

Illustration 65:

रानी लिमिटेड का 31 मार्च, 2014 को स्थिति विवरण निम्न प्रकार था :

Following is the Balance Sheet of Rani Ltd. as on 31st March, 2014 :

Liabilities	₹	Assets	₹
Equity Share Capital	20,000	Goodwill at Cost	12,000
General Reserve	4,000	Fixed Assets	28,000
8% Loan on Mortgage	16,000	Stock	6,000
Trade Creditors	6,000	Debtors	4,000
Bank Overdraft	2,000	Bank	8,000
Proposed Dividend	2,000	Prepaid Expenses	2,000
Taxation :			
Current	2,000		
Future	2,000		
Profit and Loss Account :			
Profit for the year after interest and tax	12,000		
Less : Transferred to Reserve 4,000			
Dividend <u>2,000</u>	<u>6,000</u>	6,000	
		60,000	
			60,000

विक्रय की राशि ₹ 1,20,000 है।

आपको निम्न से सम्बन्धित अनुपातों की गणना करनी है :

(अ) तरलता की जाँच; (ब) शोधन क्षमता की जाँच; (स) लाभदायकता की जाँच;
(द) पूँजी दन्तिकरण की जाँच।

Sales amounted to ₹ 1,20,000.

You are required to calculate ratios relating to followings :

(a) Testing Liquidity; (b) Testing Solvency; (c) Testing Profitability; (d) Testing Capital Gearing.
[R.U. B.Com., 2006]

Solution :

Computation of Ratios :

(a) For Testing Liquidity :

$$(i) \text{ Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{₹ 20,000}{₹ 12,000} = 1.67 : 1$$

Current Assets = Stock + Debtors + Bank + Prepaid Expenses

$$= ₹ 6,000 + ₹ 4,000 + ₹ 8,000 + ₹ 2,000 = ₹ 20,000$$

$$\begin{aligned}
 \text{Current Liabilities} &= \text{Trade Creditors} + \text{Bank Overdraft} \\
 &\quad + \text{Proposed Dividend} + \text{Current Taxation} \\
 &= ₹ 6,000 + ₹ 2,000 + ₹ 2,000 + ₹ 2,000 = ₹ 12,000
 \end{aligned}$$

$$\text{(ii) Liquid Ratio} = \frac{\text{Liquid Assets}}{\text{Current Liabilities}} = \frac{₹ 12,000}{₹ 12,000} = 1 : 1$$

$$\begin{aligned}
 \text{Liquid Assets} &= \text{Current Assets} - (\text{Stock} + \text{Prepaid Expenses}) \\
 &= ₹ 20,000 - (₹ 6,000 + ₹ 2,000) = ₹ 12,000
 \end{aligned}$$

(b) For Testing Solvency :

$$\text{(i) Proprietary Ratio} = \frac{\text{Proprietor's Fund}}{\text{Total Assets}} = \frac{₹ 32,000}{₹ 60,000} = 0.533 : 1$$

$$\begin{aligned}
 \text{Proprietary Fund} &= \text{Equity Share Capital} + \text{General Reserve} + \text{P & L A/c} \\
 &\quad + \text{Future Taxation}^* \\
 &= ₹ 20,000 + ₹ 4,000 + ₹ 6,000 + ₹ 2,000 = ₹ 32,000
 \end{aligned}$$

$$\text{(ii) Debt-Equity Ratio} = \frac{\text{Outsiders' Fund}}{\text{Proprietors' Fund}} = \frac{₹ 28,000}{₹ 32,000} = 0.875 : 1$$

$$\begin{aligned}
 \text{Outside fund} &= \text{Loan on Margage} + \text{Trade Creditors} + \text{BOD} + \text{Proposed} \\
 &\quad \text{Dividend} + \text{Current Taxation} \\
 &= ₹ 16,000 + ₹ 6,000 + ₹ 2,000 + ₹ 2,000 + ₹ 2,000 = ₹ 28,000
 \end{aligned}$$

$$\begin{aligned}
 \text{(iii) Total Fixed Assets to Proprietorship Fund} \\
 &= \frac{\text{Total Fixed Assets}}{\text{Proprietor's Fund}} = \frac{₹ 40,000}{₹ 32,000} = 1.25 : 1
 \end{aligned}$$

$$\text{Total Fixed Assets} = \text{Fixed Assets} + \text{Goodwill at Cost}$$

$$\text{(iv) Current Assets to Proprietor's Fund}$$

$$= \frac{\text{Current Assets}}{\text{Proprietor's Fund}} = \frac{₹ 20,000}{₹ 32,000} = 0.625 : 1$$

(c) For Testing Profitability :

$$\text{(i) Net Profit Ratio} = \frac{\text{Net Profit after tax}}{\text{Sales}} \times 100 = \frac{₹ 14,000}{₹ 1,20,000} \times 100 = 11.67\%$$

$$\text{(ii) Return on Net Capital Employed}$$

$$= \frac{\text{Net Profit before Interest and Tax}}{\text{Net Capital Employed}} \times 100$$

$$\text{Net Profit before Interest and Tax} = \text{Net Profit after Interest and Tax} + \text{Taxation (Current and Future)} + \text{Interest}$$

$$= \frac{₹ 12,000 + ₹ 4,000 + ₹ 1,280}{₹ 48,000} \times 100 = \frac{₹ 17,280}{₹ 48,000} \times 100 = 36\%$$

$$\text{Net Capital Employed} = \text{Total Assets} - \text{Current Liabilities} \\ = ₹60,000 - ₹12,000 = ₹48,000$$

(iii) Return on Shareholders' Fund

$$= \frac{\text{Net Profit after tax}}{\text{Shareholders' Fund}} \times 100 = \frac{₹14,000}{₹32,000} \times 100 = 43.75\%$$

(d) For Testing Capital Gearing :

Capital Gearing Ratio

$$= \frac{\text{Fixed Income Bearing Securities}}{\text{Equity Share Capital} + \text{Reserve and Surplus}} = \frac{₹16,000}{₹32,000} = 0.5 : 1$$

Illustration 16

अरुणा लिमिटेड के 31 मार्च, 2014 को समाप्त होने वाले वर्ष के विवरण नीचे दिये गये हैं—

The following details of Aruna Ltd. for the year ended 31st March, 2014 are furnished below :

Operating leverage	3 : 1
Financial leverage	2 : 1
Interest charges per annum	₹ 20 lakhs
Corporate tax rate	30%
Variable cost as percentage of sales	60%

कम्पनी का आय विवरण तैयार कीजिये।

Prepare the Income statement of the company.

[R.U. B.Com., 2010]

Solution :

$$\text{Financial Leverage} = \frac{\text{EBIT}}{\text{EBT}} = 2$$

$$\left[\frac{\text{EBIT}}{\text{EBIT} - \text{Interest}} \right] = 2$$

$$\left[\frac{\text{EBIT}}{\text{EBIT} - ₹ 20,00,000} \right] = 2$$

$$\text{EBIT} = 2(\text{EBIT} - ₹ 20,00,000)$$

$$\text{EBIT} = 2\text{EBIT} - ₹ 40,00,000$$

$$2\text{EBIT} - \text{EBIT} = ₹ 40,00,000$$

$$\text{EBIT} = ₹ 40,00,000$$

Operating Leverage :

$$\left[\frac{\text{Contribution}}{\text{EBIT}} \right] = 3 \quad \left[\frac{\text{Contribution}}{₹ 40,00,000} \right] = 3$$

$$\text{Contribution} = 3 \times ₹ 40,00,000 = ₹ 1,20,00,000$$

Calculation of Fixed Cost

Contribution	₹ 1,20,00,000
Less : EBIT	₹ 40,00,000
Fixed Cost	₹ 80,00,000

8.24

परिचालन एवं वित्तीय उत्तोलक

Variable Cost = 60% of Sales

∴ Contribution is 40% of Sales

If 40% is ₹ 120 lakhs

$$100\% = \left(\frac{100}{40} \times 12,00,000 \right) = ₹ 300 \text{ lakhs Sales}$$

Income Statement of Aruna Ltd. for the Year ended 31-3-2014

(₹)

Sales	3,00,00,000
Less : Variable Cost	1,80,00,000
Contribution	120,00,000
Less : Fixed Cost	80,00,000
EBIT	40,00,000
Less : Interest	20,00,000
EBT	20,00,000
Less : Tax @ 30%	6,00,000
PAT	14,00,000

Illustration 18 :

ओसवाल लिमिटेड के निम्न चिह्नों से रोकड़ प्रवाह विवरण (लेखा प्रमाण-3 के अनुसार) तैयार कीजिये।

Prepare cash flow statement (as per AS-3) from the following balance sheets

Balance Sheets

Liabilities	31-3-2013 ₹	31-3-2014 ₹
Equity Share Capital	2,00,000	2,50,000
Security Premium	—	10,000
Reserves and Surplus	40,000	1,15,000
12% Debentures	—	1,20,000
Provision for Tax	30,000	40,000
Trade Creditors	75,000	1,15,000
Bills Payable	15,000	12,000
Outstanding Expenses	—	12,000
Total	3,60,000	6,74,000

अतिरिक्त सूचनाएँ :

- मशीनरी का एक भाग जिसकी वास्तविक लागत ₹ 50,000 थी (एकत्रित हास ₹ 27,000) को ₹ 35,000 में बेच दिया गया।
- वर्ष में मशीनरी पर ₹ 15,000 हास चार्ज किया गया।
- चालू वर्ष में वर्ष 2012-13 के लिए समता पूँजी पर 15% की दर से लाभांश चुकाया गया।

Additional Information :

- A part of machinery whose original cost was ₹ 50,000 (accumulated depreciation was ₹ 27,000) was sold for ₹ 35,000.
- Depreciation on machinery charged during the year ₹ 15,000.
- Dividend for 2012-13 paid during the year @ 15% on equity share capital.

(R.U. B.Com., 2012)

Solution : Cash Flow Statement (As per AS-3) Indirect Method

(A) Cash From Operating Activities		₹	75,000
Net Profit for the year	(₹ 1,15,000 – ₹ 40,000)		
Add : Non-Trading Expenses :		₹	
(i) Goodwill written off	14,000		
(ii) Share issue Expenses written off	5,000		
(iii) Underwriting Commission written off	4,000		
(iv) Depreciation on Machinery	15,000		
(v) Dividend paid on Equity Shares	30,000		
(vi) Tax Provision	40,000		1,08,000
Less : Non Trading Income			1,83,000
(i) Profit on sales of Machine			(12,000)
Adjusted Profit before working capital changes			1,71,000
Add : Decrease in current Assets		₹	
Prepaid Expenses	2,000		
Increase in current Liabilities			
Creditors	40,000		
Outstanding Expenses	12,000		54,000
Less : Increase in Current Assets			2,25,000
Stock	1,10,000		
Debtors	70,000		
Decrease in Current Liabilities			
Bills Payables	3,000		(1,83,000)
Less : Tax Paid			42,000
Cash from Operating Activities		(A)	30,000
(B) Cash from Investing Activities			12,000
Sale of Machinery	35,000		
Purchase of Machinery	(1,58,000)		
Cash from Investing Activities		(B)	(1,23,000)
(C) Cash from Financing Activities :			
Equity Shares Issued	50,000		
Security Premium	10,000		
12% Debentures issued	1,20,000		
Dividend Paid	(30,000)		
Cash from Financing Activities		(C)	1,50,000
Net Cash and Cash Equivalents		(A + B + C)	39,000
Add : Opening Cash and Bank Balance			13,000
Closing Cash and Bank Balance			52,000

Illustration 18 : एक सीमित कम्पनी की पूँजी संरचना निम्न प्रकार है :

A limited company has the following capital structure :

	₹
Equity Share Capital (2,00,000 shares)	40,00,000
6% Preference Shares	10,00,000
8% Debentures	30,00,000
	<u>80,00,000</u>

कम्पनी के समता अंश का बाजार मूल्य 20 ₹ है। यह आशा की जाती है कि कम्पनी 2 ₹ प्रति अंश लाभांश का भुगतान करेगी, जिसमें हमेशा 7% की वृद्धि होती रहेगी। कर की दर 50% मानी जा सकती है। आपको निम्न की गणना करनी है—

(अ) वर्तमान पूँजी संरचना के आधार पर पूँजी की भारित औसत लागत।

(ब) पूँजी की नई भारित औसत लागत यदि कम्पनी 10% ऋणपत्रों के निर्गमन द्वारा 20,00,000 ₹ का अतिरिक्त ऋण जारी करती है। इसके परिणामस्वरूप प्रत्याशित लाभांश 3 ₹ हो जायेगा तथा लाभांश में वृद्धि की दर अपरिवर्तित रहेगी, परन्तु अंश का बाजार मूल्य गिरकर 15 ₹ प्रति अंश हो जायेगा।

(स) उपरोक्त (ब) में पूँजी की लागत, यदि लाभांश में वृद्धि की दर बढ़कर 10% हो जाती है।

The market price of the company's equity share is ₹ 20. It is expected that company will pay a current dividend of ₹ 2 per share which will grow at 7 per cent for ever. The tax rate may be presumed at 50 per cent. You are required to compute the following :

(a) A weighted average cost of capital based on existing capital structure.

(b) The new weighted average cost of capital if the company raises an additional ₹ 20,00,000 debt by issuing 10 per cent debentures. This would result in increasing the expected dividend to ₹ 3 and leave the growth rate unchanged but the market price of share will fall to ₹ 15 per share.

(c) The cost of capital, if in (b) above, growth rate increases to 10 per cent.

Solution : (a) Statement Showing Weighted Average Cost of Capital

Source	Amount ₹	After Tax Cost	Weights	Weighted Cost
Equity Share Capital	40,00,000	0.17 ¹	0.500	0.0850
Preference Share Capital	10,00,000	0.06	0.125	0.0075
Debentures	30,00,000	0.04 ²	0.375	0.0150
Weighted Average Cost of Capital				0.1075 or 10.75%

1. The Cost of Equity Share Capital i.e.

$$C_e = \frac{DPS}{MP} \times 100 + G = \frac{₹ 2}{₹ 20} \times 100 + 7\% \\ = 10\% + 7\% = 17\% \text{ or } 0.17$$

$$2. C_d \text{ (after tax)} = C_d \text{ (before tax)} \times (1 - T) \\ = 8\% \times (1 - 0.5) \\ = 8\% \times 0.5 = 4\% = 0.04$$

(b) Statement Showing Weighted Average Cost of Capital

Source	Amount ₹	After Tax Cost	Weights	Weighted Cost
Equity Share Capital	40,00,000	0.27*	0.40	0.108
6% Pref. Share Capital	10,00,000	0.06	0.10	0.006
8% Debentures	30,00,000	0.04	0.30	0.012
10% Debentures	20,00,000	0.05	0.20	0.010
Weighted Average Cost of Capital				0.136 or 13.60%

*Cost of equity share capital i.e.

$$C_e = \frac{DPS}{MP} \times 100 + G = \frac{₹ 3}{₹ 15} \times 100 + 7\% \\ = 20\% + 7\% = 27\% \text{ or } 0.27$$

(c) Statement Showing Weighted Average Cost of Capital

Source	Amount ₹	After Tax Cost	Weights	Weighted Cost
Equity Share Capital	40,00,000	0.30*	0.40	0.120
6% Pref. Share Capital	10,00,000	0.06	0.10	0.006
8% Debentures	30,00,000	0.04	0.30	0.012
10% Debentures	20,00,000	0.05	0.20	0.010
Weighted Average Cost of Capital				0.148 or 14.80%

*Cost of Equity Share capital i.e.

$$C_e = \frac{DPS}{MP} \times 100 + G = \frac{₹ 3}{₹ 15} \times 100 + 10\% \\ = 20\% + 10\% = 30\% \text{ or } 0.30$$

What is meant by audit
mention the objects and
advantages of an audit



⋮

An **audit** is an independent examination of the financial information of any entity, whether profit-oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

In simpler terms, it's a systematic, independent process of reviewing an organization's books, accounts, and financial statements to ensure they present a "true and fair view" of its financial position and performance, and are free from material misstatement, whether due to error or fraud.

Advantages of an Audit

A professionally conducted audit offers several benefits to the organization and its stakeholders:

- 1. Increased Credibility and Confidence:** The independent opinion on the financial statements enhances the confidence of various stakeholders, including shareholders, investors, creditors, and the public, in the reliability of the financial data.
- 2. Facilitates Loans and Capital:** Banks and financial institutions often require audited financial statements before granting loans, as it provides assurance about the financial health and stability of the business.
- 3. Detection and Prevention of Errors and Frauds:** The audit process acts as a deterrent, encouraging employees to be more vigilant. If errors or frauds exist, the audit is designed to provide reasonable assurance of their detection.
- 4. Improved Internal Controls:** Auditors often provide management with recommendations to improve and strengthen the organization's internal control system, leading to better operational efficiency and risk management.
- 5. Settlement of Claims:** In case of events like a fire, insurance claims can be more easily settled based on audited accounts of previous years.
- 6. Tax Assessment:** Tax authorities often accept audited accounts, which can simplify the process of tax assessment.
- 7. Valuation of Business:** Audited accounts are essential and more reliable when the business is being sold, merged, or when a new partner is admitted, as they provide an independent basis for valuing assets and goodwill.

Objects of an Audit

The objectives of an audit are typically categorized into a primary objective and secondary or subsidiary objectives.

1. Primary Objective

The main objective is to enable the auditor to express an **independent opinion** on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, thereby showing a **true and fair view** of the entity's financial position and results of operations.

2. Secondary/Subsidiary Objectives

These objectives help the auditor in achieving the primary goal:

- **Detection and Prevention of Errors:** Identifying and bringing to light unintentional mistakes in the accounting records, such as errors of omission, commission, principle, or compensating errors.
- **Detection and Prevention of Frauds:** Identifying intentional misrepresentations or misappropriations, which can include manipulation of accounts, misappropriation of cash or goods, or suppression of transactions.
- **Verification of Transactions:** Checking the authenticity, validity, and proper classification (e.g., capital vs. revenue) of financial transactions.
- **Checking System of Internal Control:** Evaluating the effectiveness of the organization's internal check and internal control systems.
- **Ensuring Statutory Compliance:** Verifying that the entity has complied with all relevant laws, regulations, and accounting standards.

- ◆ The provisions regarding the qualifications, removal, and remuneration of a company auditor in India are primarily governed by the **Companies Act, 2013**, specifically Sections 141, 140, and 142 respectively. ☀

Here is a breakdown of the provisions:

1. Qualifications and Eligibility (Section 141)

A. Qualifications:

A person is eligible for appointment as an auditor of a company only if he/she is a **Chartered Accountant (CA)** within the meaning of the Chartered Accountants Act, 1949. ☀

- **Audit Firm:** A firm (including a Limited Liability Partnership-LLP) can be appointed as an auditor, provided that a **majority of partners practising in India are qualified for appointment** as CAs. Only the partners who are CAs are authorised to act and sign on behalf of the firm. ☀ ☀

B. Disqualifications:

The following persons are **not eligible** for appointment as an auditor:

1. A **body corporate** (other than an LLP). ☀
2. An **officer or employee** of the company. ☀
3. A person who is a **partner** or is in the **employment** of an officer or employee of the company. ☀
4. A person who, or his **relative or partner**, has certain financial or business interests:
 - **Holding security or interest** in the company, its subsidiary, holding, associate company, or a subsidiary of such holding company (subject to a *de minimis* exception for a relative holding security of face value not exceeding a prescribed limit, currently ₹1,00,000 as per rules). ☀

- **Indebtedness** to the company or its group companies in excess of a prescribed amount (currently ₹5 Lakhs).
• Has given a **guarantee or provided any security** in connection with the indebtedness of any third person to the company or its group companies in excess of a prescribed amount (currently ₹1 Lakh).
- 5. A person or firm that has a direct or indirect **business relationship** with the company or its group companies of a prescribed nature.
- 6. A person whose **relative is a Director** or is in the **employment** of the company as a Director or Key Managerial Personnel (KMP).
- 7. A person who is in **full-time employment elsewhere**, or a person or partner of a firm who holds an appointment as auditor of **more than twenty companies** (subject to certain exemptions for private companies and one-person companies).
- 8. A person convicted by a court of an offence involving **fraud** and a period of **ten years** has not elapsed from the date of such conviction.
- 9. A person who directly or indirectly renders any of the **prohibited non-audit services** specified in Section 144 to the company, its holding company, or its subsidiary company.

If an auditor incurs any of these disqualifications after appointment, they must **vacate their office**, which is treated as a casual vacancy.

2. Removal and Resignation of Auditor (Section 140)

A. Removal Before Expiry of Term:

An auditor can be removed from office before the expiry of their term only by following a strict procedure:

1. The company must pass a **Board Resolution**.
2. The company must obtain the **prior approval of the Central Government (CG)** by filing an application in Form ADT-2 within **30 days** of the Board Resolution.
3. The CG's approval must be obtained.
4. The company must then pass a **Special Resolution** in a General Meeting within **60 days** of receiving the CG's approval.
5. Crucially, the auditor concerned **must be given a reasonable opportunity of being heard** before any action is taken.

B. Removal by Tribunal (NCLT):

The National Company Law Tribunal (NCLT) can order a company to change its auditor if it is satisfied, either *suo motu* (on its own) or on an application by the Central Government or any concerned person, that the auditor has acted in a **fraudulent manner** or abetted or colluded in any fraud.

- The NCLT can bar such an auditor from being appointed in any company for a period of **five years**.

The auditor who has resigned must file a statement in the prescribed form (**Form ADT-3**) with the company and the Registrar of Companies (RoC) within **thirty days** from the date of resignation, indicating the reasons for resignation. In the case of certain government companies, the statement must also be filed with the Comptroller and Auditor-General of India (CAG).

3. Remuneration of Auditors (Section 142)

1. The **remuneration** of the auditor shall be **fixed in the company's General Meeting** or in such manner as may be determined therein.
2. An **exception** is for the **first auditor** of a company (other than a Government company) appointed by the Board of Directors, where the Board may fix their remuneration.
3. **Definition of Remuneration:** Remuneration includes the **fee** payable to the auditor, plus any **expenses** incurred by the auditor in connection with the audit of the company, and anything given to them otherwise than in cash.
4. **Exclusion:** Remuneration **does not include** any amount paid to the auditor for any other **service** rendered by them at the request of the company.