total amount due on allotment (40 × ₹ 5)	200
Amount due but not paid on allotment (₹ 200 - ₹ 16)	184

(ii) Calculation of allotment money received later on

	₹
Total allotment money due (2,000 × ₹ 5)	10,000
Less: (a) Already received ₹ 800	
(b) Not received (as per note 1) ₹ 184	984
	9,016

(iii) The question is silent as to the utilization of ₹16 (received from Mohit) between share capital and securities premium, it has been assumed that the entire excess of ₹16 is exclusively for share capital and hence credited to Forfeited Shares Account in full.

**Alternative Calculation –

Ratio of allotment = 2,000:2,400 = 5:6

Advance per share = $(6 \times 2 - 5 \times 2) / 5 = ₹0.40$

due on allotment = $₹5 - 0.40 = ₹4.60$

Unpaid money or calls in arrear —

	allot	Call-1	Call-2
Mohit (40) @ 4.60	184	120	-
Jagat (60)	<u>-</u>	<u>180</u>	<u>120</u>
	<u>184</u>	<u>300</u>	<u>120</u>

Illustration 7

Give journal entries for the following:

- PK Ltd. forfeited 10,000 equity shares of ₹10 each for nonpayment of first call of ₹2 and final call of ₹3 per share. These shares were reissued at a discount of ₹3.50 per share.
- KP Ltd. forfeited 20,000 equity shares of ₹15 each (including ₹5 per share as premium), for non-payment of final call of ₹3 per share. Out of these 10,000 shares were reissued at a discount of ₹4 per share.
- KP Ltd. forfeited 15,000 equity shares of ₹15 each (including ₹5 per share as premium), for non-payment of allotment money ₹8 (including premium money) and first & final call of ₹5 per share. Out of these 10,000 shares were reissued at ₹14 per share.

Solution:

In the books of Journals

		Dr.	Cr.
	Particulars	₹	₹
a)	Equity Share Capital A/c Dr. To Calls in Arrear A/c To Forfeited Share A/c (10,000 shares forfeited for non-payment of first and final call money)	1,00,000	50,000 50,000
	Bank A/c Dr. Forfeited Share A/c Dr. To Equity Share Capital Account (Reissue of 10,000 sh. @ ₹ 6.50 each)	65,000 35,000	1,00,000
	Forfeited Share A/c Dr. To Capital Reserve A/c (Balance of Forfeited share Account transferred)	15,000	15,000
b)	Equity Share Capital A/c Dr. To Calls in Arrear A/c To Forfeited share A/c (20,000 shares forfeited for non-payment of final call money)	200,000	60,000 140,000

	Bank A/c	Dr.	60,000	
	Forfeited Share A/c	Dr.	40,000	
	To Equity Share Capital A/c			100,000
	(Reissue of 10,000 sh. @ ₹ 6 each)			
	Forfeited Share A/c	Dr.	30,000	
	To Capital Reserve A/c			30,000
	(Balance of Forfeited share A/c relating to 10,000 shares transferred)[10,000 × (7-4)]			
c)	Equity Share Capital A/c	Dr.	150,000	
	Securities Premium A/c	Dr.	75,000	
	To Calls in Arrear A/c			1,95,000
	To Forfeited share A/c			30,000
	(15,000 shares forfeited for non-payment of allotment and first and final call money)			
	Bank A/c	Dr.	140,000	
	To Security Premium A/c			40,000
	To Equity Share Capital A/c			100,000
	(Reissue of 10,000 sh. @ ₹ 15 each)			
	Forfeited Share A/c	Dr.	20,000	
	To Capital Reserve A/c			20,000
	(Balance of Forfeited share A/c on 10,000 shares transferred)(10,000×2)			

Illustration 8

SOS Limited issued a prospectus inviting applications for 6,000 shares of ₹10 each at a premium of ₹2 per share, payable as follows;

On application ₹2 per share; On allotment ₹5 per share (including premium): On 1st call ₹3 per share; On Second and Final Call ₹2 per share.,

Applications were received for 9,000 shares and allotment was made prorata to the applicants of 7,500 shares, the remaining applicants were refused allotment. Money overpaid on applications were applied towards sums due on allotment.

D to whom 100 shares were allotted, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Z, the holder of 200 shares, failed to pay both the calls, and his shares were forfeited after the second and final call.

Of the shares forfeited 200 shares were sold to C credited as fully paid up for ₹8.50 per share, the whole of D's shares being included.

Solution:

In the books of SOS Limited Cash Book (Bank Column)

Dr.			Cr.
Particulars	₹	Particulars	₹
To Share Capital: (₹ 2 on 9,000 shares)	18,000	By Share Application A/c	3,000

To Share Allotment A/c (allotment money received)	26,550		
To Share 1st Call A/c (₹ 3 on 5,700 shares)	17,100		
To Share 2nd & Final Call A/c	11,400		
To Share Capital A/c (₹ 8.50 on 200 shares)	1,700	By Balance c/d	71,750
	74,750		74,750

Journal

Particulars	(₹)	Dr.	Cr.
Share Application A/c To Share Capital (Being Share application money transferred to Share Capital Account)	12,000		12,000
Share Application A/c To Share Allotment A/c (Being Share application money at ₹2 on 1,500 shares adjusted against allotment or @ ₹0.50 on 6,000 shares issued)	3,000		3,000
Share Allotment A/c To Share Capital A/c To Securities Premium A/c [Being the allotment money due]	30,000		18,000 12,000
Calls -in-arrear A/c To Share Allotment A/c	450		450
Share First Call A/c To Share Capital A/c [Being the first call money due]	18,000		18,000
Calls-in-arrear A/c To Share First Call A/c [300×3]	900		900
Share Capital A/c (100×8) Securities Premium A/c (100×2) To Forfeited Share A/c [100 ×(2×0.50)] To Calls in arrear A/c[100 ×5 (4.50+3)] [Being 100 shares of ₹10 each, ₹8 per Share called up, forfeited for non payment of allotment and first call]	800 200		250 750
Share Second and Final Call A/c To Share Capital A/c [Being the second and final call money due on 5,900 Shares]	11,800		11,800
Calls -in-arrear A/c To Share Second and Final Call A/c [200×2]	400		400
Share Capital A/c (200×10) To Forfeited Share A/c [200×(2+3)] To Calls-in arrear A/c [200×(2+3)]	2,000		1,000 1,000

[Being 200 shares of ₹10 each forfeited for non-payment of first and final call]		
Forfeited Share A/c Dr. To Share Capital A/c	300	300
[Being discount on 200 shares re-issued]		
Forfeited Share A/c Dr. To Capital Reserve A/c	450	450
[Being the transfer of profit on re-issue]		

Working Notes:

(i) Calculation of the amount due but no paid on allotment in Case of D.

No. of applied Shares by Mr. D. $(100 \times 7500/6,000)125$

** Alternatively:

Ratio of allotment = $6,000 : 7,500 = 4:5$

Advance per share adjustable allotment = $\frac{5X-4X}{4 \text{ shares}} = ₹ 0.50$ and due per share ₹ 4.50

So unpaid allotment money by D = $100 \times (5 - 0.50) = ₹450$

Total amount received on allotment = $(6,000 - 1,000) \times ₹4.50 = ₹26,550.$

** Profit on reissue:

On D's Share = $100 (2.50 - 1.50) = ₹ 100$

On Z's share = $100 \times (5-1.50) = ₹ 350$

₹ 450

	₹
Total money sent on application by Mr. D. (125×2)	₹ 250
Excess application money [₹ 250 - $(100 \times ₹ 2)$]	₹ 50
Total amount due on allotment $(100 \times ₹ 5)$	₹ 500
Amount due but not paid on allotment $(₹ 500 - ₹ 50)$	₹ 450

(ii)

	₹
Calculation of allotment money received later on Total allotment money due	₹ 30,000
Less: (a) Already received ₹ 3,000	
(b) Not received (as per note 1) ₹ 450	3,450
	<u>26,550</u>

Illustration 9

On 1st April 2017. H Ltd. issued 442, 10% Debentures of ₹1000 each at a discount of 10% redeemable at a premium of 5% after 4 years. It was decided to create a Sinking Fund for the purposes of accumulating sufficient funds to redeem the Debentures and to invest in some readily convertible securities yielding 10% interest p.a. Reference to the table shows that ₹1.00 p.a. at 10% compound interest amounts to ₹4.641 in 4 years. Investments are to be made in the Bonds of ₹1000 each available at par.

On 31st March 2021, the investments realized ₹3,40,000 and debentures were redeemed. The bank balance as on that date was ₹50,000.

Required: Prepare Debenture Redemption Fund Account and Debenture Redemption Fund Investments Account for 4 years.

Solution:

DRF = Debenture Redemption Fund, DRFI = Debenture Redemption Fund Investment

Debenture Redemption Fund Account

Dr.			CR.		
Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Balance c/d	1,00,000	31.03.2018	By P&L App.A/c	1,00,000
31.03.2019	To Balance c/d	2,10,000	01.04.2018	By Balance b/d	1,00,000
			31.03.2019	By Interest on DRFI A/c	10,000
				By P&L App. A/c	1,00,000
		2,10,000			2,10,000
31.03.2020	To Balance c/d	3,31,000	01.04.2019	By Balance b/d	2,10,000
			31.03.2020	By Interest on DRFI A/c	21,000
			31.03.2020	By P&L App. A/c	1,00,000
		3,31,000			3,31,000
31.03.2021	To Loss on issue of Debentures/ Premium on redemption of Debentures A/c	22,100	01.04.2020	By Balance b/d	3,31,000
	To Debenture Redemption Reserve A/c	4,51,000	31.03.2021	By Interest on DRFI A/c	33,100
			31.03.2021	By P&L App. A/c	1,00,000
				By Debenture Redemption Fund Investment A/c (Profit)	
		4,73,100			4,73,100

Debentures Redemption Fund Investment (DRFI) Account

Dr.			Cr.		
Date	Particulars	₹	Date	Particulars	₹
31.03.2018	To Bank A/c	1,00,000	31.03.2018	By Balance c/d	1,00,000
01.04.2018	To Balance b/d	1,00,000	31.03.2019	By Balance c/d	2,10,000
31.03.2019	To Bank A/c	1,10,000			
		2,10,000			2,10,000
01.04.2019	To Balance b/d	2,10,000	31.03.2020	By Balance c/d	3,31,000

31.03.2020	T Bank A/c	1,21,000			
		3,31,000			3,31,000
01.04.2020	To Balance b/d	3,31,000	31.03.2021	By Bank A/c (Sales)	3,40,000
31.03.2021	To Debenture Redemption Fund A/c (Profit)	9,000			
		3,40,000			3,40,000

Working Note:

(i) Calculation of the amount of profit set aside

₹

a. Face Value of Debentures	4,42,000
b. Premium Payable on Redemption	22,100
c. Depreciable Cost (A + B)	4,64,100
d. Value of annuity per ₹ 1	4,641
e. Annual amount to be charged (C/D)	1,00,000

(ii)

Calculation of the amount of investments and interest

Year a	Opening Balance b	Interest c = $b \times 10/100$	Saving d	Investments e = c + d	Closing Balance f = b + e
2017-18	—	—	1,00,000	1,00,000	1,00,000
2018-19	1,00,000	10,000	1,00,000	1,10,000	2,10,000
2019-20	2,10,000	21,000	1,00,000	1,21,000	3,31,000
2020-21	3,31,000	33,100	1,00,000	—	—

Illustration 10

A company purchased its own 12% Debentures in the open market for ₹25,00,000 (cum-interest). The interest amount included in the purchase price is ₹75,000. The face value of the debentures purchased is ₹26,00,000. The company immediately cancelled the debentures so purchased. Pass journal entries to record the purchase and immediate cancellation (ignoring transactions relating to Debenture Redemption Reserve and Debenture Redemption Investment).

Solution:

In the books ofJournal

Dr.

Cr

Date	Particulars	₹	₹
	Debenture Interest A/c Dr. To Bank A/c (Being debenture interest paid)	75,000	75,000
	12 % Debentures A/c Dr. To Bank A/c (25,00,000 - 75,000) To Profit on Cancellation of Debentures A/c [B/Fig.]	26,00,000	24,25,000 1,75,000

	(Being ₹26,00,000 own 12% Debentures purchased @ ₹24,25,000 for immediate cancellation and profit on cancellation recognized)		
	Profit on Cancellation of Debentures A/c.....Dr. To Capital Reserve A/c (Being profit on cancellation of debentures transferred to Capital Reserve)	1,75,000	1,75,000

Illustration 11

The following underwriting took place for P Ltd. which invited applications for 10,000 shares of Rs. 10 each: X: 6,000 shares Y: 2,500 shares Z: 1,500 shares

In addition, there were firm underwriting as follows:

X: 800 shares Y: 300 shares Z: 1,000 shares

Total subscription including firm underwriting was 7,100 shares, and the forms included the following marked forms:

X: 1,000 shares Y: 2,000 shares Z: 500 shares

Show the allocation of liability of the underwriters, if -

- Firm underwriting is treated as unmarked applications.
- Firm underwriting is treated as marked applications

Solution:

(i) When firm underwriting is treated as unmarked applications.

Calculation of Liability of the underwriters (No. of shares)

Particulars	X	Y	Z
Gross Liability	6,000	2,500	1,500
Less: Marked Applications	1,000	2,000	500
	5,000	500	1,000
Less: Unmarked Applications	2,160	900	540
	2,840	(400)	460
Surplus of Y apportioned between X & Z in the ratio of Gross Liability (12:3 or 4:1)	(320)	400	(80)
Net Liability under contract	2,520	Nil	380
Add: Firm Underwriting	800	300	1,000
Net Liability	3,320	300	1,380

Working:

(i) Allocation of unmarked applications

Total Applications (including marked and firm underwriting) = 7,100
Marked applications = 1000 + 2000 + 500 = 3,500

Unmarked applications including firm underwriting = 7,100 - 3,500 = 3,600 to be shared in Gross Liability i.e., 6000:2500:1500 = 12:5:3.

(ii) When firm underwriting is treated as marked applications.

Calculation of Liability of the underwriters (No. of shares)

Particulars	X	Y	Z
Gross Liability	6,000	2,500	1,500
Less: Marked Applications including firm underwriting	1,800	2,300	1,500
	4,200	200	Nil
Less: Unmarked Applications	900	375	225
	3,300	(175)	(225)
Surplus of Y and Z apportioned to X	(400)	175	225
Net Liability under contract	2,900	Nil	Nil
Add: Firm Underwriting	800	300	1,000
Net Liability	3,700	300	1,000

Working:

a. Marked Applications including firm underwriting

Particulars	X	Y	Z
Marked applications	1,000	2,000	500
Add: Firm underwriting	800	300	1,000
	1,800	2,300	1,500

b. Allocation of unmarked applications

Total applications (including marked and firm underwriting) = 7,100

Marked applications (including firm underwriting) = 1800 + 2300 + 1500 = 5,600

Unmarked applications = 7,100 - 5,600 = 1,500 to be shared in Gross Liability i.e.,

6000:2500:1500 = 12:5:3

Illustration 12

D Ltd. issued 2,000 shares of ₹100 each credited as fully paid to the promoters for their services and issued 1,000 shares of ₹100 each credited as fully paid to the underwriters for their underwriting services. Journalize these transactions.

Solution:

In the books of D Ltd. Journal

Particulars	Dr.	Cr.
Goodwill A/c Dr. To Share Capital A/c (Being the issue of 2,000 shares of ₹100 each at par to promoters as per Board's Resolution no..... dated)	2,00,000	2,00,000
Underwriting Commission A/c Dr. To Underwriter's A/c (Being the Underwriting commission due on shares)	1,00,000	1,00,000
Underwriter's A/c Dr. To Share Capital A/c (Being the issue of 1,000 shares of ₹100 each at par to Underwriters as per the Board's Resolution no..... dated.)	1,00,000	1,00,000

Illustration 13

Classify the following transactions into cash flow from operating, investing and financing activities in respect of a pharmaceutical company:

- a. Issued equity shares
- b. Bonus shares issued
- c. Right shares issued
- d. Purchased 90% shares of subsidiary company
- e. Dividend received from subsidiaries
- f. Dividend received from investment in other companies
- g. Payment of license fees
- h. Royalty received from the goods patented
- i. Rent received from the letting out of free space
- j. Interest received on loans to Y Ltd.
- k. Preference Dividend paid
- l. Interest paid on security deposits
- m. Acquired the assets of a company through issue of equity shares
- n. Purchased goodwill
- o. Interim dividends paid
- p. Sale of investment in subsidiary

Solution:

Classification of cash received and paid

Transaction	Nature of Cash Flow	Inflow/Outflow
a) Issued equity shares	a) C/F from financing activities	Inflow
b) Bonus shares issued	b) Not a Cash flow at all.	N. A
c) Right shares issued	c) C/F from financing activities	Inflow
d) Purchased 90% shares of subsidiary company	d) C/F from investing activities	Outflow
e) Dividend received from subsidiaries	e) C/F from investing activities	Inflow
f) Dividend received from investment in other companies	f) C/F from investing activities	Inflow
g) Payment of license fees	g) C/F from investing activities	Outflow
h) Royalty received from the goods patented	h) C/F from operating activities	Inflow
i) Rent received from the letting out of free space	i) C/F from investing activities	Inflow
j) Interest received on loans to Y Ltd.	j) C/F from investing activities	Inflow
k) Preference Dividend paid	k) C/F from financing activities	Outflow
l) Interest paid on security deposits	l) C/F from financing activities	Outflow
m) Acquired the assets of a company through issue of equity shares	m) No cash flow	N. A
n) Purchased goodwill	n) C/F from investing activities	Outflow

o) Interim dividends paid	o) C/F from financing activities	Outflow
p) Sale of investment in subsidiary	p) C/F from investing activities	Inflow

Illustration 14

The following is the income statement XYZ Company for the year 2020 - 21.

			(₹)
Sale			1,62,700
Add: Equity in ABC company's earning			6,000
			1,68,700
Expenses			
Cost of goods sold		89,300	
Salaries		34,400	
Depreciation		7,450	
Insurance		500	
Research and development		1,250	
Patent amortization		900	
Interest		10,650	
Bad debts		2,050	
Income tax:			
Current	6,600		
Deferred	1,550		
Total expenses		8,150	1,54,650
Net income			14,050

Additional information is:

- 70% of gross revenue from sales were on credit.
- Merchandise purchases amounting to ₹ 92,000 were on credit.
- Salaries payable totaled ₹ 1,600 at the end of the year.
- Amortization of premium on bonds payable was ₹1,350.
- No dividends were received from the other company.
- XYZ Company declared cash dividend of ₹ 4,000.
- Changes in Current Assets and Current Liabilities were as follows:

	Increase (Decrease) ₹
Cash	500
Marketable securities	1,600
Accounts receivable	(7,150)
Allowance for bad debt	(1,900)
Inventory	2,700
Prepaid insurance	700
Accounts payable (for merchandise)	5,650
Salaries payable	(2,050)
Dividends payable	(3,000)

Prepare a statement showing the amount of cash flow from operations.

Solution:

Statement showing cash flow from operations

Cash flow from operations	₹	₹
Cash sales (30% 1,62,700)	48,810	
Collection from debtors	1,20,890	
Total cash from operations		1,69,700
Uses of cash from operations		
Payment to suppliers	86,350	
Salaries expense	36,450	
Payment for insurance	1,200	
Research and development	1,250	
Interest payment	12,000	
Income tax payment	6,600	
Total operating cash payment		1,43,850
Net cash flow from operations		25,850

Notes:

(1)

Collection from debtors	₹
Credit sales (70% × 1,62,700)	1,13,890
Less: Bad debts (2,050 less 1,900)	150
	1,13,740
Add: decrease in accounts receivables	7,150
Collection from debtors on credit sales	1,20,890

(2) Dividends earned ₹6,000 on equity of ABC Company has not been considered as it has not been received in cash.

(3)

Payment to suppliers	₹
Cost of goods sold	89,300
Add: Increase in inventory	2,700
Purchases	92,000
Less: increase in accounts payable	5,650
Payment to suppliers	86,350

(4)

Calculation of salaries payment	₹
Salary expense	34,400
Add: decrease in salary payable	2,050
Payment of salaries	36,450

(5)

Insurance payments	₹
Insurance	500

Add: increase in prepaid insurance	700
Payment for insurance	1,200

(6)

Interest expenses	10,650
Add: Amortization of bond premium	1,350
Interest payments	12,000

(7)

Income tax payments	₹
Income tax expense	8,150
Less: Deferred tax	1,550
	6,600
Changes in current tax payable	Nil
Income tax payments	6,600

Illustration 15

PQR Ltd. Was registered with a nominal of ₹ 5,00,000 dividend into shares of ₹ 100 each. The following Trial Balance is extracted from the books on 31st March, 2023:

Particulars	₹	Particulars	₹
Buildings	2,90,000	Sales	5,20,000
Machinery	1,00,000	Outstanding Expenses	2,000
Opening stock	10,000	Provisions for Doubtful Debts (1-4-2022)	3,000
Loose Tools	23,000	Equity share capital	2,00,000
Purchases	2,90,000	General Reserve	40,000
Salaries	60,000	Profit and Loss A/c (01.04.2022)	25,000
Directors Fees	10,000	Creditors	92,000
Rent	26,000	Provision for depreciation	
Depreciation	20,000	On Building	50,000
Bad Debts	6,000	On Machinery	55,000
Investment	1,20,000	14% Debentures	2,00,000
Interest accrued on investment	2,000	Interest on debentures accrued but not due	14,000
Debenture Interest	28,000	Dividend Received	12,000
Advance Tax	60,000	Unclaimed dividend	5,000
Sundry expenses	18,000		
Debtors	1,25,000		
Bank	30,000		
	12,18,000		12,18,000

You are required to prepare Statement of Profit and Loss for the year ending 31st March, 2023 and Balance Sheet as at that date after taking into consideration the following information:

- Closing stock is more than opening stock by ₹ 90,000
- Provide for doubtful debts @ on Debtors.

- iii. Make a provision for income tax @ 30%.
- iv. Depreciation expense included depreciation of ₹ 8,000 on Building and that of ₹ 12,000 on Machinery.
- v. The Directors proposed a dividend @ 25% and transfer to General Reserve ₹ 10,000. Notes to Accounts should form part of your answer.

Solution:**PQR Ltd.****Profit and Loss Statement for the year ended 31st March, 2023**

	Particulars	₹
i.	Total Revenue	5,32,000
ii.	Total Expenses	3,70,000
iii.	Profit before Tax (I-II)	1,62,000
iv.	Tax Expenses @ 30%	48,600
v.	Profit for the period	1,13,4000

Balance Sheet as on 31.03.2023

	Particulars	₹
I	EQUITY AND LIABILITIES	
	1. Shareholders' Funds	3,78,400
	2. Non-Current Liabilities	2,00,000
	3. Total Current Liabilities	1,61,600
	Total	7,40,000
II	ASSETS	
	1. Non-Current Assets	4,05,000
	2. Current Assets	3,35,000
	Total	7,40,000

Illustration 16

ABC Ltd. provides the following Trial Balance as on 31st March 2017:

Particulars	Dr. Balances (₹)	Cr. Balances (₹)
Equity Share Capital: 350000 shares of ₹ 10 each fully paid		35,00,000
10% Debentures		3,00,000
Motor Van	4,00,000	
Machinery	20,00,000	
Land and Building	12,00,000	
12% Long Term Govt. Securities	2,00,000	
Sales		60,00,000
Sales Return	3,00,000	
Interest on Debenture	22,500	
Purchase	36,00,000	

Purchase Returns		4,00,000
Opening Stock	3,00,000	
Discount	7,500	
Carriage Outward	1,50,000	
Rent and Rates	50,000	
Income from Govt. Securities		24,000
Trade Receivables	10,00,000	
Trade Payables		2,00,000
Advertisement	1,50,000	
Bad Debt	20,000	
Salaries	6,72,000	
Misc. Expenditure	30,000	
Contribution to P.F. and Gratuity Funds	1,00,000	
Cash at Bank and in hand	2,22,000	
Total	1,04,24,000	1,04,24,000

Additional Information:

- (i) Closing Stock as on 31st March 2017 was ₹ 3,50,000.
- (ii) Depreciation Rates: Motor Vehicle 10%, Machinery 20% and Land & Building 5%.
- (iii) Misc. expenditure includes ₹ 20,000 as audit fees.
- (iv) Interest on debenture is payable quarterly and the last quarter's interest is yet to be paid.
- (v) Trade receivables include a sum of ₹ 25,000 due from Mr. X who has become insolvent and only 25 paise in a rupee is expected to be recoverable from him.
- (vi) Create a provision for doubtful debt @ 2% on trade receivables.
- (vii) Provide for income tax ₹ 1,50,000.

Prepare a Statement of Profit and Loss for the year ended on 31st March 2017 and a Balance Sheet as on that date.

Solution:**Notes to Accounts:**

1. Employee Benefit Expenditure	₹
Salaries	6,72,000
Contribution to P.F.	1,00,000
	7,72,000

2. Finance Cost	₹
Interest on loan	22,500
Outstanding Interest	7,500
	30,000

3. Other Expenditure	₹
Discount	7,500

Carriage	1,50,000
Rent	50,000
Advertisement	1,50,000
Bad Debt	20,000
Audit fees	20,000
Misc. Exp.	10,000
Provision for B/D	38,250
	4,45,750

4. Trade Receivable	₹
Total Receivable	10,00,000
(-) Provision @ 2%	38,250
	9,61,750
Provision = 25000 × 0.75 + (1000000 - 25000) × 0.02	38,250

5. Fixed Assets	Motor Van	Machine	L&B
Balance	4,00,000	20,00,000	12,00,000
(-) Depreciation	40,000	4,00,000	60,000
	3,60,000	16,00,000	11,40,000
Total Fixed Assets			31,00,000
Depreciation			5,00,000

Statement of Profit and Loss for the year ended on 31.03.2017

Particulars	Note	₹
I. Revenue from operation (sales less returns)		57,00,000
II. Other Income (Income from investment)		24,000
III. Total revenue		57,24,000
IV. Expenses:		
Purchase		32,00,000
Changes in inventory i.e. opening less. Closing		(50,000)
Employee Benefit expenses	1	7,72,000
Finance cost	2	30,000
Depreciation	5	5,00,000
Other expenses	3	4,45,750
		48,97,750
V. Profit before exceptional and extraordinary items and tax		8,26,250
VI. Exceptional items		Nil
VI Profit before extraordinary items and tax		8,26,250
VII. Extraordinary items		Nil
VIII. Profit before tax		8,26,250

IX. Tax (provision for tax)		1,50,000
X. Profit after tax		6,76,250

Balance Sheet as on 31.03.2017

I. Equity and Liabilities	Note	₹
1. Shareholders' Funds		
(a) Share Capital		35,00,000
(b) Reserve and Surplus (Balance of Profit)		6,76,250
2. Share Application money pending allotment		Nil
3. Non-current liabilities (10% Debentures)		3,00,000
4. Current Liabilities		
Trade Payable		2,00,000
Outstanding interest		7,500
Provision for Tax		1,50,000
Total		48,33,750
II. Assets		
1. Non-current Assets		
(a) Fixed Assets (Tangible)	5	31,00,000
(b) Non-current Investment (12% L.T. Govt. Securities)		2,00,000
2. Current Assets		
Inventories		3,50,000
Trade Receivable	4	9,61,750
Cash and cash equivalent		2,22,000
Total		48,33,750

Illustration 17

Calculate Rebate on Bills discounted as on 31 December, 2021 from the following data and show journal entries for adjustment.

	Date of Bill	₹	Period	Rate of Discount
(i)	15.10.2021	50,000	5 months	8%
(ii)	10.11.2021	30,000	4 months	7%
(iii)	25.11.2021	40,000	4 months	7%
(iv)	20.12.2021	60,000	3 months	9%

Solution:

Calculation of Rebate on Bills Discounted

Amount of Bill (₹)	Due Date	Days after 31 December, 2013	Discount Rate	Discount (₹)
50,000	18/03/2022	31+ 29 +18 = 78	8%	852.46
30,000	13/03/2022	31+29+13 = 73	7%	418.85
40,000	28/03/2022	31+29+28 = 88	7%	673.22
60,000	23/03/2022	31+29+23 = 83	9%	1,224.59
Total				3,169.12

Journal

Date	Particulars	Dr. (₹)	Cr. (₹)
Dec. 31 2021	Interest and Discount Account Dr. To Rebate on Bills Discounted. (Being the provision for unexpired discount required at the end of the year)	3,169.12	3,169.12

Illustration 18

The books of a bank include a loan of ₹5,00,000 advanced on 31.12.2020, interest changeable @ 16% p.a. compounded quarterly. The security for the loan being 7,000 shares of ₹100 each in a public limited company valued @ ₹90 each. There is no repayment till 31.03.2022. On 31.03.2022, the value of shares declined to ₹80 per share.

How would you classify the loan as secured or unsecured in the Balance Sheet?

Solution:

Date	Particulars	(₹)
31.12.2022	Balance of Loan (Principal)	5,00,000
	Add: Outstanding Interest(working note)	1,08,326
	Total claim	6,08,326
	Less: Value of security at that date (7,000 shares × ₹ 80)	5,60,000
		48,326

Classification:

Secured ₹5,60,000

Unsecured ₹48,326

Working:

Calculation of outstanding interest

Quarters ending	Interest (₹)		Closing balance with principal (₹)
31.03.2021	20,000	(₹5, 00, 000 × 16% × 3/12)	5,20,000
30.06.2021	20,800	(₹5, 20, 000 × 16% × 3/12)	5,40,800
30.09.2021	21,632		5,62,432
31.12.2021	22,497		5,84,929
31.03.2022	23,397		6,08,326
	1,08,326		

Illustration 19

Rajatapeeta Bank Ltd. had extended the following credit lines to a Small-Scale Industry, which had not paid any Interest since March, 2015:

	Term Loan	Export Loan
Balance Outstanding on 31.03.2021	₹ 35 lakhs	₹ 30 lakhs
DICGC/ECGC cover	40%	50%
Securities held	₹ 15 lakhs	₹ 10 lakhs
Realizable value of Securities	₹ 10 lakhs	₹ 08 lakhs

Compute necessary provisions to be made for the year ended 31st March, 2021.

Solution:

Calculation for unsecured portion of loan

Particulars	Term loan (₹ in lakhs)	Export credit (₹ in lakhs)
Balance outstanding on 31.3.2021	35.00	30.00
Less: Realizable value of Securities	10.00	8.00
	25.00	22.00
Less: DICGC cover @ 40%	10.00	-
ECGC cover @ 50%	-	11.00
Unsecured balance	15.00	11.00

Required Provision:

	Term loan (₹ in lakhs)	Export credit (₹ in lakhs)
100%* for unsecured portion	15.00	11.00
100% for secured portion	10.00	8.00
Total provision required	25.00	19.00

* The above solution has been provided based on the latest NPA provisions (as per the Master Circular issued by RBI).

Illustration 20

Consider the following information provided by ABC Power Supply Company Ltd.

Security deposit received from a customer on 01.10.2020 for ₹2,00,000. Interest rate applicable was 8% for 2020-21 and 9% for 2021-22. The accrued interest for the year is adjusted against the bill for the immediate next quarter. Journalize the above transaction for 2020-21 and 2021-22.

Solution

In the books of ABC Power Supply Company Ltd.

Journal

Date	Particulars	Dr. (₹)	Cr. (₹)
01.10.20	Bank A/c Dr. To Security Deposit A/c (Being the Security Deposit received)	2,00,000	2,00,000
31.03.21	Interest Expense A/c Dr. (2,00,000 x 8% x 6/12) To Interest Accrued on Security Deposit A/c (Being the Provision for Interest Accrued on Security Deposit Made)	8,000	8,000
30.06.21	Interest Accrued on Security Deposit A/c Dr. To Sales Turnover A/c (Being the Adjustment of Interest Accrued on Security Deposit in Consumer's Bill)	8,000	8,000

31.03.22	Interest Expense A/c (2,00,000 × 8% × 6/12) To Interest Accrued on Security Deposit A/c (Being the Provision for Interest Accrued on Security Deposit Made)	Dr.	8,000	8,000
30.06.22	Interest Accrued on Security Deposit A/c To Sales Turnover A/c (Being the Adjustment of Interest Accrued on Security Deposit in Consumer's Bill)	Dr.	8,000	8,000

Illustration 21

Consider the following information provided by XYZ Power Supply Company Ltd. (₹ in lakhs):

Gross opening equity ₹3,000 as on 01.04.2019.

Adjustment in opening equity - Nil Adjustment during the year - Nil

Increase in equity due to addition during the year (over 5 years): ₹500 Decrease due to reversal and de-capitalization (over 5 years): Nil Increase due to discharges during the year: Nil

Rate of ROE: 18%

Calculate total ROE for the next five years.

Solution

Statement showing Return on Equity at Normal Rate

(₹ in lakhs)

S. NO	Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
1	2	3	4	5	6	7
	Return on Equity					
1	Gross Opening Equity (Normal)	3,000	3,500	4,000	4,500	5,000
2	Less: Adjustment in Opening Equity	Nil	Nil	Nil	Nil	Nil
3	Adjustment during the year	Nil	Nil	Nil	Nil	Nil
4	Net Opening Equity (Normal)	3,000	3,500	4,000	4,500	5,000
5	Add: Increase in equity due to addition during the year / period	500	500	500	500	500
6	Less: Decrease due to De-Capitalisation during the year / period	Nil	Nil	Nil	Nil	Nil
7	Less: Decrease due to reversal during the year / period	Nil	Nil	Nil	Nil	Nil
8	Add: Increase due to discharges during the year / period	Nil	Nil	Nil	Nil	Nil
9	Net closing Equity (Normal)	3500	4,000	4,500	5,000	5,500
10	Average Equity (Normal)	3250	3,750	4,250	4,750	5,250
11	Rate of ROE	18%	18%	18%	18%	18%
12	Total ROE	585	675	765	855	945

Illustration 22

Consider the following estimated information provided by XYZ Power Supply Company Ltd. (Rs. in lakhs) for the next 5 years:

Cost of coal: ₹2,000 per year

Cost of secondary fuel oil: ₹200 per year for first 2 years and ₹300 per year for 3-5 years

O & M expenses: ₹250 per year for first 2 years and ₹350 per year for 3-5 years
Maintenance spares: ₹100 per years

Receivables: ₹1,800 per year

Rate of interest: 12%

Calculate the interest on working capital.

Solution:

Statement of Interest on Working Capital (₹ in lakhs)

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

Illustration 23

The life insurance fund of Prakash Life Insurance Co. Ltd. was ₹ 34,00,000 on 31st March, 2021. Its actuarial valuation on 31st March, 2021 disclosed a net liability of ₹ 28,80,000. An interim bonus of ₹ 40,000 was paid to the policyholders during the previous two years. It is now proposed to carry forward ₹ 1,10,000 and to divide the balance between the policyholders and the shareholders. Show (a) the Valuation Balance Sheet, (b) the net profit for the two-year period, and (c) the distribution of the profits.

Solution:

In the Books of Prakash Life Insurance Co. Ltd.

Valuation Balance Sheet as on 31st March, 2021

Liabilities	(₹)	Assets	(₹)
Net liability	2,880,000	Life Assurance Fund	3,400,000
Net Profit	520,000		
	3,400,000		3,400,000

Net profit for the two-year period		(₹)
Profit as per Valuation Balance Sheet		5,20,000
Add: Interim Bonus paid during the previous two years		40,000
Net Profit		5,60,000
Distribution of the profits		
Net Profit		5,60,000
Less: Amount proposed to be carried forward		1,10,000
Balance		4,50,000
Share of policyholders (95% of ₹ 4,50,000)		4,27,500
Less: Interim bonus paid		40,000
Amount due to policyholders		3,87,500
Share of Shareholders (5% of ₹ 4,50,000)		22,500

Illustration 24

From the following figures of Well Life assurance Co. Ltd. prepare a Valuation Balance Sheet and Profit Distribution Statement for the year ended 31st March 2014. Also pass necessary journal entries to record the above transactions with narrations:

Particulars	₹ (in lakhs)
Balance of Life Assurance Fund as on 1.4.2021	167.15
Interim bonus paid in the valuation period	25.00
Balance of Revenue Account for the year ended 31.3.2022	240.00
Net Liability as per valuer's Certificates as on 31.3.2022	165.00

The company declares a reversionary bonus of ₹185 per ₹1,000 and gave the policyholders an option to take bonus in cash ₹105 per ₹1,000. Total business conducted by the company was ₹600 lakhs. The company issued profit policy only. 3/5th of the policyholders in value opted for cash bonus.

Solution:

**In the Books of Well Assurance Co. Ltd.
Valuation Balance Sheet As at 31st March 2022**

Liabilities	(₹)	Assets	(₹)
Net Liabilities as per Actuarial Valuation	1,65,00,000	Life Insurance Fund	2,40,00,000
Surplus/Net Profit	75,00,000		
	2,40,00,000		2,40,00,000

Distribution Statement, i.e., Distribution of Surplus

Particulars	₹ (in lakhs)
Surplus/ Net Profit	75,00,000
Add: Interim Bonus Paid	25,00,000
	1,00,00,000
Policyholders' shares @ 95% of ₹1,00,00,000	95,00,000
Less: Interim Bonus paid	25,00,000
	70,00,000
Shareholders' Share @ 5% of ₹1,00,00,000	5,00,000

Journal

Date	Particulars	(₹)	Dr.	Cr.
?	Life Assurance Fund A/c To, Profit and Loss A/c (Surplus/Net Profit transferred to P&L A/c as per Valuation Balance Sheet)	75,00,000		75,00,000
	Profit and Loss A/c To, Bonus (in cash) Payable A/c (Bonus payable in cash)	37,80,000		37,80,000
	Profit and Loss A/c To, Life Assurance Fund A/c (Reversionary Bonus payable transferred to Life assurance Fund)	44,40,000		44,40,000

Workings:

- Bonus payable in Cash (@ ₹105 per ₹1000)
= 6,00,00,000 × 3/5 × 105/1000 = ₹37,80,000
- Reversionary Bonus payable (@ ₹185 per ₹1000)
= 600,00,000 × 2/5 × 185/1000 = ₹44,40,000

Illustration 25

From the following figures appearing in the books of Fire Insurance division of a General Insurance Company, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 2014:

Particulars	Direct Business	Re-Insurance
	₹	₹
Claim paid during the year	46,70,000	7,00,000
Claim Payable — 1st April, 2013	7,63,000	87,000
31st March, 2014	8,12,000	53,000
Claims received	-	2,30,000
Claims Receivable — 1st April, 2013	-	66,000
31st March, 2014	-	1,13,000
Expenses of Management (includes ₹ 35,000 Surveyor's fee and ₹ 45,000 Legal expenses for settlement of claims)	2,30,000	-

Solution:

General Insurance Company
(Abstract showing the amount of claims)

Particulars	₹ '000	₹ '000
Claims less Re-insurance:		

Paid during the year	52,20	
Add: Outstanding claims at the end of the year	7,52	
	59,72	
Less: Outstanding claims at the beginning of the year	7,84	51,88

Working Notes:

	Particulars	₹ '000	₹ '000
1.	Claims paid during the year		
	Direct business	46,70	
	Reinsurance	7,00	53,70
	Add: Surveyor's fee	35	
	Legal expenses	45	80
			54,50
	Less: Claims received from re-insurers		2,30
			52,20
2.	Claims outstanding on 31st March, 2014		
	Direct business	8,12	
	Reinsurance	53	8,65
	Less: Claims receivable from re-insurers		1,13
			7,52
3.	Claims outstanding on 1st April, 2013		
	Direct business	763	
	Reinsurance	87	8,50
	Less: Claims receivable from re-insurers		66
			7,84

Illustration 26

The total stock of A Ltd. as on 31.3.2021 was ₹5,00,000 of which stock amounting to ₹31,000 were not ascertained as per Ind AS 2.

Compute the value of the said stocks as per Ind AS 2 for inclusion in financial statements as on that date.

Type of Product	Cost of Materials (₹)	Production Expenses incurred (₹)	Selling and Distribution expense to be incurred (₹)	Estimated Selling Price (₹)
P	10,000	2,000	1,000	15,000
S	5,000	---	500	4,500
T	12,000	3,000	2,000	18,000
	27,000	5,000	3,500	37,500

Solution:

As per Ind AS 2, inventories are usually written-down to net realizable value on item-by-item basis. Thus, value of stock will be computed as:

Type of Product	Cost Price (including Production Exp.) (₹)	Net Realizable Value (excluding Selling & Distribution Expenses from Selling Price) (₹)	Value of Stock to be taken (lower of Cost Price & Net Realizable Value) (₹)
P	12,000 (₹ 10,000 + ₹ 2,000)	14,000 (₹15,000 - ₹ 1,000)	12,000
S	5,000	4,000 (₹ 4,500 - ₹500)	4,000
T	15,000 (₹ 12,000 + ₹ 3,000)	16,000 (₹18,000 - ₹ 2,000)	15,000
			31,000

So, Value of Stock will be ₹31,000 for inclusion in financial statements as per Ind AS 2.

Illustration 27

A Ltd. closed its accounting year on 31/03/2021 and the accounts for that period were considered and approved by the board of directors on 20th May, 2021. The company was engaged in boring tunnels for metro railway. While doing the boring work on 01/06/2021 it hit an aquifer and as a result 18 building were damaged. It was estimated that there would be extra cost to the tune of ₹15 crores. You are required to state with reasons, how it would be dealt with in the financial statements for the year ended 31.03.2021.

Solution:

Ind AS 10 defines 'events after the reporting date' are those 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors'. In this case the incidence, which was expected to push cost, became evident after the date of approval of the accounts. So that was not an 'event after the reporting date' as per Ind AS 10. However, this may be mentioned in the Director's Report.

Illustration 28

Mr. X is an employee of ABC Ltd. His annual salary is ₹15 lakh. The company follows a 300 working days policy. As per the policy of the company, Mr. X is entitled to a leave of 10 days for 2020-21. He, however, utilizes 8 days leave. The unutilized leaves are not allowed to be carried forward but are settled by way of payment to the employee. Compute the total employee benefit expenses of ABC Ltd. in respect of Mr. X.

Solution:

Salary payable per day = ₹15,00,000 ÷ 300 = ₹5,000

Unutilized leaves = 10 - 8 = 2 days

Payment for unutilized leaves = ₹ 5,000 × 2 = ₹10,000

Total expense to be recognized = ₹15,00,000 + ₹10,000 = ₹15,10,000.

Illustration 39

Consider the following information:

No. of employees (same as the previous year) = 150

Employees' turnover rate = 6%

Bonus paid to each employee last year = ₹1,00,000

Increase in bonus rate due to inflation = 7% (as per company's regular practice) Determine the liability and expense to be recognized.

Solution:

Bonus payable for current year = ₹1,00,000 + 7% of ₹1,00,000 = ₹1,07,000

No. of employees in payroll = 150 - 6% of 150 = 141

Provision for bonus = ₹1,07,000 × 141 = ₹1,50,87,000

Accounting treatment:

Employee Benefits Expenses A/c	Dr.	1,50,87,000	
			To Provision for Bonus A/c
			1,50,87,000

Note: Here, the company has a constructive obligation and not a legal obligation to increase the bonus.

Illustration 30

The following information applies to a company's defined benefit pension plan for the year:

FMV of plan assets (beginning of the year)	₹2,00,000
FMV of plan assets (end of the year)	₹2,85,000
Employer's contribution	₹ 70,000
Benefit paid	₹ 50,000

Calculate the actual return on plan assets.

Solution:

Calculation of actual return on plan assets

Particulars	₹	₹
Change in plan assets (2,85,000 - 2,00,000)		85,000
Adjustments:		
Employer's contribution	70,000	
Less: Benefit paid	50,000	20,000
Actual return on plan assets		65,000

Illustration 31

D Ltd. had outstanding ordinary shares of 10,00,000 on 01.04.2020. Profit for the year is ₹20,00,000. D Ltd. had 12% 20,000 convertible debentures outstanding of ₹100 each to be converted into 10 ordinary shares. Tax rate is 30%. Calculate (i) Basic EPS (ii) Diluted EPS

Solution:

Basic earnings per share = (20,00,000/10,00,000) = ₹2.00

Number of 12% convertible debentures of ₹ 100 each = 20

Each debenture is convertible into 10 ordinary shares

Interest expenses for the current year = 20,00,000 × 12% = ₹2,40,000

Tax relating to interest expense (30%) = 240000 × 30% = ₹72,000

Adjusted net profit for the current year ₹ (20,00,000 + 2,40,000 - 72,000) = ₹21,68,000

Number of ordinary shares on conversion = 20000 × 10 = 2,00,000

Number of equity shares used to compute diluted earnings per share = 10,00,000 + 2,00,000 = 12,00,000

Diluted earnings per share as per Ind AS-33 = 21,68,000/12,00,000 = ₹1.81

Illustration 32

Consider the following information given by F Ltd.

Net Profit for the year ended on 31.03.2021= ₹86,50,000

Paid-up capital: 25,00,000 ordinary shares of ₹10 each

100000, 10% Debentures of ₹100 each were issued on 31.09.2020.

Tax rate 30%

Conversion rate: 10 ordinary shares for each debenture.

Calculate Diluted EPS.

Solution:

Adjusted net profit for the current year:

Net Profit for the current year ₹86,50,000

Add: Interest expense for the current year ₹5,00,000

Less: Tax relating to interest expense (30% of ₹ 5,00,000) ₹(1,50,000)

Adjusted net profit for the current year ₹90,00,000

Note: Conversion of convertible debentures into Equity Share is a dilutive potential equity share. Hence, to compute the adjusted profit, the interest paid on such debentures will be added back as the same would not be payable, in case these are converted into equity shares.

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$$= (100000 \times 100)/10 = 10,00,000$$

Weighted average number of equity shares used to compute diluted earnings per share

$$= [(25,00,000 \times 12) + (10,00,000 \times 6^*)]/12 = 30,00,000 \text{ Shares}$$

Diluted earnings per share = ₹ 90,00,000/30,00,000 = ₹ 3.00 per share

Illustration 33

E Ltd. had 10,00,000 ordinary shares outstanding on 01.04.2020. Profit for 2020-21 was ₹24,00,000. Average fair value per share during 2020-21 was ₹ 20. E Ltd. has given share option to its employees of 2,00,000 shares at option price of ₹15. Calculate basic EPS and diluted EPS.

Solution:

Profit for the year = ₹24,00,000

Weighted average number of shares = 10,00,000

Basic EPS = 24,00,000/10,00,000 = ₹2.40

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

No. of shares that would have been issued at fair value = 2,00,000 × 15/20 = 1,50,000

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

Adjusted earnings = ₹24,00,000

Diluted EPS = 24,00,000/10,50,000 = ₹2.29

Illustration 34

X Ltd. has become subject to an obligating event on 01.04.2020 for which the company is committed to expenditure of ₹5,00,000 at the end of 10 years. An appropriate discount rate is 10%. Show how the same is to be treated by X Ltd. (Show treatment up to 31.03.2022)

Solution:

PV as on 01.04.2020 = ₹5,00,000/(1.10)¹⁰ = ₹1,92,772

PV as on 01.04.2020 = ₹5,00,000/(1.10)¹⁰ = ₹2,12,049;

increase = ₹19,277 PV as on 01.04.2020 = ₹5,00,000/(1.10)¹⁰ = ₹2,33,254;

increase = ₹21,205

on 01.04.2020

Expense A/c	Dr.	1,92,772	
	To Provision A/c		1,92,772

On 31.03.2021

Interest (Expense) A/c	Dr.	19,277	
	To Provision A/c		19,277

On 31.03.2022

Interest (Expense) A/c	Dr.	21,205	
	To Provision A/c		21,205

Note: Thus, every year interest @10% will be provided and interest will be written off to Profit and Loss A/c.

At the end of the 10th year, the provision will become ₹5,00,000.

Illustration: 35

Discuss the basic principles of governing an audit as per SA 200.

Solution:

SA 200 issued by ICAI (CA) gives the following basic principles that govern the auditor's responsibilities whenever an audit is carried out:

Integrity, objectivity and independence	The auditor should be straight forward, honest, sincere and free from any influence on his audit work. He should maintain impartiality and be free of any interest.
Confidentiality	He should not disclose the client's information to anybody without the client's permission or under any regulatory requirement.
Skills and competence	The audit should be performed and audit report be prepared by adequately trained, experienced and competent person.
Work performed by others	The auditor remains responsible for the work delegated by him to his assistants, other auditors or experts.
Documentation	Proper working papers should be maintained by the auditor to evidence the audit work.
Planning	The auditor should obtain the knowledge about client's business to determine the nature, timing and the extent of the audit procedures.
Audit evidence	The auditor should obtain sufficient appropriate audit evidence through performing the compliance and substantive procedures.

Accounting system and internal controls	An understanding of the accounting system and the related internal controls help in determining the nature, timing and extent of other audit procedures .
Audit conclusions and reporting	On the basis of conclusions drawn from the audit evidence obtained the auditor should give unqualified report or qualified report or adverse report or the disclaimer report .

Illustration: 36

Distinguish between Permanent and Current Audit File.

Solution:

Permanent and Current Audit File:

In case of recurring audits, some working papers files may be classified into permanent audit files and current audit files.

Sr. No.	Permanent Audit File	Current Audit File
1	Legal and organizational structure of the entity, e.g. Memorandum of Association and Article of Association in case of a company.	Correspondence relating to acceptance of annual re appointment .
2	Extracts or copies of leg documents, agreements and minutes relevant to the audit.	Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.
3	A record of study and evaluation of internal controls .	Copies of management letters .
4	Analysis of significant ratios and trends .	Analysis of transactions and balances .
5	Copies of the audited financial statements of previous year(s) .	Copies of communication with other auditors, experts and third parties .
6	Notes regarding significant accounting policies.	Audit programme.

Illustration:37

Discuss the various methods of obtaining audit evidences. How will you assess the reliability of audit evidences obtained?

Solution:

An auditor applies the following methods for obtaining sufficient and appropriate audit evidence:

- Inspection:** Inspection involves **examining records or documents**, whether internal or external, in paper form or otherwise or a physical verification of a tangible asset.
- Observation:** Observation consists of **looking at a process or procedure being performed by others** on a real time basis. For example, the auditor may observe the inventory counting by the entity's personnel and obtain evidence that it is done correctly.

3. **External Confirmation:** External confirmation represents audit evidence obtained by the auditor as a **direct written response from a third party**, in paper form or by electronic or any other medium. For example, confirmation from the customer about the terms of agreement.
4. **Recalculation:** Recalculation consists of **checking the mathematical accuracy** of documents or records. This may be performed manually or electronically.
5. **Reperformance:** Reperformance involves **auditor's independent execution of procedures** or controls that were originally performed as part of entity's internal control.
6. **Analytical Procedures:** Analytical procedures involve evaluation of financial information by **studying possible relationships among both financial and non- financial data** and investigating identified fluctuations from previous years that are inconsistent.
7. **Inquiry:** Inquiry consists of **seeking information, both financial and non-financial, from knowledgeable persons** within or outside the entity. Inquiries may range from formal written inquiries addressed to external parties to informal inquiries addressed to client's staff.

Illustration: 38

'An auditor applies various techniques to evaluate the internal control system of an organization' - Discuss.

Solution:

Techniques for Evaluation of Internal Control System:

- A. **Narrative Record:** It is a **complete and exhaustive description of the system**. It is appropriate in circumstances where a formal control system is lacking, like in the case of small businesses. Gaps in the control system are difficult to identify using a narrative record.
- B. **Check List:** It is a **series of instructions** that a member of the **audit staff** is required to **follow**. They have to be signed/initialled by the audit assistant as proof for having followed the instructions given. A specific statement is required for every weakness area.
- C. **Flow Chart:** It is a **pictorial representation of the internal control system** depicting its various elements such as operations, processes and controls, which help in giving a concise and comprehensive view of the organization's working to the auditor.
- D. **Internal Control Questionnaire:** This is the **most widely used method** for collecting information regarding the internal control system and involves asking questions to various people at different levels in the organization.
The questions are formed in a manner that would facilitate obtaining full information through answers in **"Yes" or "No"**.

Illustration: 39

Write about Statistical sampling.

Solution:

This approach is more scientific and does not depend on auditor's personal judgement. The approach includes the following methods

1. **Random Sampling:** In this method of sampling each item of the population or within a given group (popularly known as stratum) has a known chance of selection. Random sampling can again be of two types:

A. Simple Random Sampling:

- a. Under this method of sampling, **each unit of the population has an equal chance** of being selected in the sample.
- b. Here selection is normally done either by choosing a random number manually from a **random number table** or allowing the **computer programme** to select a random number.
- c. However, this method essentially requires the population units to be reasonably homogeneous or similar in nature.

B. Stratified Sampling:

- A. This method requires a given heterogeneous population to be first divided into a number of **sub-populations (known as stratum)** with homogeneous items.
- B. Then selecting equal or unequal proportion of items from each group to form a representative sample of reasonable size.

2. **Systematic/ Interval Sampling:**

This method requires selecting items **using a constant interval between selections** with the first selection being random.

3. **Monetary Unit Sampling:**

- A. It is also known as **value-based sampling or value-weighted sampling**
- B. This method uses the monetary value of the transaction rather than the items as the basis for sample size determination and item selection.

4. **Multi-Stage Sampling:**

- A. This method is **suitable** when **data are stored in more than one level**.
- B. For example, an organisation may have stock stored at a number of shops. Here, the first step would be to randomly select a few shops and then to randomly select a few stock items from the shops already selected.

Illustration: 40

Write a short note on Benefits offered by Joint Audit

Solution

Advantages of Joint Audit:

1. Sharing of expertise
2. Advantage of mutual consultation
3. Lower work load
4. Better quality of performance
5. Improved service to the client
6. Displacement of the auditor of the company often obviated.
7. Lower staff deployment cost
8. Lower cost to carry out the work
9. A sense of healthy competition towards a better performance.

Illustration: 41

Who are the persons not qualified for appointment as an Auditor of a company under Section 141 of the Companies Act, 2013?

Solution:

Section 141 of Companies Act, 2013 provides that none of the following persons shall be qualified for appointment as auditor of a company.

- A. a **body corporate** other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008 (60 2009);
- B. an **officer or employee** of the company;
- C. a person who is a **partner**, or who is in the **employment**, of an officer or employee of the company;
- D. a person who, or his relative or partner-
 - a) is holding any **security** of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company;
 - b) is **indebted to the company**, or its subsidiary, or its holding or associate company or a subsidiary of such holding company.
 - c) has **given a guarantee or provided any security** in connection with the indebtedness of any third person to the company, or Its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed.
- E. a person or a firm who, whether directly or indirectly, has **business relationship** with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;
- F. a person whose **relative is a director** or is in the employment of the company as director or **key managerial personnel**;
- G. a person who has been **convicted by a court** of an offence involving **fraud** and a period of ten years has not elapsed from the date of such conviction;
- H. a person who, directly or indirectly, renders any service referred to in **section 144** to the company or its holding company or its subsidiary company.

Illustration: 42

Discuss the provisions under Section 139 (7) relating to the appointment of the first auditor in a Government Company. How can an auditor, duly appointed by a company, be removed before expiry of his term?

Solution:**1. Appointment of First Auditor in Case of a Government Company [Section 139(7)]:**

- A. In the case of a Government company the first auditor shall be appointed by the **Comptroller, and Auditor-General** of India **within sixty days** from the date of registration of the company.
- B. In case the Comptroller and Auditor-General of India does not appoint such auditor within the aforesaid period, the **Board of Directors** of the company shall appoint such auditor within the **next thirty days**.

- C. Further, **in the case of failure** of the Board to appoint such auditor within the next thirty days, it shall inform the **members** of the company who shall appoint such auditor within **sixty days** at an extraordinary general meeting.
- D. The auditor, so appointed, shall hold office till the conclusion of the first annual general meeting.

2. Removal of Auditor before the Expiry of His Term:

The auditor appointed under section 139 may be removed from his office before the expiry of his term subject to the fulfilment of the following conditions under **Section 140(1) read with Rule 7 of CAAR 2014**.

- A. An application to the Central Government for removal of the auditor shall be made in Form **ADT-2**.
- B. The application shall be made to the **Central Government within thirty days** of the resolution passed by the Board.
- C. The company shall hold the general meeting **within sixty days** of receipt of approval of the Central Government for passing the special resolution for removal of the said auditor.
- D. The auditor concerned shall be given a **reasonable opportunity of being heard**.

Illustration: 43

Discuss the functions and power of the Audit Committee.

Solution:

Functions of Audit Committee:

- A. For the appointment and fixation of the remuneration of Auditor
- B. Inspection of the financial statement
- C. Scrutiny of Inter Corporate Loans and Investment
- D. Valuation of the Assets of the company
- E. Assessment of the internal financial control and risk management system of the entity
- F. Assessment of the use of funds rose through public offers.
- G. Assessment of an related party transaction

Powers of the Audit Committee

- A. Audit Committee has the power to call for comments of the Auditor about Internal Control systems and the scope of the audit including its observation
- B. Before submission of the report to the Board, the Audit Committee have the power to review the financial Statement
- C. Power to discuss any issue with the Statutory and Internal Auditor and the Management of the company in relation to matter contained in the Financial Statement

Illustration: 44

What is the procedure of appointing a cost auditor in a company?

Solution:

Procedure for Appointment of a Cost Auditor:

1. The cost auditor is to be appointed by the **Board of Directors (BOD)** on the recommendation of the Audit Committee, where the company is required to have an Audit Committee.

2. The cost auditor proposed to be appointed is required to give a letter of consent to the Board of Directors.
3. The company shall **inform** the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the **Central Government** within a period of **thirty days** of the Board meeting in which such appointment is made or within a period of **one hundred and eighty days of the commencement** of the financial year, **whichever is earlier**, through electronic mode, in form **CRA-2** along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.
4. Any **casual vacancy** in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the **Board of Directors (BOD)** within **thirty days** of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.

Illustration: 45

Write short notes on

1. Auditor's duty regarding interim dividend
2. Audit of Property, Plant and Equipment

Solution:

1. Auditor's duty regarding Interim Dividend:

In connection with the payment of interim dividend, the auditor must consider the following points:

- A. The auditor **should examine the Articles of Association** of the company to ascertain whether payment of interim dividend is permitted by the articles or not.
- B. The auditor should also **examine the minute book** of directors' meeting to verify resolution approving the payment of interim dividend.
- C. The amount of interim dividend **shall be deposited in a scheduled bank** in a separate account within five days from the date of declaration of such dividend.
- D. Based on the particulars of Dividend Register, the auditor **must verify whether the dividend warrants have been issued to rightful owners**. In case of payment through electronic mode (ECS), he must verify from the bank statements that the payment has been properly credited to the account of shareholder.
- E. The auditor **should verify the Dividend Register** and returned dividend warrants to determine the amount of interim dividend that could not be paid. He shall also to enquire the reason for such dividend remaining unpaid and ensure that the legal requirement, in this context, has been duly complied with.

2. Audit of Property, Plant and Equipment:

An auditor should follow the procedure mentioned below while performing an audit of PPE.

- A. The auditor must ensure **physical verification of the assets** to confirm that they exist and are under the possession of the client. He shall ensure that PPE additions up to the date of verification have been updated in the register.

- B. He shall specifically ensure that assets that are not in the working condition have been accounted for as deletions.
- C. He shall also **verify the PPE schedule** (asset class wise) maintained by the management and tally the closing balances to the entity's books of accounts.
- D. He should also **check the arithmetical accuracy** of the movement in PPE schedule and reconcile the opening balance with the closing balance of each class of asset by considering the additions and disposals during the year.
- E. He shall also **verify whether appropriate internal processes and procedures** like inviting competitive quotations or floating tenders were done before finalising the vendor.

Illustration: 46

What are the objects of verification of Assets and liabilities.

Solution:

Verification of assets and liabilities is done with the following objects:

1. To know whether the Balance Sheet exhibits a true and fair view of the State of affairs of the business.
2. To find out whether the assets were in existence.
3. To find out the ownership and title of the assets.
4. To show correct valuation of assets and liabilities.
5. To verify the arithmetical accuracy of the books of accounts.
6. To ensure that the assets have been recorded properly.
7. To detect frauds & errors, if any
8. To find out whether there is an adequate internal control regarding acquisition, utilization and disposal of assets.

Illustration: 47

As an auditor of a company, how will you audit of re-issue of forfeited shares?

Solution:**Re-issue of forfeited shares:**

1. The auditor should ascertain that the Board of Directors has the **authority** under the **Articles of Association** of the company to reissue forfeited shares. Check the relevant resolution of the Board of Directors.
2. Vouch the amounts collected from persons to whom the shares have been allotted and verify the entries recorded from re-allotment. Auditor should check the total amount received on the shares including received prior to forfeiture, is not less than the par value of shares.
3. Verify that **computation of surplus amount arising on the reissue of shares** credited to Capital Reserve Account and
4. Where **partly paid shares are forfeited** for non-payment of call, and re-issued as fully paid, the reissue is considered as an allotment at a **discount and compliance of the provisions of Section 53 is essential.**

Illustration: 48

Discuss the basic elements of an audit report.

Solution:**The Basic Elements of the Auditors' Report are**

1. **Title:** The Auditor's Report should have an appropriate title i.e. "Auditor's Report". It should be distinguished from other Reports, e.g. reports of officers of the entity, Board of Directors.
2. **Addressee:** The Auditor's Report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations. Ordinarily, the Auditor's Report is addressed to the authority appointing the Auditor.
3. **Opening or Introductory Paragraph:**
 - A. **Scope** The Auditor's Report should identify the Financial Statements of the entity that have been audited, including the date of and period covered by the Financial Statements.
 - B. The Report should include a Statement that the Financial Statements are the responsibility of the entity's management and a Statement that the responsibility of the Auditor is to express an opinion on the Financial Statements based on the audit.
4. **Opinion Paragraph:** The Opinion paragraph of the Report should indicate the Financial Reporting framework used to prepare the Financial Statements. It should state the Auditor's opinion as to whether the Financial Statements give a true and fair view in accordance with the financial reporting framework and, where appropriate, whether the Financial Statements comply with the statutory requirements.
5. **Date of the Report:** The date of an Auditor's Report is the date on which the Auditor signs the Report expressing an opinion on the Financial Statements. The Auditor should not date the Report earlier than the date on which the Financial Statements are signed or approved by Management.
6. **Place of Signature:** The Report should name the specific location, which is ordinarily the city where the Audit Report is signed.
7. **Auditor's Signature:** The Report should be signed by the Auditor in his personal name. Where a Firm is appointed as the Auditor, the Report should be signed in the personal name of the Auditor and in the name of the Audit Firm. The Partner/ Proprietor signing the Report should mention his ICAI Membership Number.

Illustration: 49

Write a short note on Audit of a Hospital

Solution:**Audit of Hospital**

The following points are to be considered necessary for conducting an audit of Hospital.

1. Study the **Charter or Trust Deed** under which the hospital has been set up and take a special note of the provisions affecting the accounts.
2. Examine, evaluate and **verify the system of internal check**, internal control and determine the nature, timing and the extent of the audit procedures.

3. **Government grants or grants from local bodies** should be verified with the reference to the correspondence with the concerned authorities.
4. Clear **distinction** should be made between the items of **capital and revenue nature**.
5. The capital expenditure should be incurred under proper authorization by a valid resolution of the trustees or the Managing Committee.
6. Verify the system of internal check as regards purchases and issue of **stores, medicines** etc.
7. Examine that the **appointment of the staff, payment of salaries etc. are duly authorized**.
8. **Physically verify the investments, fixed assets (PPE)** and inventories.
9. Check that **adequate depreciation** has been provided on all the depreciable assets.

Illustration: 50

Write short note on Audit of Education Institutions

Solution:**Audit of Education Institutions**

The Special steps involved in the audit of an educational institution are the following:

1. Examine the **Trust Deed, or Regulations** in the case of school or college and note all the provisions affecting accounts.
2. Check names entered in the **Students' Fee Register** for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged.
3. Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
4. Check admission fees with **admission slips signed** by the **head of the institution** and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
5. See that **free scholarship** and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.
6. Confirm that **hostel dues were recovered** before students' accounts were closed and their deposits of caution money refunded.
7. Verify **rental income** from landed property with the rent rolls, etc.
8. Verify the **inventories of furniture, stationery, clothing, provision and all equipment**, etc.

*** ALL THE BEST ***