Test Series: February, 2015

MOCK TEST PAPER – 1

INTERMEDIATE (IPC) : GROUP – II

PAPER – 5: ADVANCED ACCOUNTING

*Question No. **1** is compulsory.*

*Answer any **five** questions from the remaining **six** questions.*

Wherever necessary suitable assumptions may be made and disclosed by way of a note.

Working Notes should form part of the answer.

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

1. (a) A Company had deferred research and development cost amounting Rs. 225 Lakhs. Sales expected in the subsequent years are as under:

Years	Sales (Rs. in lakhs)
1	600
2	450
3	300
4	150

You are asked to suggest how should research and development cost be charged to Profit and Loss Account assuming entire cost of Rs. 225 Lakhs is development cost. If at the end of 3rd year, it is felt that no further benefit will accrue in the 4th year, how the unamortized expenditure would be dealt with in the accounts of the company ?

(b) Path Ltd. purchased a fixed asset for US $ 50 lakhs on 01.04.2014 and the same was fully financed by the foreign currency loan [i.e. US $] repayment in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $=Rs. 60]. As on 31.03.2015 the first instalment was paid when 1 US $ fetched Rs. 62.00. The entire loss on exchange was included in cost of goods sold. Path Ltd. normally provides depreciation on fixed assets at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss and its treatment.

(c) Power Ltd. has acquired a generator on 1.4.2013 for Rs. 100 lakhs. On 2.4.2013, it applied to Indian Renewal Energy Development Authority (IREDA) for a subsidy. The subsidy was granted in June, 2014 after the accounts for 2013-14 were finalized. The company has not accounted for the subsidy for the year ended 31.3.2014.

State

(i) Is this a prior period item?

(ii) How should the subsidy be accounted in the accounting year 2014-15?

(d) A machine having expected useful life of 6 years, is leased for 4 years. Both the cost and the fair value of the machinery are Rs. 7,00,000. The amount will be paid in 4 equal instalments and at the termination of lease, lessor will get back the machinery. The unguaranteed residual value at the end of the 4th year is Rs. 70,000. The IRR of the investment is 10%. The present value of annuity factor of Rs. 1 due at the end of 4th year at 10% IRR is 3.169. The present value of Rs. 1 due at the end of 4th year at 10% rate of interest is 0.683.

State with reasons whether the lease constitutes finance lease and also compute the unearned finance income. *(4 x 5 = 20 Marks)*

2. (a) The following figures have been taken from the books of Centura Bank Limited as on 31st March, 2014:

	Rs.
Paid up share capital	20,00,000
Interest and discount received	74,11,000
Interest paid on deposits	40,74,000
Salaries and allowances	4,00,000
Rent and taxes paid	1,80,000
Directors' fees and allowances	60,000
Statutory reserve fund	16,00,000
Postages and telegrams	1,20,000
Rent received	1,30,000
Commission, exchange and brokerage	3,80,000
Profit on sale of investments	4,00,000
Depreciation on bank's property	60,000
Law charges	80,000
Auditors' fees	10,000

The following additional information is given to you:

(i) One customer to whom a sum of Rs. 20 lakhs was advanced has become insolvent and it is expected that only 50% of the amount will be recovered from his estate.

(ii) Auditors find that a provision of Rs. 3 lakhs is necessary against other debts.

(iii) Rebate on bills discounted on 31st March, 2013 was Rs. 24,000 and on 31st March, 2014 was Rs. 32,000.

(iv) Provide Rs. 13,00,000 for income tax.

(v) The Board of Directors decides to declare dividend @ 10% after transfer of 25% of the year's profit to Statutory Reserve.

You are required to prepare Profit and Loss Account of the bank with all the necessary schedules for the year ended 31st March, 2014. Ignore figures for the previous year and corporate dividend tax.

(b) State any four alternative accounting treatment of the fund received by an Electricity Company from consumer towards capital expenditure/ service line contributions.

(12 + 4 = 16 Marks)

3. O and M are partners of O and Co., sharing profits and losses in the ratio of 3 : 1 and M and G are partners of M & Co., sharing profits and losses in the ratio of 2: 1.On 31st March, 2014, they decide to amalgamate and form a new firm M/s OMG & Co., wherein O, M and G would be partners sharing profits and losses in the ratio of 3 :2 :1. The Balance Sheets of two firms on the above date are as under:

Liabilities	*O & Co.*	*M & Co.*	*Assets*	*O & Co.*	*M & Co.*
	Rs.	*Rs.*		*Rs.*	*Rs.*
Capitals:			Fixed Assets:		
O	4,80,000	–	Building	1,00,000	-
M	3,20,000	4,00,000	Machinery	3,00,000	3,20,000
G	-	2,00,000	Furniture	40,000	12,000
Reserves	1,00,000	3,00,000	Current Assets:		
Creditors	2,40,000	2,32,000	Stock	2,40,000	2,80,000
Due to O & Co.	-	2,00,000	Debtors	3,20,000	4,00,000
Bank Loan	1,60,000	-	Cash at Bank	60,000	1,80,000
			Cash in hand	40,000	20,000
			Due from M & Co.,	2,00,000	-
			Advances	-	1,20,000
	13,00,000	13,32,000		13,00,000	13,32,000

The amalgamated firm took over the business on the following terms:

(a) Building of O & Co., was valued at Rs. 2,00,000. (b) Machinery of O & Co., was valued at Rs. 4,50,000 and that of M & Co. at Rs. 4,00,000. (c) Goodwill valued O and Co. Rs.1,00,000 and M & Co., Rs. 82,000 but the same will not appear in the books of OMG & Co., (d) Partners of the new firm will bring the necessary cash to pay other partners to adjust their capitals according to the profit sharing ratio.

You are required to pass journal entries in the books of M/s OMG & Co. and prepare the Balance Sheet as at 31.3.2014. *(16 Marks)*

4. Alia Limited was wound up on 31.3.2014 and its draft Balance Sheet as on that date was given below:

Balance Sheet of Alia Limited as on 31.3.2014

Liabilities	*Rs.*	*Assets*		*Rs.*
Share capital:		Fixed assets		4,82,000
60,000 Equity shares of Rs. 10 each	6,00,000	Current assets:		
		Inventory	3,87,500	
Reserves and surplus:		Trade receivables	91,000	
Contingency reserve	1,56,000	Cash at bank	1,64,500	6,43,000
Profit and loss A/c	1,26,000			
Current liabilities:				
Trade payables	1,33,000			
Provisions:				
Provision for income tax	1,10,000			
	11,25,000			11,25,000

Details of Trade receivables and Trade payables:

Trade Receivables			
Sundry debtors	80,000		
Less: Provision for bad and doubtful debts	4,000	76,000	
Bills receivable		15,000	91,000
Trade payables			
Sundry creditors		1,13,000	
Bills payable		20,000	1,33,000

Burger Limited took over the following assets at values shown as under:

Fixed assets Rs. 6,40,000, Inventory Rs. 3,85,000 and Bills Receivable Rs. 15,000.

Purchase consideration was settled by Burger Limited: Rs. 2,55,000 of the consideration was satisfied by the allotment of fully paid 10% Preference shares of Rs. 100 each. The balance was settled by issuing equity shares of Rs. 10 each at Rs. 8 per share paid up.

Sundry debtors realised Rs. 75,000. Bills payable was settled for Rs. 19,000. Income tax authorities fixed the taxation liability at Rs. 1,11,000.

Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to Rs. 4,000.

You are required to:

(i) Calculate the number of equity shares and preference shares to be allotted by Burger Limited in discharge of purchase consideration.

(ii) Prepare the Realisation account, Cash/Bank account, Equity shareholders account and Burger Limited account in the books of Alia Limited.

(iii) Pass journal entries in the books of Burger Limited. *(16 Marks)*

5. (a) From the following particulars relating to Pune branch for the year ending December 31, 2013, prepare Branch Account in the books of Head office.

		Rs.
Stock at Branch on January1, 2013		10,000
Branch Debtors on January 1, 2013		4,000
Branch Debtors on Dec. 31, 2013		4,900
Petty cash at branch on January 1, 2013		500
Furniture at branch on January 1, 2013		2000
Prepaid fire insurance premium on January 1, 2013		150
Salaries outstanding at branch on January 1, 2013		100
Good sent to Branch during the year		80,000
Cash Sales during the year		1,30,000
Credit Sales during the year		40,000
Cash received form debtors		35,000
Cash paid by the branch debtors directly to the Head Office		2,000
Discount allowed to debtors		100
Cash sent to branch for Expenses:		
Rent	2,000	
Salaries	2,400	
Petty Cash	1,000	
Insurance up to March 31, 2014	600	6,000
Goods returned by the Branch		1,000
Goods returned by the debtors		2,000
Stock on December 31,2013		5000
Petty Cash spent by branch		850
Provide depreciation on furniture 10% p.a.		

Goods costing Rs. 1,200 were destroyed on account of fire and a sum of Rs. 1,000 was received from the Insurance Company.

(b) From the data, prepare Departmental Trading Profit and Loss Account and thereafter the combined Profit and Loss Account revealing the concern's true result for the year ended on 31st December 2014:

	Departments	
	A (Rs.)	*B (Rs.)*
Stock (January)	40,000	-
Purchase from outside	2,00,000	20,000
Wages	10,000	1,000
Transfer of goods from Dept. A	-	50,000
Stock (December 31st) at cost to the Department	30,000	10,000
Sale to outside	2,00,000	71,000

B's entire stock represents goods from Department A which transfers them at 25% above its cost. Administrative and selling expenses amount to Rs. 15,000 which are to be allocated between departments A and B in the ratio 4:1 respectively.

(10 + 6 = 16 Marks)

6. (a) Beta Ltd. has its share capital divided into shares of Rs. 10 each. On 1st April, 2013, it granted 25,000 employees stock options at Rs. 50 when the market price was Rs. 140 per share. The options were to be exercised between 1st January, 2014 and 28th February, 2014. The employees exercised options for 24,000 shares only; the remaining options lapsed. The company closes its books of account on 31st March every year. You are required to show necessary journal entries reflecting these transactions.

(b) Shubha Limited issued 8% Debentures of Rs. 3,00,000 in earlier year on which interest is payable half yearly on 31st March and 30th September. The company has power to purchase its own debentures in the open market for cancellation thereof. The following purchases were made during the financial year 2013-14 and cancellation made on 31st March, 2014:

(i) On 1st April, Rs. 50,000 nominal value debentures purchased for Rs. 49,450, ex-interest.

(ii) On 1st September, Rs. 30,000 nominal value debentures purchased for Rs. 30,250 cum interest.

Show the Journal Entries (without narrations) for the transactions held in the year 2013-14.

(c) From the following information of Reliable Marine Insurance Ltd. for the year ending 31st March, 2014, find out the Net claims incurred:

	(Rs.) *Direct Business*	*(Rs.)* *Re-insurance Business*
Claims:		
Paid	69,00,000	5,54,000
Payable – 01.04.2013	89,000	15,000
Payable – 31.03.2014	95,000	12,000
Received		2,01,000
Receivable – 01.04.2013		40,000
Receivable – 31.03.2014		38,000

(4 + 6 + 6 = 16 Marks)

7. Answer any **four** of the following:

(a) EXOX Ltd. is in the process of finalizing its accounts for the year ended 31st March, 2013. The company seeks your advice on the following:

The Company's sales tax assessment for assessment year 2010-11 has been completed on 14th February, 2013 with a demand of Rs. 2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.

(b) A company capitalizes interest cost of holding investments and adds to cost of investment every year, thereby understating interest cost in profit and loss account. State whether the accounting done by the company is usual or not?

(c) Sohan Ltd. provides you the following information:

Issued capital	1,00,000 equity shares of Rs. 10 each
Reserves and surplus	Capital reserve Rs. 5,00,000
Securities premium	Rs. 9,00,000
Revenue reserve	Rs. 15,00,000

The company resolved to buy 10% of its equity share capital @ Rs. 60 per share. Give the necessary journal entries in the books of Sohan Ltd.

(d) AB Limited was incorporated on 1st January, 2014 and it issued a prospectus inviting applications for 40,000 equity shares of Rs. 10 each. The whole issue was fully underwritten by A, B and C as follows:

A - 20,000 Shares, B - 12,000 Shares, C - 8,000 Shares

Applications were received for 32,000 shares, of which marked applications were as follows:

A - 16,000 Shares, B - 5,700 Shares, C - 8,300 Shares

You are required to find out the liabilities of individual underwriters.

(e) Calculate the diluted earnings per share from the following information:

Net profit for the current year (after tax)	Rs. 85,50,000
Number of equity shares outstanding	20,00,000
Number of 8% convertible debentures of Rs. 100 each	1,00,000
Each debenture is convertible into 10 equity shares.	
Interest expenses for the current year	Rs. 6,00,000
Tax relating to interest expenses	30%

(4 x 4 = 16 Marks)

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PAPER – 5: ADVANCED ACCOUNTING

SUGGESTED ANSWERS/HINTS

1. (a) Based on sales, research and development cost (assumed that entire cost of Rs. 225 lakhs is development cost) is allocated as follows:

Year	*Research and Development cost allocation*
	(Rs. in lakhs)
1	225/1,500 x 600 = 90
2	225/1,500 x 450 = 67.5
3	225/1,500 x 300 = 45
4	225/1,500 x 150 = 22.5

(ii) If at the end of the 3rd year, the circumstances do not justify that further benefit will accrue in the 4th year, then the company has to charge the unamortised amount i.e. remaining Rs. 67.5 lakhs [225 – (90 + 67.5)] as an expense immediately.

(b) Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring fixed assets should be adjusted in the carrying amount of the respective fixed assets as Path Ltd. has exercised the option and it is long term foreign currency monetary item.

Thus, the entire exchange loss due to variation of Rs. 20 lakhs on 31.03.2015 on payment of US $ 10 lakhs, should be added to the carrying amount of fixed assets and not to the cost of goods sold.

Calculation of Exchange loss:

Foreign currency loan (in Rs.) = (50 lakhs $ x Rs. 60) = Rs. 3,000 lakhs

Exchange loss on outstanding loan on 31.03.2015 = Rs. 40 lakhs US $ x (62.00-60.00) = Rs. 80 lakhs.

So, Rs. 80 lakhs should also be added to cost of fixed asset with corresponding credit to outstanding loan in addition to Rs. 20 lakhs on account of exchange loss on payment of instalment. The total cost of fixed asset to be increased by Rs. 100 lakhs.

Total depreciation to be provided for the year 2014-15 = 20% of (Rs. 3,000 lakhs + 100 lakhs) = Rs. 620 lakhs.

(c) (i) Whether a subsidy applied is to be classified as prior period item as per AS 5, depends upon whether the company has committed an error in 2013-14 by not recognising the subsidy? The answer is in para 13 of AS 12 "Accounting for Government Grants" which permits recognition of grant only when there is reasonable assurance that (i) the enterprise will comply with the conditions attached to them and (ii) the subsidy will be received. Mere making of an application does not provide the reasonable assurance that the subsidy will be received. Letter of sanction from IREDA is required to provide this assurance. Since, the subsidy was granted in June, 2014 after approval of accounts, non-recognition of grant in 2013-14 will not be considered as an error. Hence, this is not a prior period item. Therefore, the company was right in not recognizing the grant.

Further, AS 4 requires adjustment of events occurring after the balance sheet date only upto the date of approval of accounts by the Board of Directors. In view of this, the company is correct in not adjusting the same in the accounts in the year 2013-14.

(ii) The subsidy should be deducted from the cost of the generator. The revised unamortised amount of generator should be written off over the remaining useful life.

Alternatively, the same may be treated as Deferred Income and allocated over the remaining useful life in the proportion in which depreciation is charged.

(d) (i) Determination of nature of lease

Fair value of asset = Rs. 7,00,000

Unguaranteed residual value = Rs. 70,000

Present value of residual value at the end of 4^{th} year = Rs. 70,000 x 0.683
= Rs. 47,810

Present value of lease payments recoverable = Rs.7,00,000 - Rs. 47,810

= Rs. 6,52,190

The percentage of present value of lease payment to fair value of the asset is

= (Rs. 6,52,190/Rs. 7,00,000)x100= 93.17%

Since, it substantially covers the major portion of lease payment and life of the asset, the lease constitutes a finance lease.

(ii) Calculation of Unearned Finance Income

Annual lease payment = Rs. 6,52,190 / 3.169

= Rs. 2,05,803 (approx.)

Gross investment in the lease = Total minimum lease payment + unguaranteed residual value

= (Rs. 2,05,803 x 4) + Rs. 70,000

= Rs. 8,23,212 + Rs. 70,000

= Rs. 8,93,212

Unearned finance income = Gross investment – Present value of minimum lease payment and unguaranteed residual value.

= Rs. 8,93,212 – Rs. 7,00,000 (Rs. 6,52,190 + Rs. 47,810)

= Rs. 1,93,212.

2. (a) Centura Bank Limited

Profit and Loss account for the year ended 31st March, 2014

		Schedule No.	**Year ended 31.3.2014**
			Rs.
I.	Income		
	Interest earned	13	74,03,000
	Other income	14	9,10,000
			83,13,000
II.	Expenditure		
	Interest expended	15	40,74,000
	Operating expenses	16	9,10,000
	Provisions and contingencies (W.N.2)		26,00,000
			75,84,000
III.	Profit		
	Net profit for the year		7,29,000
	Profit brought forward		-
			7,29,000
IV.	Appropriations		
	Transfer to Statutory Reserve		1,82,250
	Proposed dividend		2,00,000
	Balance carried over to balance sheet		3,46,750
			7,29,000

Schedule 13 – Interest earned

	Rs.
Interest and discount earned (W.N.1)	74,03,000
	74,03,000

Schedule 14 - Other Income

	Rs.
Commission, exchange and brokerage	3,80,000
Profit on sale of investment	4,00,000
Rent	1,30,000
	9,10,000

Schedule 15-Interest Expended

	Rs.
Interest paid on deposits	40,74,000
	40,74,000

Schedule 16-Operating Expenses

	Rs.
Payment and provisions for employees	4,00,000
Rent and taxes paid	1,80,000
Depreciation on bank's property	60,000
Directors' fees and allowances	60,000
Auditors' fees	10,000
Law charges	80,000
Postage and Telegrams	1,20,000
	9,10,000

Working Notes:

		Rs.
1.	**Calculation of interest earned**	
	Interest and discount received	74,11,000
	Add: Rebate on bills discounted as on 31st March, 2013	24,000
		74,35,000

	Less: Rebate on bills discounted as on 31st March, 2014		(32,000)
			74,03,000
2.	**Provisions and Contingencies**		
	Provision for doubtful debts:		
	Doubtful debts due to insolvency of a customer (50% of Rs. 20 lakhs)	10,00,000	
	Provision for other debts	3,00,000	13,00,000
	Provision for income tax		13,00,000
			26,00,000

(b) Accounting treatment of the fund received by an Electricity Company from consumer towards capital expenditure / service line contributions can be given as follows:

(i) Amount received from consumer towards capital/service line contributions is accounted as liability and subsequently recognised as income over the life of the asset;

(ii) Amount received from consumer towards capital/service line contributions is accounted as reserves as the amount is not refundable and reported under the head Reserves and Surplus without transferring any proportionate amount to the income statement over the life of asset;

(iii) Amount received from consumer towards capital/service line contributions is accounted as Capital Reserve as the amount is not refundable and subsequently proportionate amount is transferred to income statement during the expected life of asset to match against depreciation on total cost of such asset;

(iv) Amount received from consumer towards capital/service line contributions is accounted as reduction in the cost of Non-current Asset and depreciation may be provided on such reduced cost.

3. Journal Entries

in the books of OMG& Co.

Particulars		*Dr. (Rs.)*	*Cr. (Rs.)*
Goodwill A/c	Dr.	1,00,000	
Building A/c	Dr.	2,00,000	
Machinery A/c	Dr.	4,50,000	
Furniture A/c	Dr.	40,000	
Stock A/c	Dr.	2,40,000	

Debtors A/c	Dr.	3,20,000	
Cash at Bank A/c	Dr.	60,000	
Cash in hand A/c	Dr.	40,000	
Due from M & Co. A/c	Dr.	2,00,000	
To Creditors A/c			2,40,000
To Bank Loan A/c			1,60,000
To O's Capital A/c			8,17,500
To M's Capital A/c			4,32,500
(Being the Assets and Liabilities of O & Co. taken over)			
Goodwill A/c	Dr.	82,000	
Machinery A/c	Dr.	4,00,000	
Furniture A/c	Dr.	12,000	
Stock A/c	Dr.	2,80,000	
Debtors A/c	Dr.	4,00,000	
Cash at Bank A/c	Dr.	1,80,000	
Cash in hand A/c	Dr.	20,000	
Advances A/c	Dr.	1,20,000	
To Creditors A/c			2,32,000
To Due to O & Co. A/c			2,00,000
To M's Capital A/c			7,08,000
To G's Capital A/c			3,54,000
(Being the Assets and Liabilities of M & Co. taken over)			
O's Capital A/c	Dr.	91,000	
M's Capital A/c	Dr.	60,667	
G's Capital A/c	Dr.	30,333	
To Goodwill A/c	Dr.		1,82,000
(Being Goodwill written off)			
Bank A/c	Dr.	3,69,833	
To O's Capital A/c			3,38,500
To G's Capital A/c			31,333
(Being the Cash brought in by O and G to make capitals proportionate)			

M's Capital A/c	Dr.	3,69,833	
To Bank A/c			3,69,833
(Being the excess capital withdrawn by M)			
Due to O & Co. A/c	Dr.	2,00,000	
To Due from M & Co. A/c			2,00,000
(Being the elimination of mutual indebtedness of the merged firms O & co., and M & co.			

Balance Sheet of M/s OMG& Co. as at 31st March, 2014

Liabilities	*Rs.*		*Rs.*
Capitals:		Building	2,00,000
O	10,65,000	Machinery	8,50,000
M	7,10,000	Furniture	52,000
G	3,55,000	Stock	5,20,000
Creditors	4,72,000	Debtors	7,20,000
Bank Loan	1,60,000	Advances	1,20,000
		Cash at Bank	2,40,000
		Cash in hand	60,000
	27,62,000		27,62,000

Working Notes:

1. Statement showing the Computation of Purchase Consideration

Particulars	*O & Co.*	*M & Co.*
	Rs.	*Rs.*
A. Assets		
Goodwill	1,00,000	82,000
Building	2,00,000	-
Machinery	4,50,000	4,00,000
Furniture	40,000	12,000
Stock	2,40,000	2,80,000
Debtors	3,20,000	4,00,000
Cash at Bank	60,000	1,80,000
Cash in hand	40,000	20,000
Due from M & Co.	2,00,000	-
Advances	-	1,20,000
	16,50,000	14,94,000

B.	Liabilities		
	Creditors	2,40,000	2,32,000
	Due to O & Co.	-	2,00,000
	Bank Loan	1,60,000	-
		4,00,000	4,32,000
C.	Purchase consideration (A-B)	12,50,000	10,62,000

2. Statement showing the Computation of Proportionate Capitals

Particulars		*Rs.*
A.	M/s OMG & Co. (Rs. 12,50,000+Rs. 10,62,000)	23,12,000
B.	Less: Goodwill Adjustment	(1,82,000)
C.	Total Capital of new Firm	21,30,000
D.	O's proportionate Capital (Rs. 21,30,000 x 3/6)	10,65,000
E.	M's proportionate Capital (Rs. 21,30,000 x 2/6)	7,10,000
F.	G's Proportionate Capital (Rs. 21,30,000 x 1/6)	3,55,000
		21,30,000

3. Statement showing the Computation of Capital Adjustments

Particulars	*O*	*M*	*G*	*Total*
	Rs.	*Rs.*	*Rs.*	*Rs.*
Balance transferred from O and co. (W.N. 4)	8,17,500	4,32,500	-	12,50,000
Balance transferred from M and Co. (W.N.5)	-	7,08,000	3,54,000	10,62,000
	8,17,500	11,40,500	3,54,000	23,12,000
Less: Goodwill written off in the ratio of (3:2:1)	(91,000)	(60,667)	(30,333)	(1,82,000)
(a) Existing Capital	7,26,500	10,79,833	3,23,667	21,30,000
(b) Proportionate Capital	10,65,000	7,10,000	3,55,000	21,30,000
(c) Amount to be brought in (paid off) (a-b)	3,38,500	(3,69,833)	31,333	-

4. Capital Accounts (in the Books of O & Co.)

Particulars	*O*	*M*	*Particulars*	*O*	*M*
	Rs.	*Rs.*		*Rs.*	*Rs.*
To Capital A/c – M/s OMG& Co.	8,17,500	4,32,500	By Balance b/d	4,80,000	3,20,000
(Transfer)			By Reserve (3:1)	75,000	25,000
			By Goodwill (3:1)	75,000	25,000
			By Realisation A/c*		
			-Profit (3:1)	1,87,500	62,500
	8,17,500	4,32,500		8,17,500	4,32,500

*For Building Rs. 1,00,000 and Machinery Rs. 1,50,000.

5. **Capital Accounts (in the Books of M & Co.)**

Particulars	*M*	*G*	*Particulars*	*M*	*G*
	Rs.	*Rs.*		*Rs.*	*Rs.*
OMG& Co. (Transfer)	7,08,000	3,54,000	By Balance b/d	4,00,000	2,00,000
			By Reserve (2:1)	2,00,000	1,00,000
			By Goodwill (2:1)	54,667	27,333
			By Realisation A/c*		
			-Profit (2:1)	53,333	26,667
	7,08,000	3,54,000		7,08,000	3,54,000

*For Machinery Rs. 80,000.

4. (i) **Calculation of number of equity and preference shares**

	Rs.
Fixed assets	6,40,000
Inventory	3,85,000
Bills receivable	15,000
Purchase consideration	10,40,000

Amount discharged by issue of preference shares = Rs. 2,55,000

No. of preference shares to be allotted $= \frac{₹\ 2,55,000}{100} = 2,550$ shares

Amount discharged by allotment of equity shares = Rs. 10,40,000 – Rs. 2,55,000

= Rs. 7,85,000

Paid up value of equity share = Rs. 8

Hence, number of equity shares to be issued $= \frac{₹\ 7,85,000}{8}$ = 98,125 shares

(ii) **In the books of Alia Ltd.**

Realisation Account

		Rs.			*Rs.*
To	Fixed assets	4,82,000	By	Provision for bad and doubtful debts	4,000
To	Inventory	3,87,500	By	Trade payable	1,33,000
To	Trade receivables	95,000	By	Provision for taxation	1,10,000
To	Bank account:		By	Burger Ltd. account	
	Liquidation expenses	4,000		(Purchase consideration)	10,40,000

	Bills payable	19,000	By	Bank account: Sundry debtors	75,000
	Tax liability	1,11,000			
	Sundry creditors	1,05,500			
To	Equity shareholders (profit transferred)	1,58,000			
		13,62,000			13,62,000

Cash/Bank Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Balance b/d	1,64,500	By	Realisation account:	
To	Realisation account:			Liquidation expenses	4,000
	Sundry debtors	75,000		Bills payable	19,000
				Tax liability	1,11,000
				Sundry creditors (Balancing figure)	1,05,500
		2,39,500			2,39,500

Equity Shareholders Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	10% Preference shares in Burger Ltd.	2,55,000	By	Equity share capital account	6,00,000
To	Equity shares in Burger Ltd.	7,85,000	By	Contingency reserve	1,56,000
			By	Profit and loss account	1,26,000
			By	Realisation account(Profit)	1,58,000
		10,40,000			10,40,000

Burger Limited Account

Dr.					*Cr.*
		Rs.			*Rs.*
To	Realisation account	10,40,000	By	10% Preference shares in Burger Ltd.	2,55,000
			By	Equity shares in Burger Ltd.	7,85,000
		10,40,000			10,40,000

(iii) Journal Entries in the books of Burger Ltd.

Particulars		*Amount (Rs.)*	*Amount (Rs.)*
Business purchase account	Dr.	10,40,000	
To Liquidator of Alia Ltd. account			10,40,000
(Being the amount of purchase consideration payable to liquidator of Alia Ltd. for assets taken over)			
Fixed assets account	Dr.	6,40,000	
Inventory account	Dr.	3,85,000	
Bills receivable account	Dr.	15,000	
To Business purchase account			10,40,000
(Being assets taken over)			
Liquidator of the Alia Ltd. account	Dr.	10,40,000	
To 10% Preference share capital account			2,55,000
To Equity share capital account			7,85,000
(Being the allotment of 10% fully paid up preference shares and equity shares of Rs. 10 each, Rs. 8 each paid up as per agreement for discharge of purchase consideration)			

5. (a) Pune Branch Account

Particulars		**Rs.**	**Particulars**	**Rs.**	**Rs.**
To Opening Balance			By Opening Balance:		
Stock		10,000	Salaries outstanding		100
Debtors		4,000	By Remittances:		
Petty Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received from debtors	35,000	
Prepaid Insurance		150	Cash paid by debtors directly to H.O.	2,000	
To Goods sent to Branch Account		80,000	Received from Insurance Company	1,000	1,68,000
To Bank (expenses)			By Goods sent to branch (return of goods by the branch to H.O.)		1,000
Rent	2,000		By Closing Balances:		
Salaries	2,400		Stock		5,000

Petty Cash	1,000		Petty Cash		650
Insurance	600	6,000	Debtors		4,900
To Net Profit		78,950	Furniture (2,000 – 10% depreciation)		1,800
			Prepaid insurance (1/4 x Rs. 600)		150
		1,81,600			1,81,600

Working Note:

Calculation of petty cash balance at the end:	Rs.
Opening balance	500
Add: Cash received form the Head Office	1,000
Total Cash with branch	1,500
Less : Spent by the branch	850
Closing balance	650

(b) Departmental Trading & profit and Loss Account for the year ending on 31.12.2014

Particulars	*A*	*B*	*Particulars*	*A*	*B*
	Rs.	*Rs.*		*Rs.*	*Rs.*
To Opening Stock	40,000	-	By Sales	2,00,000	71,000
To Purchases	2,00,000	20,000	By Transfer of goods (A to B)	50,000	-
To Wages	10,000	1,000	By Closing stock	30,000	10,000
To Transfer of Goods (A to B)	-	50,000			
To Gross Profit c/d	30,000	10,000			
	2,80,000	81,000		2,80,000	81,000
To Adm. & Selling Exp. (4:1)	12,000	3,000	By Gross Profit b/d	30,000	10,000
To Profit	18,000	7,000			
	30,000	10,000		30,000	10,000

General Profit and Loss Account

Particulars	*Rs.*	*Particulars*		*Rs.*
To Stock Reserve (Loading on unsold Stock at Dept. B] 10,000x 1/5]	2,000	By Profit A	18,000	
		B	7,000	25,000
To Net Profit	23,000			
	25,000			25,000

6. (a) **Journal Entries**

			Rs.	Rs.
1.1.14 to 28.2.14	Bank A/c	Dr.	12,00,000	
	Employees compensation expense A/c	Dr.	21,60,000	
	To Equity Share Capital A/c			2,40,000
	To Securities Premium A/c			31,20,000
	(Allotment of 24,000 equity shares of Rs.10 each at a premium of Rs.130 per share to the employees)			
31.3.14	Profit and Loss A/c	Dr.	21,60,000	
	To Employees Compensation Expense A/c			21,60,000
	(For transfer of employees compensation expense to profit and loss account)			

(b) **Journal Entries in the books of Shubha Limited**

			Dr. *(Rs.)*	***Cr.*** *(Rs.)*
1.4.13	Own debentures A/c	Dr.	49,450	
	To Bank A/c			49,450
1.9.13	Own debentures A/c	Dr.	29,250	
	Interest on own debentures A/c	Dr.	1,000	
	$[30,000 \times 8\% \times \frac{5}{12}]$			
	To Bank A/c			30,250
30.9.13	Interest on debentures A/c	Dr.	12,000	
	To Bank A/c			8,800
	To Interest on own debentures A/c			3,200
31.3.14	Interest on debentures A/c	Dr.	12,000	
	To Bank A/c			8,800
	To Interest on own debentures A/c			3,200
	8% Debentures A/c	Dr.	80,000	
	To Own debentures A/c			78,700

	To Profit on cancellation of Debentures A/c		1,300
	Interest on own debentures A/c Dr.	5,400	
	To Profit and Loss A/c (3,200+3,200-1,000)		5,400
	Profit and Loss A/c (12,000+12,000) Dr.	24,000	
	To Interest on debentures A/c		24,000
	Profit on cancellation of debentures A/c Dr.	1,300	
	To Capital reserve A/c		1,300

(c) **Schedule 2 : Claims Incurred (Net)**

Particulars	*Rs.*
Claims paid on direct business	69,00,000
Add: Re-insurance accepted (W.N. 1)	5,51,000
Less: Re-insurance ceded (W.N. 2)	(1,99,000)
Net claims paid	72,52,000
Add: Claims outstanding at the end of the year	95,000
Less: Claims outstanding at the beginning of the year	(89,000)
Total claims incurred	72,58,000

Working Note:

Reinsurance accepted and ceded

	Rs.
1. Claims paid under re-insurance	5,54,000
Add: Outstanding as on 31.3.2014	12,000
Less: Outstanding as on 1.4.2013	(15,000)
Reinsurance accepted	5,51,000
2. Claims received from re-insurance	2,01,000
Add: Outstanding as on 31.3.2014	38,000
Less: Outstanding as on 1.4.2013	(40,000)
Reinsurance ceded	1,99,000

7. (a) Since the company is not appealing against the addition of Rs. 0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 13. The amount paid under protest can be kept in the books as an advance and disclosed along with the contingent liability of Rs. 2.10 crore.

(b) Investments other than investment properties are not qualifying assets as per AS 16 "Borrowing Costs". Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying asset, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale. Even where the investment properties meet the definition of 'qualifying asset', for the capitalisation of borrowing costs the other requirements of the standard such as that borrowing cost should be directly attributable to the acquisition or construction of the investment property and suspension of capitalization as per paragraphs 17 and 18 of AS 16 have to be complied with.

(c) **Journal Entries**

			(Rs.)
		Dr.	*Cr.*
Equity shares buy back A/c	Dr.	6,00,000	
To Bank A/c			6,00,000
(Being Buy back of 10,000 shares @ Rs. 60)			
Equity share capital A/c	Dr.	1,00,000	
Securities premium A/c	Dr.	5,00,000	
To Equity shares buy back A/c			6,00,000
(Being cancellation of equity shares bought back)			
Revenue reserves A/c	Dr.	1,00,000	
To Capital redemption reserve A/c			1,00,000
(Being amount equal to nominal value of shares bought back transferred to capital redemption reserve, as required by Companies Act, 2013)			

(d) **Statement of Net Liability of Underwriters (Number of Shares)**

	Gross Liability	Marked applications	Unmarked applications in the ratio of gross liability	Total (2) + (3)	Credit for C's Surplus (10:6)	Total (4) + (5)	Net Liability (1) - (6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
A	20,000	16,000	1,000	17,000	438	17,438	2,562
B	12,000	5,700	600	6,300	262	6,562	5,438
C	8,000	8,300	400	8,700	(700)	8,000	-
	40,000	30,000	2,000	32,000	-	32,000	8,000

Note: The applications are for 32,000 shares out of which those for 30,000 are marked. Hence unmarked applications are for 2,000 shares.

(e) Adjusted net profit for the current year

	Rs.
Net profit for the current year	85,50,000
Add: Interest expense for the current year	6,00,000
Less: Tax relating to interest expense (30% of Rs. 6,00,000)	(1,80,000)
Adjusted net profit for the current year	89,70,000

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$= \frac{1,00,000 \times 100}{10}$ = 10,00,000 Equity shares

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

= [(20,00,000 x 12) + (10,00,000 x 9**)]/12 = 27,50,000 shares

Diluted earnings per share = $\frac{89,70,000}{27,50,000 \text{ shares}}$ = Rs. 3.26 per share

**Interest on debentures for full year amounts to Rs. 8,00,000 (i.e. 8% of Rs. 1,00,00,000). However, interest expense amounting Rs. 6,00,000 has been given in the question. It may be concluded that debentures have been issued during the year and interest has been provided for 9 months.

Test Series: February, 2015

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 6: AUDITING AND ASSURANCE

*Question No.**1** is compulsory.*

*Attempt any **five** questions from the remaining **six** questions.*

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) Discuss with reference to SAs:

   (i) The communication of findings from the audit may include requesting further information from those charged with Governance in order to complete the audit evidence obtained. *(5 Marks)*

   (ii) Factors affecting form, contents and extent of audit documentation. *(5 Marks)*

   (b) Discuss the following:

   (i) The discipline of behavioural science is closely linked with the subject of auditing. *(5 Marks)*

   (ii) Inspection is one of the audit procedures to obtain audit evidence. *(5 Marks)*

2. State with reason (in short) whether the following statements are correct or incorrect (Answer any eight):

   (i) PQR Ltd. included underwriting commission and stamp duty under the head preliminary expenses.

   (ii) Cost of abnormal amounts of wasted materials included in the cost of inventories.

   (iii) Internal control is part of internal check system.

   (iv) Computer software which is the integral part of the related hardware can be treated as fixed assets.

   (v) The auditor appointed under section 139 of the Companies Act, 2013 may be removed from his office before the expiry of his term only by an ordinary resolution of the company.

   (vi) Mr. Rajat, an auditor, recovering fees on progressive basis is said to be indebted to the company.

   (vii) "Examination in depth" implies examination of a few selected transactions from the beginning to the end through the entire flow of the transaction.

   (viii) Inherent and control risk, and detection risk have same meaning.

(ix) An officer of the company is not qualified for appointment as Auditor of a Company.

(x) Operational Audit involves examination of all operations and activities of the entity.

(2 x 8 = 16 Marks)

3. (a) What are accounting estimates according to the Standards on Auditing 540? Give some examples. *(5 Marks)*

(b) "Doing a statutory audit is full of risk". Narrate the factors which cause the risk.

(5 Marks)

(c) Despite of several disadvantages, audit programme is required to start an audit.

(6 Marks)

4. (a) To prepare an audit plan in CIS environment an auditor should gather information. Mention any four such important information which he has to collect. *(4 Marks)*

(b) How will you vouch/verify the following?

(i) Purchase of Goods through its invoice only.

(ii) Patterns, dies, loose tools etc.

(iii) Refund of General Insurance Premium paid. *(3 x 4 = 12 Marks)*

5. (a) State the circumstances which could lead to any of the following in an Auditor's Report:

(i) A modification of opinion

(ii) Disclaimer of opinion

(iii) Adverse opinion

(iv) Qualified opinion. *(4 x 2 = 8 Marks)*

(b) What are the points on which an auditor should concentrate while planning audit of an N.G.O.? *(8 Marks)*

6. (a) KBC & Co. a firm of Chartered Accountants has three partners, namely, Mr. K, Mr. B & Mr. C. Mr. K is also in whole time employment elsewhere. The firm is offered the audit of ABC Ltd. and is already holding audit of 40 companies. Comment.

(6 Marks)

(b) Due to the resignation of the existing auditor(s), the Board of Directors of X Ltd. appointed Mr. Hari as the auditor. Is the appointment of Mr. Hari, as auditor, valid?

(6 Marks)

(c) At the Annual General Meeting of the Company, a resolution was passed by the entire body of shareholders restricting some of the powers of the Statutory Auditors. Whether powers of the Statutory Auditors can be restricted? *(4 Marks)*

7. Write short notes on any four of the following:

   (a) Impairment of Assets.

   (b) Application of Securities Premium Account.

   (c) Importance of audit working papers.

   (d) Inherent limitations of Internal Control system.

   (e) Auditor's approach for Re-issue of forfeited shares. *(4 x 4 = 16 Marks)*

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 6: AUDITING AND ASSURANCE

SUGGESTED ANSWERS/HINTS

1. (a) (i) As per SA-260 "Communication with Those Charged with Governance", the auditor shall communicate the following significant findings from the audit, with those charged with governance:

(1) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;

(2) Significant difficulties, if any, encountered during the audit;

(3) Unless all of those charged with governance are involved in managing the entity:

(a) Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and

(b) Written representations the auditor is requesting; and

(4) Other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

(ii) As per SA-230 on "Audit Documentation", the form, content and extent of audit documentation depend on the following factors:

(1) The size and complexity of the entity.

(2) The nature of the audit procedures to be performed.

(3) The identified risks of material misstatement.

(4) The significance of the audit evidence obtained.

(5) The nature and extent of exceptions identified.

(6) The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.

(7) The audit methodology and tools used.

(b) (i) The Discipline of Behavioural Science is Closely Linked with the Subject of Auditing: The field of auditing as a discipline involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. Thus, it is quite logical and natural that the function of audit can be performed if and only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.

The discipline of behavioural science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organisation. As against the financial auditor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures. One of the basic elements in designing the internal control system is personnel. Howsoever, if a sound internal control structure is designed, it cannot work until and unless the people who are working in the organisation are competent and honest. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties.

(ii) Inspection as Audit Procedure to Obtain Audit Evidence: Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records for evidence of authorisation.

Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a stock or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition.

Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

2. (i) Incorrect: The expenditure incidental to the creation and floating of a company includes stamp duties, registration fees, legal costs, accountant's fees, cost of printing, etc. Underwriting commission and brokerage paid for shares and debentures should not be included under the head preliminary expenses. Therefore, PQR Ltd. should include stamp duty as preliminary expense but exclude underwriting commission.

(ii) **Incorrect**: As per AS-2 on Valuation of Inventories, in determining the cost of inventories, it is appropriate to exclude abnormal amounts of wasted materials, labour or other production costs and recognise them as expenses in the period in which they are incurred. Therefore, it is not appropriate to include abnormal amounts of wasted materials cost in the cost of inventories.

(iii) **Incorrect:** Internal check has been defined as "checks on day-to-day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud". Internal check is a part of the overall internal control system and operates as a built-in device as far as the staff organisation and job allocation aspects of the control system are concerned.

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

(v) **Incorrect.** The auditor appointed under section 139 of the Companies Act, 2013 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government.

(vi) **Incorrect:** According to the Research Committee of the Institute, a question often arises as to whether indebtedness arises in cases where in accordance with the terms of his engagement by a client (e.g. resolution passed by the general meeting) the auditor recovers his fees on a progressive basis as and when a part of work is done without waiting for the completion of the whole job. Where in accordance with such terms, the auditor recovers his fees on a progressive basis, he cannot be said to be indebted to the company at any stage.

In view of the above, Mr. Rajat cannot be said to be indebted to the company.

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

(viii) **Incorrect:** Inherent and control risks differ from detection risk in that they exist independently of an audit of financial information. Inherent and control risks are functions of the entity's business and its environment and the nature of the account balances or classes of transactions, regardless of whether an audit is conducted. Even though inherent and control risks cannot be controlled by the auditor, the auditor can assess them and design his substantive procedures to produce an acceptable level of detection risk, thereby reducing audit risk to an acceptably low level.

(ix) **Correct:** Section 141(3)(b) of the Companies Act, 2013 evidently excludes an officer or employee of the company to be qualified for appointment as auditor of a company. Therefore, the statement that an officer is not qualified for appointment as Auditor of a Company is correct.

(x) **Correct:** Operational Audit involves examination of all operations and activities of the entity. The objects of operational audit include the examination of the control structure and of the relation of department controls to general policies. Therefore, the statement given is correct.

3. (a) **Accounting Estimates:** According to the SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", accounting estimate means an approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. SA 540 addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

Because of the uncertainties inherent in business activities, some financial statement items can only be estimated. Further, the specific characteristics of an asset, liability or component of equity, or the basis of or method of measurement prescribed by the financial reporting framework, may give rise to the need to estimate a financial statement item. Some financial reporting frameworks prescribe specific methods of measurement and the disclosures that are required to be made in the financial statements, while other financial reporting frameworks are less specific.

Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements, for example:

- Accounting estimates arising in entities that engage in business activities that are not complex.
- Accounting estimates that are frequently made and updated because they relate to routine transactions.

For some accounting estimates, however, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:

- Accounting estimates relating to the outcome of litigation.

- Fair value accounting estimates for derivative financial instruments not publicly traded.

Additional examples of accounting estimates are:

- Allowance for doubtful accounts.
- Inventory obsolescence.
- Warranty obligations.
- Depreciation method or asset useful life.
- Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.
- Outcome of long term contracts.
- Financial Obligations/Costs arising from litigation settlements and judgments.

(b) **Factors which cause Risk:** As Per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion.

An independent audit whether performed in terms of applicable financial reporting framework or in terms of the engagement, the auditor has to be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable for the preparation of financial statements. Since the entire process of auditing is based on the assessment of judgements made by the management of the entity as well as evaluation of internal controls, the audit suffers certain inherent risks. Factors which may cause such risk in conducting an audit are discussed below:

(i) *Exercising judgement on the part of the auditor:* The auditor's work involves exercise of judgement, for example, in deciding the extent of audit procedures and in assessing the reasonableness of the judgements and estimates made by management in preparing the financial statements.

(ii) *Nature of audit evidence:* Much of the evidence available to the auditor can enable him to draw only reasonable conclusions therefrom. The auditor normally relies upon persuasive evidence rather than conclusive evidence.

Even in circumstances where conclusive evidence is available, the cost of obtaining such evidence may far exceed the benefits.

(iii) *Inherent limitations of internal control:* Internal control can provide only reasonable, but not absolute, assurance on account of several inherent limitations such as potential for human error, possibility of circumstances of control through collusion, etc.

On account of above, it is quite clear that an audit suffers from control risk on account of inherent limitations of internal control and detection risk on account of test nature of audit and judgement and estimates involved in formulating accounting policies.

(c) Despite Several Disadvantages, Audit Programme is Required to Start an Audit: Despite of several disadvantages, the audit programme is required to start an audit due to the following considerations-

(i) The audit programme lists down areas of audit before commencement.

(ii) The audit timing is built therein; thereby it becomes a schedule of audit plan.

(iii) The staff who are entrusted with the audit assignment is also specified. It is a plan of resource allocation of the firm.

(iv) It specifies the procedures to be checked during the audit.

(v) As the audit work is split into various elements of procedures to be performed, the audit programme acts as a guiding chart or check list during the performance of audit.

(vi) Since the staff in charge of each work is specified and they sign the programme, it extracts the responsibility from the audit assistants.

(vii) The working papers of the audit staff can be reviewed against the audit programme which helps a base of reference for evaluation of the performance before reporting on the financial statements.

(viii) It also helps in preparing a diary of the performance and plan and also base for billing the clients for the time and manpower involved in the audit.

4. (a) The Auditor should Gather Information about the CIS Environment that is Relevant to the Audit Plan, Including Information as to:

(i) How the CIS function is organized and the extent of concentration or distribution of computer processing throughout the entity.

(ii) The computer hardware and software used by the entity.

(iii) Each significant application processed by the computer, the nature of the processing (e.g. batch, on-line), and data retention policies.

(iv) Planned implementation of new applications or revisions to existing applications.

(v) When considering his overall plan the auditor should consider matters, such as:

(a) Determining the degree of reliance, if any, he expects to be able to place on the CIS controls in his overall evaluation of internal control.

(b) Planning how, where and when the CIS function will be reviewed including scheduling the works of CIS experts, as applicable.

(c) Planning auditing procedures using computer-assisted audit techniques.

(b) (i) Vouching of Purchases Through Invoice: While vouching entries for purchases with the invoices, the following points should be specially observed-

(1) that the date of invoice falls within the accounting period;

(2) that the invoice is made out in the name of the client;

(3) that the supplier's account has been credited with the full amount of the invoice and that the deduction in the amount of the invoice, if any, has been made on a proper basis;

(4) that the goods purchased are those that are regularly dealt in by the concern or required for the process of manufacture carried on by it and that the price payable has been correctly arrived at;

(5) that the cost of purchases has been debited to an appropriate nominal account or accounts;

(6) that the invoice is signed by the accountant to show that he has verified it as well as the store-keeper to indicate that the delivery of goods have been taken by him. If the invoice relates to the purchase of a technical store or a chemical, the price whereof is dependent on its quality, a copy of the report of a technical person showing that the article purchased is of the specification for which the order has been placed; and

(7) that the manager or some other official, competent to sanction payment, has authorised its payment.

(ii) Patterns, Dies, Loose Tools, etc.: Several entities have large investments in such assets which have a relatively short useful life and low unit cost. Evidently, it is a difficult matter, under the circumstances, to prepare a separate account for each such asset although a careful control over such property is necessary.

On these considerations, some entities charge off small tools and other similar items to Production Account as and when they are purchased and do not place any value on the unused stock on the Balance Sheet. Nevertheless, a record of issues and receipts of tools to workmen is kept, as a check on the same being pilfered and a memorandum stock account of dies and patterns is also maintained. In other concerns, the cost of tools, dies, etc. purchased is debited to appropriate assets account, and an inventory of the unused items at the end of the year is prepared and valued; the sum total of opening balance and purchase reduced by the value of closing stock, as disclosed by the inventory, is charged off to Production Account in respect of such assets. On the other hand, some concerns carry such assets at their book values at the end of the first year and charge off the cost of all the purchases in the subsequent year to the Production Account on the plea that they represent cost of replacement.

The most satisfactory method, however, is that of preparing an inventory of serviceable articles, at the close of each year, and revaluing the assets on this basis, the various articles included in the inventory being valued at cost. It should be seen that the inventory does not include any worn out or defective articles the life of which has already run out.

(iii) Refund of General Insurance Premium paid: The refund of insurance premium may be because of earlier provisional payment of premium or may be a policy might have been cancelled at a later date. The auditor should take following steps while vouching such refunds-

(a) Ascertain the reasons for refund of insurance premium.

(b) Examine insurance policy or cover note to find out the amount of premium.

(c) Verify advice of refund received from the insurance company. When refund is admitted, the insurance company sends the advice. This will be evidence as a covering letter to the cheque for the refund. Sometimes, a cheque is issued after a receipt is sent in advance to the insurance company.

(d) Scrutinise correspondence between the insurance company and the client.

(e) Check entries in the bank book or the bank statement. If necessary, the counterfoil of the pay-in-slips can also be verified.

5. (a) (i) Modification of Opinion: The auditor shall modify the opinion in the auditor's report when-

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

(2) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

(ii) **Disclaimer of opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

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

(iv) **Qualified Opinion:** The auditor shall express a qualified opinion when-

(1) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

(2) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

(b) Planning Audit of an N.G.O.: While planning the audit of an N.G.O, the auditor should concentrate on the following-

(i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates.

(ii) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 1976, Societies Registration Act, 1860, Income Tax Act, 1961 etc. and the Rules related to the statutes.

(iii) Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.

(iv) Reviewing the NGO's Organisation chart, Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.

(v) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.

(vi) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.

(vii) Setting of materiality levels for audit purposes.

(viii) The nature and timing of reports or other communications.

(ix) The involvement of experts and their reports.

(x) Review the previous year's Audit Report.

6. (a) Ceiling on Number of Company Audits: Section 141(3)(g) of the Companies Act, 2013 states that the following persons shall not be eligible for appointment as an auditor of a company i.e. a person who is in full time employment elsewhere; or a person, or a partner of a firm holding appointment as its auditor, if such person, or partner is at the date of such appointment, or reappointment holding appointment as auditor of more than twenty companies.

In the given case, Mr. K, a partner in the firm KBC & Co., is in whole-time employment elsewhere, therefore, he will be excluded in determining the number of company audits that the firm can hold. If Mr. B and Mr. C do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by KBC & Co., is forty, and in the given case company is already holding forty audits, therefore, KBC & Co. can't accept the offer for audit of ABC Ltd.

(b) Board's Powers to Appoint an Auditor: As per Section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall-

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

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

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

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

In the given case, casual vacancy has been created due to resignation of the existing auditor(s) of X Ltd. However, the Board of Directors appointed Mr. Hari as the auditor of the company.

Therefore, the appointment of Mr. Hari made by the Board of Directors of X Ltd. is void as, in the case of casual vacancy due to resignation of the auditor, the vacancy can be filled by the Board of Directors within thirty days and such appointment should be approved by the company at a general meeting to be convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

(c) **Restrictions on Powers of Statutory Auditors**: Section 143 of the Companies Act, 2013 provides that an auditor of a company shall have right of access at all times to the books and accounts and vouchers of the company whether kept at the Head Office or other places and shall be entitled to require from the offices of the company such information and explanations as the auditor may think necessary for the purpose of his audit. These specific rights have been conferred by the statute on the auditor to enable him to carry out his duties and responsibilities prescribed under the Act, which cannot be restricted or abridged in any manner. Hence, any such resolution even if passed by entire body of shareholders is *ultra vires* and therefore void.

7. (a) Impairment of Assets: Besides charging annual depreciation on assets by the reason of normal wear and tear, effluxion of time and obsolescence to reinstate the correct value of the assets considering the future cash flows that the assets can generate, impairment loss needs to be provided. The difference between the carrying amount of an asset and recoverable amount is termed as impairment loss. The treatment of impairment loss is similar to depreciation except the fact that it can be reinstated in future, if the recoverable amount of the asset exceeds the carrying amount.

The auditor must ensure that provisions of AS 28 "Impairment of assets" are followed.

(b) Application of Securities Premium Account: According to section 52 of the Companies Act, 2013, the securities premium account may be applied by the company—

(i) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;

(ii) in writing off the preliminary expenses of the company;

(iii) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

(iv) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or

(v) for the purchase of its own shares or other securities under section 68.

(c) Importance of Audit Working Papers:

(i) It provides guidance to the audit staff with regard to the manner of checking the schedules.

(ii) The auditor is able to fix responsibility on the staff member who signs each schedule checked by him.

(iii) It acts as evidence in the court of law when a charge of negligence is brought against the auditor.

(iv) It acts as the process of planning for the auditor so that he can estimate the time that may be required for checking the schedules.

The auditor should adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirements of record retention.

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

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

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

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

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

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

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

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

(viii) Inherent limitations of Audit.

(e) Auditor's Approach for Re-issue of Forfeited Shares: The auditor should-

(i) ascertain that the Board of Directors has the authority under the Articles to re-issue forfeited shares;

(ii) refer to the resolution of the Board of Directors, re-allotting forfeited shares;

(iii) vouch the amounts collected from person to whom the shares have been allotted and verify the entries recorded from re-allotment and see that the total amount received on the share, including that received prior to forfeiture, is not less than the par value;

(iv) verify that computation of the amount of surplus resulting on the reissue of shares credited to the Capital Reserve Account; and

(v) 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 of the Companies Act, 2013 is essential as issuance of shares at discount other than sweat equity share are void.

Test Series: February, 2015

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

Question No. **1** is compulsory.

Attempt any **five** questions from the rest.

Time Allowed – 1½ Hours **Maximum Marks – 50**

1. Answer all the following questions in brief.
   - (i) Decision Table
   - (ii) Value Chain
   - (iii) Computer Bus
   - (iv) Wi-Fi
   - (v) Vulnerability
   - (vi) Repeater
   - (vii) Knowledge Management Systems
   - (viii) XBRL
   - (ix) Business Application
   - (x) HTTPS *(1 x 10 = 10 Marks)*
2. (a) Discuss the architecture of Cloud Computing. *(5 Marks)*

   (b) List down some of the business uses of Internet. *(3 Marks)*
3. (a) What is an Expert System? Discuss its components in brief. *(5 Marks)*

   (b) Discuss about Smart Card and its types? *(3 Marks)*
4. (a) Discuss Network Virtualization and its application. *(5 Marks)*

   (b) Why Grid computing is needed? *(3 Marks)*
5. (a) Differentiate between Hierarchical Database Model and Network Database Model**.** *(5 Marks)*

   (b) Differentiate between Transport Layer and Network Layer of OSI Model. *(3Marks)*
6. (a) A company ABC Ltd. is engaged in selling consumer goods to different categories of customers. In order to increase its sales, different types of discounts are offered

to customers. The policy of discount is as given below:

(i) On cooking range, a discount of 12 percent is allowed to dealers and 9 percent to retailers irrespective of the value of the order.

(ii) A discount of 12 percent is allowed on washing machine irrespective of the category of customer and the value of the order.

(iii) On decorative products, dealers are allowed a discount of 20 percent provided that the value of the order is Rs. 10,000 and above. Retailers are allowed a discount of 10 percent irrespective of the value of the order.

Draw a flow chart to calculate the discount for the above policy. *(5 Marks)*

(b) Give advantages of using Decision Tree. *(3 Marks)*

7. Write short notes on any **four** of the following.

(a) Bluetooth

(b) Business Process Reengineering (BPR)

(c) Mesh Network

(d) Core Banking System (CBS)

(e) Application Controls *(4 × 2 = 8 Marks)*

Test Series: February, 2015

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – II

PAPER –7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – B: STRATEGIC MANAGEMENT

*Question No.**1** is compulsory.*

*Attempt any **five** questions from the rest.*

Time Allowed – 1½ Hours **Maximum Marks – 50**

1. (a) Organization can wield considerable power and influence over some of the elements of the external environment. Discuss. *(3 Marks)*

   (b) Explain the meaning of market penetration. *(3 Marks)*

   (c) What is meant by concentric diversification? *(3 Marks)*

   (d) The first step in strategic management model is developing a strategic vision and mission. Explain. *(3 Marks)*

   (e) Describe briefly the use of strategic management techniques in educational institutions. *(3 Marks)*

2. (a) State with reasons which of the following statements is correct/incorrect:

   (i) Strategy needs to be perfect, flawless and optimal.

   (ii) A strength is an inherent capacity of an organization. *(2×2 = 4 Marks)*

   (b) Distinguish between strategy formulation and strategy implementation. *(3 Marks)*

3. Write short notes on the following:

   (a) Industry. *(2 Marks)*

   (b) Key success factors. *(2 Marks)*

   (c) Value chain analysis. *(3 Marks)*

4. Discuss PESTLE as a framework for analysis of macro environmental factors of a business. *(7 Marks)*

5. (a) 'Strategic planning and implementation are must for all organizations'. In light of statement discuss the importance of strategic planning. *(4 Marks)*

   (b) What tips can you offer to write a 'right' mission statement? *(3 Marks)*

6. Under what conditions would you recommend the use of turnaround strategy in an organization? What could be a suitable work plan for this? *(7 Marks)*

7. Explain prominent areas where Human Resource Manager can play a strategic role.

   (7 Marks)

Test Series: February, 2015

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

SUGGESTED ANSWERS/HINTS

1. **(i) Decision Table:** A Decision Table is a table which may accompany a flowchart defining the possible contingencies that may be considered within the program and the appropriate course of action for each contingency. A Decision Table is divided into four quadrants: Condition Stub, Condition Entries, Action Stub and Action Entries, with each quadrant having specific significance.

   (ii) Value Chain: Value Chain is defined as a chain of activities that a firm operating in a specific industry performs in order to deliver a valuable product or service for the market. Research and development; Design of products, services, or processes; Production; Marketing and sales; Distribution and Customer service are some of the business functions of the value chain.

   (iii) Computer Bus: Computer Bus is a communication system that transfers data between components inside a computer, or between computers that covers all related hardware components (wire, optical fiber, etc.) and software, including communication protocol.

   (iv) Wi-Fi: Wi-Fi is a popular wireless networking technology that uses radio waves to provide wireless high-speed Internet and network connections and have limited range. A typical wireless access point might have a range of 32 meters (120 ft.). Wi-Fi networks use radio technologies called 802.11 to provide secure, reliable, fast wireless connectivity. A Wi-Fi network can be used to connect electronic devices to each other, to the Internet, and to wired networks (which use Ethernet technology).

   (v) Vulnerability: Vulnerability is an inherent weakness in the design, configuration, or implementation of a network or system that renders it susceptible to a threat. Software Bugs, insecure default configurations, trusting untrustworthy information and negligence at end-users' parts are some of the factors responsible for occurrence of vulnerabilities in the software.

   (vi) Repeater: Repeater is a communication processor that boosts or amplifies the signal before passing it to the next section of cable in a network.

   (vii) Knowledge Management Systems: Knowledge Management System (KMS) refers to any kind of IT system that stores and retrieves knowledge, improves collaboration, locates knowledge sources, mines repositories for hidden knowledge, captures and uses knowledge, or in some other way enhances the Knowledge Management process.

(viii) **XBRL:** eXtensible Business Reporting Language (XBRL) is freely available international standards-based business reporting language developed by accountants for financial reporting.

(ix) **Business Application:** Business Application is defined as a computer program used to fulfill a person's need for regular occupation or commercial activities like keeping track of inventory levels, checking for bank account balances, checking status of delivery of goods dispatched and all other business activities. Business Applications may be classified on the basis of – Nature of processing, Source of application, Nature of business and Functions covered /nature of application.

(x) **HTTPS:** HyperText Transfer Protocol Secure (HTTPS) is a communications protocol for secure communication over a computer network, with especially wide deployment on the Internet. The security of HTTPS uses long term public and secret keys to exchange a short term session key to encrypt the data flow between client and server.

2. **(a)** **Cloud Computing:** Cloud Computing architecture refers to the components and subcomponents that typically consist of a front end platform (fat client, thin client, mobile device), back end platform (servers, storage), a cloud based delivery, and a network (Internet, Intranet, Intercloud). Cloud architecture typically involves multiple cloud components communicating with each other over a tight or loose coupling of cloud resources, services, middleware, and software components.

A cloud computing architecture consists of two parts - **Front End** and a **Back End** that connect to each other through a network, usually the Internet. The front end is the side the computer user or client, sees. The back end is the "cloud" section of the system.

- **Front End:** The Front End of the cloud computing system comprises of the client's devices (or it may be a computer network) and some applications are needed for accessing the cloud computing system. All the cloud computing systems do not give the same interface to users. For example - Web services like electronic mail programs use some existing web browsers such as Firefox, Microsoft's Internet Explorer or Apple's Safari. Other types of systems have some unique applications which provide network access to its clients.

- **Back End:** Back End refers to some physical peripherals. In cloud computing, the back end is cloud itself which may encompass various computer machines, data storage systems and servers. Groups of these clouds make a whole cloud computing system. Theoretically, a cloud computing system can include practically any type of web application program such as video games to applications for data processing, software development and entertainment residing on its individual dedicated server for services. There are some set of rules, generally called as **Protocols** which are followed by this server and it uses a special type of software termed as **Middleware** that allow computers that are connected on networks to communicate with each other.

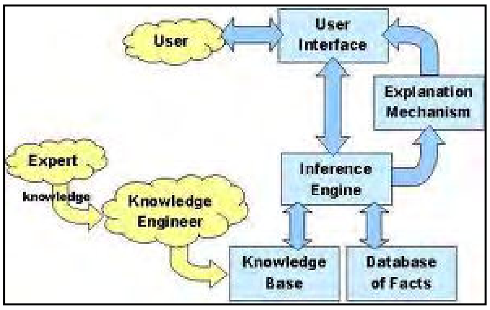
(b) Some of the business uses of the Internet are following:

- Strategic business alliances
- Providing customer and vendor support
- Collaboration among business partners
- Buying and selling products and services
- Marketing, sales, and customer service applications
- Growth of cross-functional business applications
- Emergence of applications in engineering, manufacturing, human resources and accounting.
- Enterprise communications and collaboration
- Attracting new customers with innovative marketing and products.
- Retaining present customers with improved customer service and support.
- Developing new web-based markets and distribution channels for existing products.
- Developing new information-based products accessible on the Web.
- Generating revenue through electronic commerce applications is a growing source of business value.
- Electronic commerce.

3. (a) **Expert System:** An Expert System (ES) is a computerized information system that allows non-experts to make decisions comparable to those of an expert. The aim of the expert system is to have a team of seasoned specialists holding industry-wide experience who further spread across implementations. Expert system has leveraged its strengths to plan and execute a miscellaneous variety of projects for Defence, Government, Finance, Telecom, and Engineering sectors. The key components of an Expert System take into consideration the knowledge, facts and user interface with the help of knowledge engineer to accomplish the task.

- **Knowledge Base:** This includes the data, knowledge, relationships, rules of thumb (heuristics), and decision trees used by experts to solve a particular problem. A knowledge base is the computer equivalent of all the knowledge and that encloses both realistic and heuristic knowledge.

- **Inference Engine:** This program contains the logic and reasoning mechanisms that simulate the expert logic process and deliver advice. It uses data obtained from both the knowledge base and the user to make associations and inferences, form its conclusions, and recommend a course of action.



- **User Interface:** This program allows the user to design, create, update, use and communicate with the expert system.

- **Explanation facility:** This facility provides the user with an explanation of the logic the ES used to arrive at its conclusion.

- **Database of Facts:** This holds the user's input about the current problem. Gradually a database of facts is built up which the inference engine will use to come to a decision. The quality and quantity of data gained from the user will influence the reliability of the decision.

(b) **Smart Cards:** Smart cards have an embedded microchip instead of magnetic strip. The chip contains all the information a magnetic strip contains but offers the possibility of manipulating the data and executing applications on the card. Three types of smart cards are as follows:

- **Contact Cards –** Smart cards that need to insert into a reader in order to work, such as a smart card reader or automatic teller machines.

- **Contactless Cards** – Contactless smart cards don't need to be inserted into a reader. Just waving them near a reader is just sufficient for the card to exchange data. This type of cards is used for opening doors.

- **Combi/Hybrid Cards –** Combi cards contain both technologies and allow a wider range of applications.

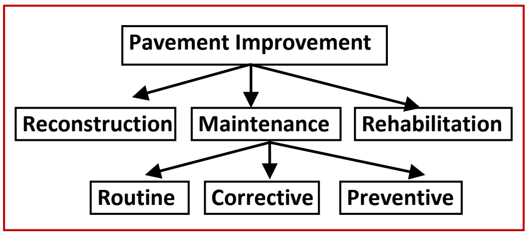
4. **(a)** **Network Virtualization:** In IT, Virtualization is the process of creating logical computing resources from available physical resources. Network Virtualization allows a large physical network to be provisioned into multiple smaller logical networks and conversely allows multiple physical LANs to be combined into a larger logical network. This behaviour allows administrators to improve network traffic control, enterprise and security." Major applications of the concepts of the virtualization are given as follows:

- **Server Consolidation:** Virtual machines are used to consolidate many physical servers into fewer servers, which in turn host virtual machines. Each physical server is reflected as a virtual machine "guest" residing on a virtual machine host system. This is also known as “Physical-to-Virtual” or 'P2V' transformation.
- **Disaster Recovery:** Virtual machines can be used as "hot standby" environments for physical production servers. This changes the classical "backup-and-restore" philosophy, by providing backup images that can "boot" into live virtual machines, capable of taking over workload for a production server experiencing an outage.
- **Testing and Training:** Hardware virtualization can give root access to a virtual machine. This can be very useful such as in kernel development and operating system courses.
- **Portable Applications:** Portable applications are needed when running an application from a removable drive, without installing it on the system's main disk drive. Virtualization can be used to encapsulate the application with a redirection layer that stores temporary files, windows registry entries and other state information in the application's installation directory and not within the system's permanent file system.
- **Portable Workspaces:** Recent technologies have used virtualization to create portable workspaces on devices like iPods and USB memory sticks.

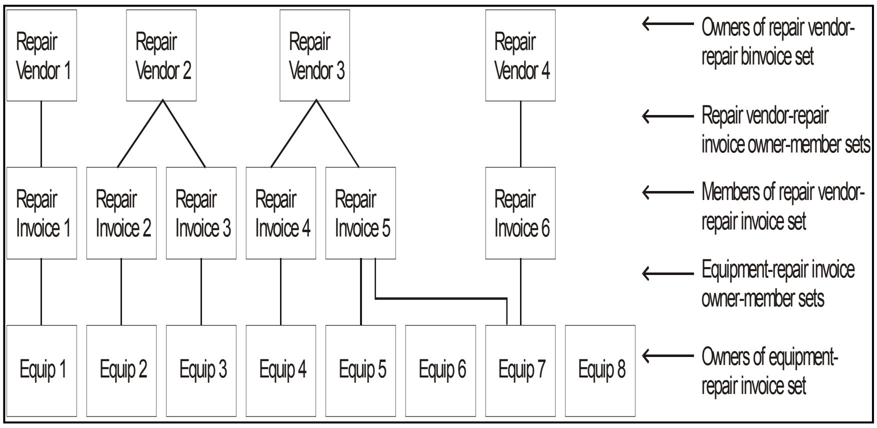
(b) We need Grid Computing because of the following reasons:

- Civil engineers collaborate to design, execute, & analyze shake table experiments.
- An insurance company mines data from partner hospitals for fraud detection.
- An application service provider offloads excess load to a compute cycle provider.
- An enterprise configures internal & external resources to support e-Business workload.
- Large-scale science and engineering are done through the interaction of people, heterogeneous computing resources, information systems and instruments, all of which are geographically and organizationally dispersed.

5. (a) **Hierarchical Database Model:** In a hierarchical database model, records are logically organized into a hierarchy of relationships. A hierarchically structured database is arranged logically in an inverted tree pattern. All records in hierarchy are called nodes. The top parent record in the hierarchy is called the **root record**. Records that "own" other records are called **parent records**. Each node is related to the others in a parent-child relationship. Each parent record may have one or more child records, but no child record may have more than one parent record. Thus, the hierarchical data structure implements one-to-one and one-to-many relationships. (Refer the fig.)



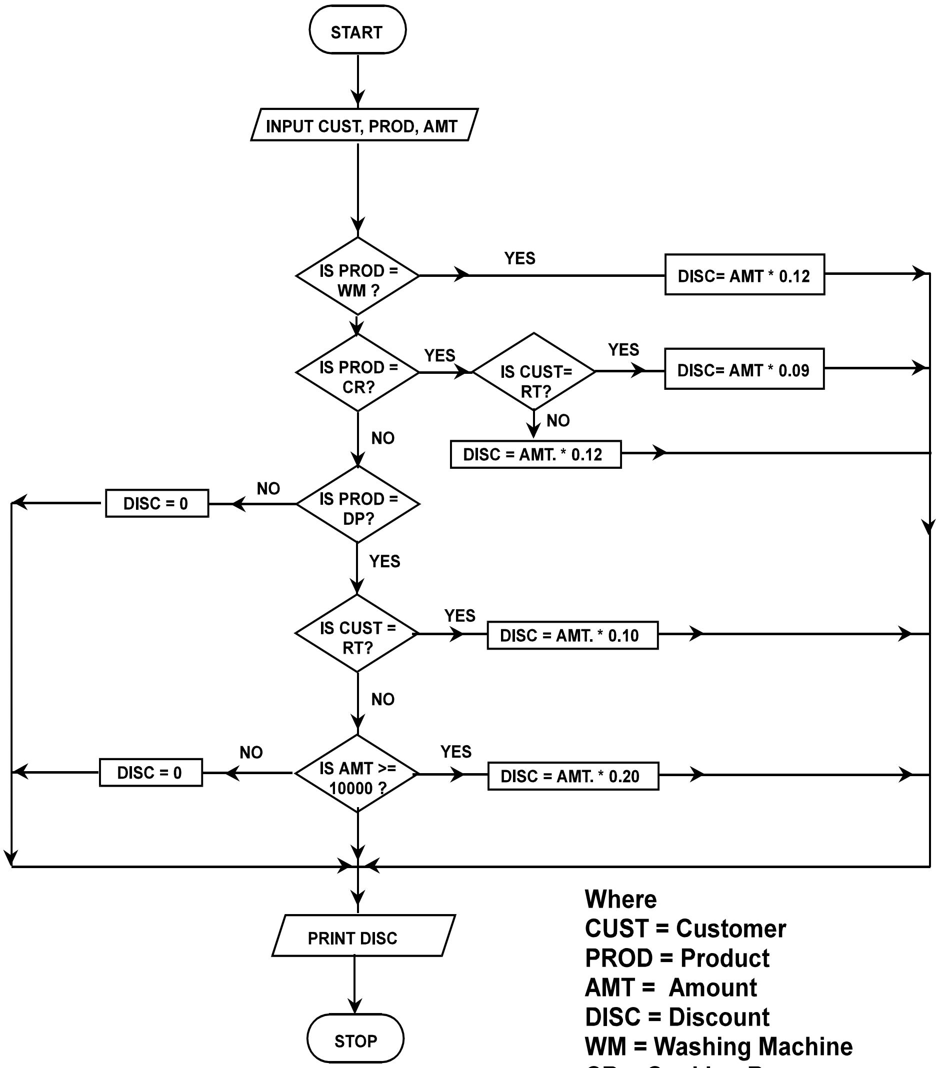
Network Database Model: The network model is a variation on the hierarchical model such that it is built on the concept of multiple branches (lower-level structures) emanating from one or more nodes (higher-level structures) and that branch may be connected to multiple nodes. The network model is able to represent redundancy in data more efficiently than in the hierarchical model. The network model also permits a record to be a member of more than one set at one time that allows the network model to implement the many-to-one and the many-to-many relationship types.



(b) Transport Layer of OSI Model: Transport Layer or Layer 4 ensures reliable and transparent transfer of data between user processes, assembles and disassembles message packets and provides error recovery and flow control. Multiplexing and encryption are undertaken at this layer level. This means that the Transport Layer can keep track of the segments and retransmit those that fail.

Network Layer of OSI Model: The Network Layer or Layer 3 provides the functional and procedural means of transferring variable length data sequences from a source to a destination via one or more networks, while maintaining the quality of service requested by the Transport Layer. The Network Layer makes a choice of the physical route of transmission; creates a virtual circuit for upper layers to make them independent of data transmission and switching; establishes, maintains, terminates connections between the nodes and ensure proper routing of data.

6. **(a)** The required flowchart is given below in Fig.



Where
CUST = Customer
PROD = Product
AMT = Amount
DISC = Discount
WM = Washing Machine
CR = Cooking Range
DP = Decorative Product
RT = Retailer

(b) Some of the advantages of using Decision Tree are as follows:

- These are simple to understand and interpret. People are able to understand decision tree models after a brief explanation.

- Possible scenarios can be added in Decision Tree.
- Worst, best and expected values can be determined for different scenarios.

7. (a) Bluetooth: Bluetooth is a wireless technology standard for exchanging data over short distances up to 50 meters (164 feet) from fixed and mobile devices, creating Personal Area Networks (PANs) with high levels of security. Bluetooth is like a very low-power, short-range radio signal and are secure from the moment they're sent. Few devices that utilize Bluetooth technology are - Keyboards and mice; Printers; Cell phones and headsets; Personal Digital Assistants; Desktop and laptop computers; Digital cameras, and Remotes. Through the use of a mobile phone with Bluetooth enabled in them, we can send pictures, videos, exchange business cards and also transfer files to our PC. Both data and voice transmissions can be sent and received through the use of short range networks.

(b) Business Process Reengineering (BPR): BPR aims at major transformation of the business processes to achieve dramatic improvement. The business objectives of the enterprise (e.g., profits, customer-satisfaction through optimal cost, quality, deliveries, etc.) are achieved by "transformation" of the business processes which may, or may not, require the use of Information Technology (IT). BPR is the main method by which organizations become more efficient and modern. It transforms an organization in ways that directly affect its performance. Information Systems are valuable assets that knowledge workers can take advantage of. BPR combines small granular functions conducted by several persons into functional units of larger granularity, and supports knowledge workers in performing these tasks with dedicated information systems.

(c) Mesh Network: In this structure, there is random connection of nodes using communication links. A mesh network may be fully connected or connected with only partial links. In fully interconnected topology, each node is connected by a dedicated point to point link to every node. The reliability is very high as there are always alternate paths available if direct link between two nodes is down or dysfunctional. In this, the network problems are easier to diagnose. However, fully connected networks are not very common because of the high cost of installation and maintenance.

(d) Core Banking Systems: CORE (Centralized Online Real-time Environment) Banking System (CBS) may be defined as the set of basic software components that manage the services provided by a bank to its customers through its branches (branch network). Core banking systems are the heart of a bank. The various elements of core banking include - Making and servicing loans; Opening new accounts; Processing cash deposits and withdrawals; Processing payments and cheques; Calculating interest; Customer relationship management (CRM) activities; Managing customer accounts; Establishing criteria for minimum balances, interest rates, number of withdrawals allowed and so on; Establishing interest rates; and

Maintaining records for all the bank's transactions etc. Examples of major core banking products include Infosys' Finacle, Nucleus FinnOne and Oracle's Flexcube application (from their acquisition of Indian IT vendor i-flex).

(e) **Application Controls:** Application Controls deal with the application functions that need to be in place to accomplish reliable information processing.

Types of Application Subsystem and their description

Application Subsystem	Description of Subsystem
Boundary	Comprises the components that establish the interface between the user and the system.
Input	Comprises the components that capture, prepare, and enter commands and data into the system.
Communication	Comprises the components that transmit data among subsystems and systems.
Processing	Comprises the components that perform decision making, computation, classification, ordering, and summarization of data in the system.
Database	Comprises the components that define, add, access, modify, and delete data in the system.
Output	Comprises the components that retrieve and present data to users of the system.

Test Series: February, 2015

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – II

PAPER –7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – B: STRATEGIC MANAGEMENT

SUGGESTED ANSWERS / HINTS

1. **(a)** By virtue of its command over resources and information organisations are also in position to yield power and influence over some of the elements of external environment. The same elements which exercise power over the organization are also subject to the influence and power of the organization in some respects. To the extent that the organization is able to hold power over the environment increases its autonomy and freedom of action. It can dictate terms to the external forces and mould them to its will.

(b) Market penetration is a growth strategy where the business focuses on selling existing products into existing markets. It is achieved by making more sales to present customers without changing products in any major way. Penetration might require greater spending on advertising or personal selling.

(c) Concentric diversification amounts to related diversification. In this form of diversification, the new business is linked to the existing businesses through existing systems such as process, technology or marketing. The new product is a spin-off from the existing facilities and products/processes. However, concentric diversification differs from vertically integrated diversification in the nature of the linkage the new product has with the existing ones. 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. In concentric diversification there are benefits of synergy with the current operations.

(d) Identifying an organisation's existing vision, mission, objectives are the starting point for any strategic management process. Determining vision and mission provides long-term direction, delineate what kind of enterprise the company is trying to become and infuse the organisation with a sense of purposeful action.

(e) Education is considered to be a noble profession. An educational institution often functions as a not-for-profit organization managed by trusts and societies. They include schools, colleges and universities. Being inherently non-commercial in nature, educational organisations do not have cut-throat competition as in case of their commercial counterparts. However, as the number of institutions belonging to both public and private sector are increasing, the competition is gradually rising. Through the use of strategic management techniques such institutions are expected to concentrate attention towards:

- Getting better name and recognition.
- Attracting talented students.
- Designing the curriculum in such a way to provide better citizenry and employability.
- Appointing and retaining quality faculty for teaching.
- Preparing students for the future challenges by capacity building.

2. (a) (i) **Incorrect:** It is in the very nature of strategy that it is flexible and pragmatic. Strategy is art of the possible. It does not preclude second-best choices, trade-offs, sudden emergencies, pervasive pressures, failures and frustrations. However, in a sound strategy, allowances are made for possible miscalculations and unanticipated events.

(ii) **Correct:** Strength is an inherent capacity which an organization can use to gain strategic advantage over its competitors. An example of strength is superior research and development skill which can be used for continuous product innovation or for new product development so that the company gains competitive advantage.

(b) Although correlated, strategy implementation is fundamentally different from strategy formulation in the following ways:

(i) Strategy formulation is positioning forces before the action. Strategy implementation is managing forces during the action.

(ii) Strategy formulation focuses on effectiveness whereas strategy implementation focuses on efficiency.

(iii) Strategy formulation is primarily an intellectual process whereas implementation of strategy is primarily an operational process.

(iv) Strategy formulation requires good intuitive and analytical skills while strategy implementation requires special motivation and leadership skills.

(v) Strategy formulation requires coordination among a few individuals while strategy implementation requires organization wide coordination.

3. (a) Industry is a consortium of firms whose products or services have homogenous attributes or are close substitutes such that they compete for the same buyer. For example, all paper manufacturers constitute the paper industry.

(b) Key Success Factors (KSFs) are those things that most affect industry members' ability to prosper in the marketplace - the particular strategy elements, product attributes, resources, competencies, competitive capabilities, and business outcomes that spell the difference between profit and loss and, ultimately, between competitive success or failure.

(c) Value chain analysis refers to separate activities which are necessary to underpin an organization's strategies and are linked together both within and around the organization. Organizations are much more than a random collection of machines, money and people. Value chain of a manufacturing organization comprises of primary and supportive activities.

4. The term PESTLE is used to describe a framework for analysis of macro environmental factors. PESTLE analysis involves identifying the political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy. 'PESTLE analysis is an acronym for:

- P - Political factors are how and to what extent a government intervenes in the economy and the activities of corporate. Political factors may also include goods and services which the government wants to provide or be provided and those that the government does not want to be provided.
- E - Economic factors have major impacts on how businesses operate and take decisions. For example, interest rates, exchange rate affect a firm's costs. The money supply, inflation, credit flow, per capita income, growth rates have a bearing on the business decisions.
- S - Social factors affect the demand for a company's products and how that company operates.
- T - Technological factors can determine barriers to entry, minimum efficient production level and influence outsourcing decisions. Furthermore, technological shifts can affect costs, quality, and lead to innovation.
- L - Legal factors affect how a company operates, its costs, and the demand for its products.
- E - Environmental factors affect industries such as tourism, farming, and insurance. Growing awareness to climate change is affecting how companies operate and the products they offer – it is both creating new markets and diminishing or destroying existing ones.

5. **(a)** Strategic planning and implementation have become must for all organizations for their survival and growth in the present turbulent business environment. Many organizational giants have also followed the path of extinction failing to manage drastic changes in the business environment. The organizations have to build competitive advantage over the competitors in the business warfare in order to win. The major benefits of strategic management are:

- ♦ Strategic management helps organisations to be more proactive instead of reactive in shaping its future. Organisations are able to analyse and take actions instead of being mere spectators. Thereby they are able to control there own destiny in a better manner.

- Strategic management provides framework for all the major business decisions of an enterprise such as decisions on businesses, products, markets, manufacturing facilities, investments and organisational structure.
- Strategic management is concerned with ensuring a good future for the firm. It seeks to prepare the corporation to face the future and act as pathfinder to various business opportunities.
- Strategic management serves as a corporate defence mechanism against mistakes and pitfalls. It helps organisations to avoid costly mistakes in product market choices or investments.

Over a period of time strategic management helps organisation to evolve certain core competencies and competitive advantages that assist in its fight for survival and growth.

(b) Mission statements broadly describe an organizations present capabilities, customer focus, activities, and business makeup. Following points are useful while writing mission of a company:

- Good mission statements are highly personalized – unique to the organization for which they are developed.
- One of the roles of a mission statement is to give the organization its own special identity, business emphasis and path for development.
- A company's business is defined by what needs it is trying to satisfy, customer groups it is targeting, technologies and competencies it uses and the activities it performs.
- Technology, competencies and activities are important in defining a company's business because they indicate the boundaries on its operation.
- The mission should not be to make profit.

6. Rising competition, business cycles and economic volatility have created a climate where no business can take viability for granted. Turnaround strategy is a highly targeted effort to return an organization to profitability and increase positive cash flows to a sufficient level. Turnaround strategy is used when both threats and weaknesses adversely affect the health of an organization so much that its basic survival is a question. Once turnaround is successful the organization may turn to focus on growth.

Conditions for turnaround strategies: When firms are losing their grips over market, profits due to several internal and external factors, and if they have to survive under the competitive environment they have to identify danger signals as early as possible and undertake rectification steps immediately. These conditions may be, inter alia cash flow problems, lower profit margins, high employee turnover and decline in market share, capacity underutilization, low morale of employees, recessionary conditions, mismanagement, raw material supply problems and so on.

Action plan for turnaround strategy

Stage One – *Assessment of current problems:* The first step is to assess the current problems and get to the root causes and the extent of damage the problem has caused. Once the problems are identified, the resources should be focused toward those areas essential to efficiently work on correcting and repairing any immediate issues.

Stage Two – *Analyze the situation and develop a strategic plan*: Before you make any major changes; determine the chances of the business's survival. Identify appropriate strategies and develop a preliminary action plan. Analyze the strengths and weaknesses in the areas of competitive position.

Stage Three – *Implementing an emergency action plan:* If the organization is in a critical stage, an appropriate action plan must be developed to stop the bleeding and enable the organization to survive. The plan typically includes human resource, financial, marketing and operations actions to restructure debts, improve working capital, reduce costs, improve budgeting practices, prune product lines and accelerate high potential products. A positive operating cash flow must be established as quickly as possible and enough funds to implement the turnaround strategies must be raised.

Stage Four – *Restructuring the business:* The financial state of the organization's core business is particularly important. If the core business is irreparably damaged, then the outlook for the entire organization may be bleak. Prepare cash forecasts, analyze assets and debts, review profits and analyze other key financial functions to position the organization for rapid improvement.

During the turnaround, the "product mix" may be changed, requiring the organization to do some repositioning. Some facilities might be closed; the organization may even withdraw from certain markets to make organization leaner or target its products toward a different niche. The 'people mix" is another important ingredient in the organization's competitive effectiveness. Reward and compensation systems that encourage dedication and creativity encourage employees to think profits and return on investments.

Stage Five – *Returning to normal:* In the final stage of turnaround strategy process, the organization should begin to show signs of profitability, return on investments and enhancing economic value-added. Emphasis is placed on a number of strategic efforts such as carefully adding new products and improving customer service, creating alliances with other organizations, increasing the market share, etc.

7. The prominent areas where the human resource manager can play strategic role are as follows:

a. *Providing purposeful direction:* The human resource management must be able to lead people and the organization towards the desired direction involving people. The management have to ensure harmony between organisational objectives and individual objectives. Objectives are specific aims which must be in the line with the goal of the organization and the all actions of each person must be consistent with them.

b. *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.

c. *Facilitation of change:* The human resource manager will be more concerned about furthering the organization not just maintaining it. He has to devote more time to promote acceptance of change rather than maintaining the status quo.

d. *Diversion 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. Maintaining a congenial healthy work environment is a challenge for HR Manager. Motivation, maintaining morale and commitment are some of the key task that a HR manager has to perform.

e. *Empowerment of human resources:* Empowerment involves giving more power to those who, at present, have little control what they do and little ability to influence the decisions being made around them.

f. *Building core competency:* The human resource manager has an important role to play in developing core competency by 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. It needs creative, courageous and dynamic leadership having faith in organization's human resources.

g. *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. Far reaching changes with the help of technical knowledge will be required for this purpose.