

CORPORATE ACCOUNTING AND AUDITING

COURSE CODE: B21CM05DC

Bachelor of Commerce
Discipline Core Course

SELF LEARNING MATERIAL



SREENARAYANAGURU OPEN UNIVERSITY

The State University for Education, Training and Research in Blended Format, Kerala

SREENARAYANAGURU OPEN UNIVERSITY

Vision

To increase access of potential learners of all categories to higher education, research and training, and ensure equity through delivery of high quality processes and outcomes fostering inclusive educational empowerment for social advancement.

Mission

To be benchmarked as a model for conservation and dissemination of knowledge and skill on blended and virtual mode in education, training and research for normal, continuing, and adult learners.

Pathway

Access and Quality define Equity.

Corporate Accounting and Auditing

Course Code: B21CM05DC

Semester - III

**Discipline Core Course
Bachelor of Commerce
Self Learning Material
(With Model Question Paper Sets)**



SREENARAYANAGURU
OPEN UNIVERSITY

SREENARAYANAGURU OPEN UNIVERSITY

The State University for Education, Training and Research in Blended Format, Kerala



SREENARAYANAGURU
OPEN UNIVERSITY

CORPORATE ACCOUNTING AND AUDITING

Course Code: B21CM05DC

Semester- III

Discipline Core Course

Bachelor of Commerce

Academic Committee

Dr. Aji S.
P. M. Ameera Mol
Shamly K.
Dr. Jeeva Jose
Dr. Priya R.
Sreekanth M. S.
Dr. Vishnukumar S.
Joseph Deril K. S.
Dr. Bindu N.
Dr. Ajitha R. S.
Dr. Anil Kumar
N. Jayaraj

Development of the Content

Dr. Suresh Kumar S.
Dhanya K.M.
Dr. A. Basheer
Dr. Sanjith S.R.

Review and Edit

Dr. T.K. Valsan

Linguistics

Prof. Joseph T.J.

Scrutiny

Dr. Midhun V.
Dr. Athena Prince
Dr. Gopika C.G.
Dr. Kavitha S.
Dr. Dany Thomas
Mahesan K.P.

Design Control

Azeem Babu T.A.

Cover Design

Jobin J.

Co-ordination

Director, MDDC :
Dr. I.G. Shibi
Asst. Director, MDDC :
Dr. Sajeevkumar G.
Coordinator, Development:
Dr. Anfal M.
Coordinator, Distribution:
Dr. Sanitha K.K.



Scan this QR Code for reading the SLM
on a digital device.

Edition
January 2025

Copyright
© Sreenarayanaguru Open University

ISBN 978-81-982853-0-0



All rights reserved. No part of this work may be reproduced in any form, by mimeograph or any other means, without permission in writing from Sreenarayanaguru Open University. Printed and published on behalf of Sreenarayanaguru Open University
by Registrar, SGOU, Kollam.

www.sgou.ac.m



Visit and Subscribe our Social Media Platforms

MESSAGE FROM VICE CHANCELLOR

Dear learner,

I extend my heartfelt greetings and profound enthusiasm as I warmly welcome you to Sreenarayanaguru Open University. Established in September 2020 as a state-led endeavour to promote higher education through open and distance learning modes, our institution was shaped by the guiding principle that access and quality are the cornerstones of equity. We have firmly resolved to uphold the highest standards of education, setting the benchmark and charting the course.

The courses offered by the Sreenarayanaguru Open University aim to strike a quality balance, ensuring students are equipped for both personal growth and professional excellence. The University embraces the widely acclaimed “blended format,” a practical framework that harmoniously integrates Self-Learning Materials, Classroom Counseling, and Virtual modes, fostering a dynamic and enriching experience for both learners and instructors.

The University aims to offer you an engaging and thought-provoking educational journey. The Bachelor of Commerce is one of the highly popular programmes due to the current need for skilled professionals in the field. This demand guided our approach as we developed the programme's curriculum. The programme offers a comprehensive grasp of theoretical concepts alongside clear explanations of practical applications. We are careful to maintain a balance in the management components to preserve the integrity of the discipline. The Self Learning Material has been thoughtfully crafted to include illustrative examples. The Self-Learning Material has been meticulously crafted, incorporating relevant examples to facilitate better comprehension.

Rest assured, the university's student support services will be at your disposal throughout your academic journey, readily available to address any concerns or grievances you may encounter. We encourage you to reach out to us freely regarding any matter about your academic programme. It is our sincere wish that you achieve the utmost success.



Warm regards.
Dr. Jagathy Raj V. P.

01-01-2025

Contents

Block 1 ACCOUNTING FOR SHARES	1
Unit 1 Introduction to Share Capital	2
Unit 2 Issue of shares and forfeiture and reissue of shares	25
Block 2 ACCOUNTING FOR DEBENTURES	49
Unit 1 Introduction to Debentures	50
Unit 2 Issue of Debentures	58
Unit 3 Redemption of Debentures	76
Block 3 FINAL ACCOUNTS OF COMPANIES	85
Unit 1 Final Accounts	86
Unit 2 Preparation of Final Accounts	96
Block 4 AUDITING	111
Unit 1 Basic Concepts of Auditing	112
Unit 2 Internal Control	131
Block 5 AUDIT REPORT	145
Unit 1 Audit Report and Audit Certificate	146
Unit 2 Types of Audit Report	160
Block 6 COMPANY AUDIT	170
Unit 1 Introduction to company audit	171
Unit 2 Audit of Companies	185
MODEL QUESTION PAPER SETS	197

1
BLOCK

ACCOUNTING FOR
SHARES

Introduction to Share Capital

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ define the concept of shares and identify Classes of Shares
- ◊ distinguish types of capital, Reserve capital & Capital reserve
- ◊ comprehend placement of shares – private, IPO, Rights, Bonus, ESOP, etc.
- ◊ record in books of accounts the issue of shares at par or premium for consideration in cash in installments, forfeiture & reissue, or consideration other than cash
- ◊ explain procedures of issue and conditions to be fulfilled in terms of minimum subscription and how can it be ensured

Prerequisites

The familiarity with forms of business organizations and how joint stock companies are distinct from other forms is the basis of learning corporate accounting for the issue of shares. We buy various products from nearby small stores such as tea, newspapers, food, groceries, etc, or pay for services such as buses, auto-rickshaws, mobile phone recharges, movies, etc. on a day-to-day basis. We may come across sole traders, partnership firms, and even companies in all such deals. For example, you buy a phone recharge coupon at a corner shop run by a sole trader but you pay basically for a mobile network service provided by a company. While coming back, you may refill fuel in your two-wheeler from a petrol bunk which may be run as a partnership by two business people of the same city. Thus, you are transacting with two or more forms of business organizations in a single deal. As laymen,

we may be more concerned about what we get rather than what type of organization is behind what is provided. However, as a student of business and commerce, how can one ignore the intricacies that are interwoven in the transactions they come across practically now and then?

Imagine the role of mobile network service providers, in the above example, who maintain a distributor-dealer web across the country enabling us to buy recharge coupons any time, though not 24/7. Such big firms providing mobile network services cannot be normally run by one or two persons like you and me. It is in this context, that the role of companies becomes highlighted in terms of their huge capital requirement, and raising such an enormous volume of capital assumes significance.

The understanding of the formation and constitution of public and private limited companies in terms of the public issue of shares is an essential body of knowledge on which the accounting for share issues can be built. Acquaintance to the flip side of the coin namely the perception of investors, their motives and risk/return perspective gives a lead to open up vistas of knowledge in financial management and security analysis. The IPO exposure among the general public, invitation to the public for subscription of shares or debentures through prospectus, etc. is a necessity for understanding the practical implications in real-life situations.

Keywords

Equity/IPO, ESOP, Price bands, Forfeiture and re-issue of Shares, Buyback, and redemption. Cash dividends and scrip dividends (Bonus issue), Rights issue, minimum subscription

Discussion

1.1.1 Share Capital

As we know, people venture out into business either themselves or joining hands with others. Self-entry into business as a 'sole proprietorship' and jointly entering into an agreement called 'partnership' with a few known persons to set up a business for sharing the profits or losses therefrom are characterized by the unlimited liability of owners. By unlimited liability, we mean that the business liabilities are not confined to the business assets. It extends over to the personal assets of owners. In short, the owner, either the sole trader or each partner in a partnership firm, is personally liable to pay off his business debts using his wealth in case business assets are insufficient to pay off such obligations. In contrast, the limited liability of owners is one distinctive feature of joint stock companies, yet another form of business organization.

A Company is an artificial person created by law with a separate legal entity, where owners are not personally liable to pay off business debts from their private assets. It is a voluntary association of people where the owners pool their resources by contributing towards the capital as members. Thus, the total capital of a company is divided into several pieces, each piece called a share with distinctive value.

For example, the total capital of a company is Rs. 1, 00, 000 may be divided into 1, 000 shares, each share having a distinct value of Rs. 100 each (1, 000 shares x 100 Rs = Rs. 1, 00, 000) or 10, 000 shares of Rs. 10 each (10, 000 shares x 10 Rs = Rs. 1, 00, 000). Or even 1, 00, 000 shares of Rs. 1 each (1, 00, 000 shares x 1 Re. = Rs. 1, 00, 000). Those who contribute to the share capital of the company as members are contributors, who are known as shareholders of the company. Thus, each share has a value known as face value or par value, whether it be Rs. 10, Rs. 100, or Re. 1 Per share. Technically, the liability of a shareholder is limited to the face value of shares held by him. In its simplest sense, a shareholder of 100 shares of Rs. 10 each will have a liability, limited to Rs. 1000 (100 shares x Rs. 10 each = Rs. 1000). Hence, he is not liable to pay anything more than Rs. 1, 000 even if the business debts of the company amount to millions of rupees.

It may be recalled that companies may either be incorporated as a private limited company or a public limited company. A private limited company, by its nature, has to limit its shareholders to persons who know each other such as family members, friends, or associates. The Companies Act itself restricts private limited companies from inviting the general public to buy their shares or having an unlimited number of shareholders. On the contrary, public limited companies are free of such restrictions and can invite the general public to buy rather than subscribe to any number of shares issued by them. The body corporates, incorporated or registered as public limited companies, often approach the general public inviting offers from them to buy shares. Since the company is directly approaching the general public with newly created instruments such as shares or debentures, this market is known as the 'primary market.'

1.1.2 Share Vs Stock

Shares represent the smallest unit of ownership of any company denoting the proportion of ownership in the company. For example, a person who bought 10000 shares of a company that has issued 1, 00, 000 shares is said to be a 10 percent shareholder since he holds 10% of the shares issued by the company. Shares are issued at par or premium or theoretically at a discount.

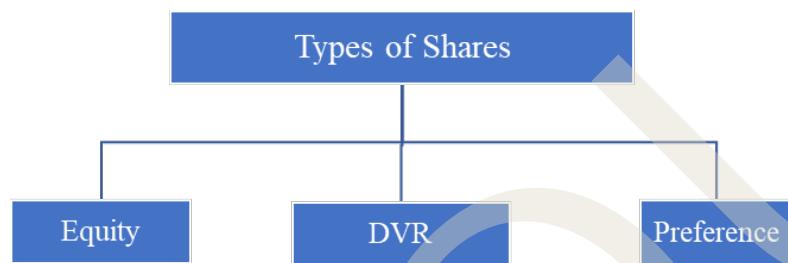
Stocks are the collection of shares of a single company or multiple companies. It represents the holder's part-ownership in one or several companies. For example, a shareholder who holds 10000 shares of a company having 100000 shares can consider his 10000 shares as one stock representing 10% ownership in the company. Stock may denote shares of one company or a collection of shares of several companies. Stocks are not issued but are conversions of shares of any member into a fund.

While shares of a company have equal value, stocks of one company may or may not have equal value depending on the denomination of shares that have been converted

into stock. Since on-listing companies change shares into stock, the share market came to be popularly known as the stock market. Conversion of shares into stock enabled buying and selling in lots known as market lots, which is no longer significant since shares can be bought and sold in any denomination online making market lots a thing of the past.

1.1.3 Types of Shares

Shares represent ownership in a company. In common parlance, shares mean equity shares in India, since it is not mandatory to issue preference shares. Currently, companies in India can issue equity shares, shares with differential voting rights, and preference shares



1.1.3.1 Equity Shares

Equity shares are shares that represent true ownership in companies and are also called ordinary shares. The holders of the equity shares are entitled to dividends that are shared in the profits of the company. They are also entitled to voting rights which enables them to exercise their ownership rights. Equity shares are listed on the stock exchanges which enables buying and selling between investors. This increases liquidity to investors due to the capability of equity shares of any-time convertibility into cash. A high demand for equity shares of a company in stock markets can fetch a higher market price for the equity shareholders. It is in this context that we need to examine why people buy equity shares offered by companies. The merits and demerits of equity shares may be summarised as

Merits:

- i. It carries voting rights enabling equity shareholders to have controlling power in companies.
- ii. Equity shareholders are real owners of the company and are entitled to any residue in profits or assets after the claims of all other stakeholders are settled.
- iii. It carries dividends that are not fixed. Dividends on equity shares vary according to the level of profits. Hence, there is a higher return potential if the company makes more profit.
- iv. Equity shares of listed companies are traded in stock exchanges. It

can be sold any time the shareholders wish and hence there is a ready market and liquidity to shareholders.

- v. The market price of the equity shares is dependent on fundamentals namely company, industry, and economy factors. A high market price enables shareholders to derive capital gains (selling price – cost of buying) besides the dividends that have been received during the period of holding.

De-merits:

- i. The voting rights and controlling power are purely technical in the sense that shareholders with small holdings do not have much voice in general meetings and day-to-day management of the company.
- ii. Being the real owners, equity shareholders are prone to risk associated with low profits and prospects of the company. They have to end up with no dividends if the company is not profitable. Similarly, in the event of winding up of the company, they have to be contented with whatever is left, if any, after settlement of all other claims.
- iii. The market prices of equity shares are vulnerable to wide fluctuations. Hence, the possibility of disaster or a fall in market values exposes shareholders to risk and uncertainty.

1.1.3.2. Shares with Differential Voting Rights

Shares with Differential Voting Rights, popularly known as DVR, is a modified variant of equity shares that companies may generally issue to raise capital without losing the controlling power of the existing management. The differential rights concern voting power and dividends. Generally, one equity share carries one vote, but in the case of differential voting rights, one share carries more than or less than one voting right. Usually, equity shares with fewer voting rights carry a higher rate of dividend. However, equity shares with higher voting rights may also be issued, particularly to promoters, key managerial persons, Managing directors, etc. In such cases, the shares may carry a lesser rate of dividend. With voting rights different from equity shares, shares with differential voting rights (DVR) issued to the general public may trade at lower prices in the stock exchange despite higher dividends.

Equity shares with differential voting rights should only be issued with authorization by way of a special resolution passed at the general meeting of the shareholders. Further, the shares with superior voting rights must have been held for at least 6 months before the filing of the red herring prospectus. A red herring prospectus is a preliminary prospectus filed by a company before a regulatory commission such as the Securities Exchange Board of India (SEBI) which may be incomplete and subject to change. It does not state the price or size of the issue, which may be subsequently stated in the final prospectus.

1.1.3.3 Preference Shares

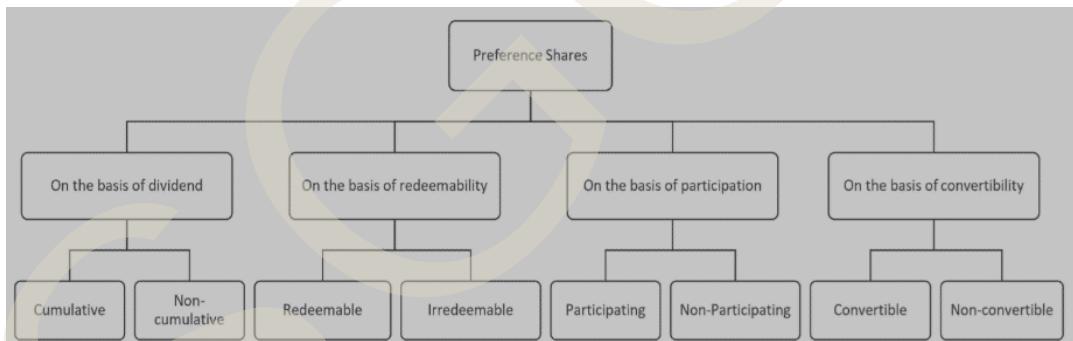
Preference Shares are yet another category of shares that are issued by companies in India. Preference shareholders enjoy two preferences over equity shareholders. They are

- i. **Preference in the matter of getting dividends:** These shares give shareholders the right to dividends ahead of the equity shareholders.
- ii. **Preference in the matter of getting repayment of capital:** Though preference shares do not carry voting rights, the preference shareholders have preference in getting repayment of capital in the event of winding up of the company.

Thus, preference shares have a prior claim on the profits and assets of the company. However, the dividend on preference shares is fixed. The preference shareholders will not benefit from the prosperity of the company since they are not eligible for higher dividends, as equity shareholders get when profits are high.

Preference shares or preferred shares/ stocks are shares that extend a fixed dividend, though they do not come with voting rights. Different types of preference shares that are distinct in features and associated benefits are issued by companies. Even though all types of preference shares are not entitled to voting rights, preference shareholders are owners of the company though in a partial sense only.

Based on their dividends pay-out, maturity period or redeemability, participation in profits and assets, and convertibility preference shares may be classified as follows.



1. Cumulative and Non-cumulative Preference Shares

Cumulative preference shares are preference shares on which dividends get accumulated. If the company does not declare a dividend on preference shares in a particular year such unpaid dividend is accumulated and carried forward to subsequent years. Eventually when the company decides to pay dividends then it has to first pay the accumulated dividend of previous years to the preference shareholders before paying any dividend on ordinary shares. The holders of cumulative preference shares thus do not lose the right of preference dividend of any year. They are assured of getting all the unpaid dividends of past years if the company pays dividends in any subsequent year.

Non-Cumulative Preference Shares are preference shares on which the unpaid dividend does not get accumulated and the preference shareholders lose the right to dividend for the past year(s). If in any year the company fails to pay a preference dividend, such dividend is lost forever as far as the holders of non-cumulative preference shares are concerned. In simple words, the non-cumulative preference shareholders are not entitled to receive any dividend arrears for the past unpaid years.

2. Redeemable and Irredeemable Preference Shares

Redeemable preference shares are preference shares that have a fixed period of life. They are redeemed after a definite period stated by the company at the time of their issue itself. Redemption is the process of returning the capital and buying back the shares. As per the predetermined redemption clause stated at the time of issue, the company pays back the preference shareholders to buy back the redeemable preference shares. The redemption price is pre-determined and stated at the time of issue of redeemable preference shares itself. Redemption at par means the price payable on redemption is simply the face value collected by the company at the time of issue. On the other hand, redemption at a premium means that the company agrees to repay the face value collected together with an agreed premium on redemption of preference shares. The issuing company can redeem the redeemable preference shares any time before the expiry of its specified life.

Irredeemable preference shares do not have a fixed period of life. They are perpetual and are only redeemed at the time of liquidation of the company. As long as the company is in existence, such non-redeemable preference shares continue to exist making it a permanent liability to the company. Since irredeemable preference shares do not offer flexibility to the issuing company to buy back the shares any time they desire, such shares are not as popular as redeemable preference shares. Companies are not allowed to issue irredeemable/ perpetual preference shares under the Companies Act, 2013.

3. Participating and Non-participating Preference Shares

Participating preference shares are shares that give the right to their holders to participate in surplus profits and assets. The holders of participating preference shares thus participate in profits remaining after paying fixed preference dividends and equity dividends of any year. Similarly, in the event of winding up of the company, they are entitled to a share of a surplus of assets remaining after payment of all liabilities including the equity capital. Hence, participating preference shares allow holders to participate on the same footing as the holders of equity shares as far as a surplus of profits or assets is concerned.

Non-Participating Preference Shares do not grant its holders any right to participate in surplus profits or assets of the company. The holders of these shares do not enjoy rights over and above their fixed entitlements of dividends and capital repayment.

4. Convertible and Non-convertible Preference Shares

Convertible preference shares are shares that are convertible to equity shares at the option of the shareholders on the expiry of a definite period. Such preference shares may either be partially or fully converted into equity shares if the preference shareholders wish to do so, after holding it for a specified period.

Preference shares that do not qualify for conversion into equity shares are called non-convertible preference shares. Such shares will continue to remain as preference shares in the hands of shareholders until its maturity if any or perpetually till the liquidation or winding up of the company.

1.1.4 Phases of Capital

The share capital of the company may be raised at different stages. Though the capital that can be raised is more, the company may decide to collect it in part as and when capital requirements arise. In this section, we will discuss the terms relating to various phases of capital and how one differs from the other.

1.1.4.1 Authorised Capital

Companies are required to mention the capital which it is authorized to raise from the public in their memorandum of association, at the time of registration. ‘Authorised Capital’ refers to the maximum amount of capital that the company is authorized to raise from the public, though such maximum may be increased by amendments to the memorandum of association later. It is the capital with which the company is registered and is also referred to as ‘Registered Capital’.

For example, a company may be registered with an authorized capital of say 1, 00, 000 equity shares of Rs. 10 each aggregating to an authorized capital of Rs. 10, 00, 000. This is the maximum amount of capital the company can raise in its lifetime unless it has been increased by amending the memorandum of association.

1.1.4.2 Issued Capital

Issued capital is that part of the authorized capital which is issued to the public for subscription. Though the company is authorized to raise a higher amount of capital, it may not raise it altogether. A part of such authorized capital may only be issued at a point in time. ‘Issued Capital’ is the nominal value of the shares which are offered to the public for subscription.

For example, if a company has an authorized capital of 1, 00, 000 equity shares of Rs. 10 each aggregating to Rs. 10, 00, 000 and if they have issued 50, 000 equity shares of Rs. 10 each for public subscription, then the issued capital will be 50, 000 equity shares of Rs. 10 each aggregating to Rs. 5, 00, 000.

	Rs
Authorised Capital	
1,00,000 Equity shares of Rs. 10 each	<u>10,00,000</u>
Issued Capital	
50,000 Equity shares of Rs. 10 each	<u>5,00,000</u>

It may be noted that issued capital is always less than or equal to the authorized capital and in no instance can issued capital exceed authorized capital. Issued capital and authorized capital will be the same if all shares authorized are issued by the company for public subscription.

1.1.4.3 Subscribed Capital

A part of the issued capital may not be taken up by the public. In that case, the value of number of shares subscribed for by the public constitutes the subscribed capital. ‘Subscribed capital’ is the portion of issued share capital that is taken up or subscribed by the public. When all the shares that have been issued are not taken over by the public, subscribed capital will be lesser than the issued capital.

For example, if a company has an authorized capital of 1, 00, 000 equity shares of Rs. 10 each aggregating to Rs. 10, 00, 000 and if they have issued 50, 000 equity shares of Rs. 10 each for public subscription, and if the public has only offered to subscribe 45, 000 equity shares of Rs. 10 each, then the subscribed capital will be 45, 000 equity shares of Rs. 10 each aggregating to Rs. 4, 50, 000.

	Rs
Authorised Capital	
1,00,000 Equity shares of Rs. 10 each	<u>10,00,000</u>
Issued Capital	
50,000 Equity shares of Rs. 10 each	<u>5,00,000</u>
Subscribed Capital	
45,000 Equity shares of Rs. 10 each	<u>4,50,000</u>

It may be noted that subscribed capital is always less than or equal to the issued capital and in no instance can subscribed capital exceed issued capital. Subscribed capital and issued capital will be the same if all shares issued are subscribed for by the public.

1.1.4.4 Called-Up Capital

It is not always necessary for the company to collect the entire par value and premium if any in a lump sum. The total amount payable by the subscriber may be collected in instalments by the company. In such cases, subscribers are required to pay only what the company has asked so far. The amount per share that has been asked by the company is referred to as the called-up amount. The company may allow as many installments as they decide. The amount payable by the subscriber on an equity share of Rs. 10, may be collected in four instalments of Rs. 3, Rs. 2, Rs. 2.50, and Rs. 2.50 at different

intervals of time. In such cases, the first instalment is called the share application, the second instalment is the share allotment and the subsequent installments are referred to as calls like first call, second call, etc. Whether it be application money allotment money or call money, the amount that has been requested to be paid is referred to as the called-up amount.

‘Called-up capital’ is the portion of the face value of the shares that the company has demanded to pay and the shareholders are called upon to pay. When the whole par value has not been demanded to be paid by the company the capital will be lesser than the subscribed capital.

For example, if a company has an authorized capital of 1, 00, 000 equity shares of Rs. 10 each aggregating to Rs. 10, 00, 000 and if they have issued 50, 000 equity shares of Rs. 10 each for public subscription, and if the public has only offered to subscribe 45, 000 equity shares of Rs. 10 each, then the subscribed capital will be 45, 000 equity shares of Rs. 10 each aggregating to Rs. 4, 50, 000. However, if the company has so far collected Rs. 3 per share on application Rs. 2 per share on allotment and Rs. 2.50 on the first call, then only Rs. 7.50 ($3+2+2.50$) has been called up. Hence the called-up capital will be 45, 000 equity shares of Rs. 10 each, Rs. 7.50 called up aggregating to Rs. 3, 37, 500 ($45,000 \times 7.50 = 3,37,500$).

	Rs
Authorised Capital	
1,00,000 Equity shares of Rs. 10 each	<u>10,00,000</u>
Issued Capital	
50,000 Equity shares of Rs. 10 each	<u>5,00,000</u>
Subscribed Capital	
45,000 Equity shares of Rs. 10 each	<u>4,50,000</u>
Called-Up Capital	
45,000 Equity shares of Rs. 10 each, Rs.7.50 called up	3,37,500

It may be noted that called-up capital is always less than or equal to the subscribed capital and in no instance can called-up capital exceed subscribed capital. Called-up capital and subscribed capital will be the same if all shares subscribed are fully called up for by the company.

1.1.4.5 Paid-up Capital

The amount paid by the shareholders is known as Paid-up Capital. **‘Paid-up’** capital is that portion of the called-up capital which has been received from the shareholders. When all the shareholders have paid all the call amount, the called-up capital is the same as the paid-up capital.

The difference between the called-up capital and paid-up capital arises due to the calls in arrears. Calls in arrears refer to that amount called up by the company but have not been paid by any of the shareholders within the specified time allowed.

In the example cited above, if certain shareholders holding 800 shares altogether have failed to pay the last instalment namely the first call of Rs.2.50, then calls in arrears amount to Rs. 2000 (800 x Rs. 2.50 = Rs. 2, 000). In that case, the paid-up capital will be Rs 3, 35, 500 (Rs. 337500- Rs. 2,000).

	Rs.	Rs
Authorised Capital		
1,00,000 Equity shares of Rs. 10 each		10,00,000
Issued Capital		
50,000 Equity shares of Rs. 10 each		5,00,000
Subscribed Capital		
45,000 Equity shares of Rs. 10 each		4,50,000
Called-Up Capital		
45,000 Equity shares of Rs. 10 each, Rs.7.50 called up		337500
Paid-Up Capital		
45,000 Equity shares of Rs. 10 each, Rs.7.50 called up	3,37,500	
Less Calls in Arrears (800 shares @ Rs.2.50 each)	2,000	3,35,500

It may be noted that Paid-up capital is always less than or equal to the called-up capital and in no instance can paid-up capital exceed called-up capital. Paid-up capital and called-up capital will be the same if the amount called-up is fully paid by the shareholders.

1.1.5 Reserve Capital and Capital Reserve

Reserve Capital is that part of the uncalled capital that is kept as a reserve to be called upon and collected to meet exigencies. It cannot be called up except in the approved circumstances like liquidation. It is noteworthy that reserve capital is not a portion of authorized capital that has not been issued, since in the event of an unforeseen circumstance like winding up, such shares will not be subscribed if issued. However, in the case of issued and subscribed capital, the shareholders are legally obliged to pay the calls and it is prudent to reserve a call on subscribed capital so that such reserved capital can be called up and collected to meet unforeseen exigencies like liquidation of the company. It is created from uncalled capital though it is neither mandatory to create it nor disclose it in the balance sheet. It can only be used at the time of winding up and cannot be used to write off capital losses.

Capital reserve, on the contrary, has nothing to do with the capital authorized, issued, or subscribed. It refers to the reserve created from profits that have not been earned through regular operations of the business. Capital Reserve refers to mandatory reserve created from capital profits, which is not available for distribution as dividends. It may be recalled that profits may be revenue profits or capital profits. While revenue profits are earned profits from the operations of the company, capital profits are non-recurring or irregular profits arising from the sale of fixed assets or issue of shares and debentures. Capital reserves are created from capital profits and are hence not free for the distribution of dividends.

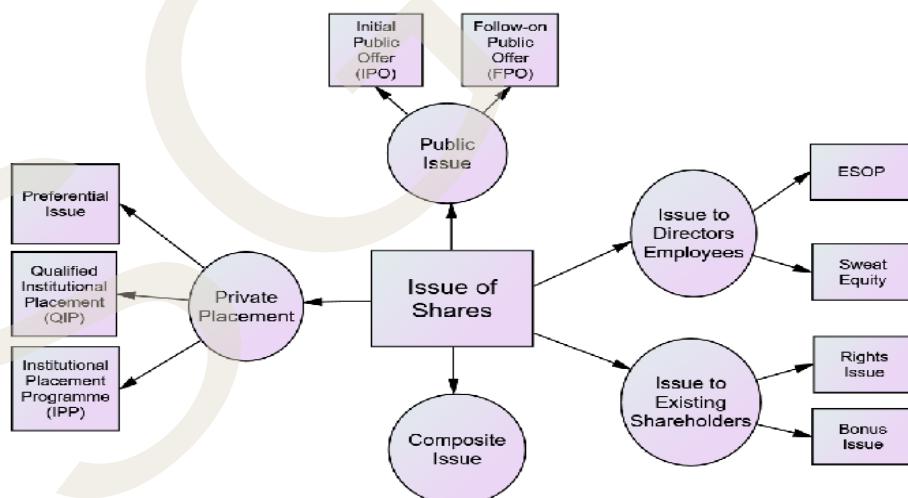
Test your knowledge

Imagine a company that has been registered with a capital of 10,000 equity shares of Rs. 100 each. What will be its

- i. Authorised Capital
..... Equity Shares of Rs.....each = Rs.....
- ii. Issued Capital if it offers 5,000 shares for subscription currently
..... Equity Shares of Rs..... each = Rs.
- iii. Subscribed Capital if 4,500 shares are only subscribed for by public
..... Equity Shares of Rs..... each = Rs.
- iv. Called up Capital, if the company has not yet called up Rs. 50 per share out of the par value per share of Rs. 100.
..... Equity Shares of Rs..... each, Rs..... called up = Rs.
- v. Paid up Capital if holders of 600 shares failed to pay allotment money of Rs. 25 per share out of the called up Rs. 50 per share.
..... Equity Shares of Rs..... each, Rs..... called up, = Rs.
Less calls in arrears Shares @ Rs.... = Rs.....
= Rs.....

1.1.6 Issue of Shares

Issue of Shares is the process in which companies allot new shares to shareholders, either individuals or corporations. There are several ways in which the shares of a company can be issued which include private placement, public issue, issue to directors/ employees, issue to existing shareholders, and composite issue.



1.1.6.1 Private placement

A private placement is a sale of shares/ stock or bonds to pre-selected investors and institutions rather than on the open market. Private placements are adopted by start-up companies who are in quick need of funds, as an alternative to an initial public offering (IPO). A company that has not so far approached the market seeking to raise capital for expansion may depend on a private placement for the immediate need of capital.

Private Placement of Shares refers to the sale of shares of the company to the investors and institutions that are selected by the company which generally includes banks, mutual fund companies, wealthy individual investors, insurance companies, etc rather than issuing it in the open market for the public as a whole. In certain cases, a portion of the issued capital may be reserved for private placement while the balance is made available to the public in a public issue. The private placement of shares to a selected group of investors such as mutual funds, banks, insurance companies, pension funds, etc. may take either of the following forms.

1. Preferential - Issue

When a publicly listed company allots shares to a selected group of investors such as individuals, venture capitalists, or other companies on a preferential basis, the private placement is referred to as a preferential Issue.

2. Qualified Institutional Placement (QIP)

Qualified Institutional Placement or QIP refers to the process of a listed company offering equity shares or non-convertible securities to a qualified institutional buyer, such as mutual funds, venture capital funds, public financial institutions, insurance funds, scheduled commercial banks, pension funds, etc. for sale or to raise capital.

3. Institutional Placement Programme (IPP)

If shares are allotted to the QIBs only, to achieve minimum public shareholding and not for reselling to the public it is referred to as an Institutional placement program (IPP). In such placements listed company makes a follow-on offer of equity shares or the promoters offer for the sale of shares. In an Offer for Sale, promoters of a company dilute their stake by selling their shares to Qualified Institutional Buyers (QIBs). It is noteworthy that the offer for sale by promoters is not confined to sales to QIBs but extends to sales to retail investors, companies, and foreign institutional investors.

1.1.6.2 Public Issue

Public issue refers to the raising of capital from the general public through a public offering of shares or convertible securities for sale. It is the process of companies approaching the primary market to attract new investors to subscribe to the issue of shares made by the company. In a public issue, the company invites offers for subscription from the public through a prospectus. The investors who wish to subscribe for the shares make an application to the company. The company then allots shares to them or rejects the application depending upon the volume of applications. The applicants receive a 'letter of regret' once their application is rejected or a 'letter of allotment' if they are allotted shares. The issue of shares to the public may either be an Initial Public Offer (IPO) or a Follow-on/ Further public offer (FPO).

1. Initial Public Offering (IPO)

Initial Public Offer is the sale of shares to the public for the first time. Technically, the process of inviting the general public to buy shares offered by a private limited company on its conversion to a public limited company is officially referred to as 'going public.' Since the hitherto private limited company is first time issuing shares to the general public this issue is known as an 'Initial Public Offer' or 'IPO'. However, even when a company registered as a public limited company which is not yet listed on stock exchanges issues shares for the first time it is referred to as an initial public offering or IPO.

When a company, which is presently not listed on any stock exchange, either makes a fresh issue of shares or makes an offer for the sale of its existing shares or both for the first time to the public it is known as an IPO (initial public offering). The issuer of shares thus makes an offer for new investors to enter its shareholding family which was till now confined privately to a group of people who knew each other. Through IPO, the unlisted company can go public and list its shares on the recognized stock exchanges.

2. Follow-on or Further Public Offer (FPO).

Follow-on or Further Public Offer (FPO) refers to the issue of shares by an already listed company. If the public company issues additional shares to the public for sale any time after its initial public offering, to expand its equity base or pay off debts, it is known as a Follow-on Public Offer or Further Public Offer (FPO).

1.1.6.3 Issue of shares to directors/ employees

Besides raising funds by issuing shares to owners namely shareholders, a company can issue shares to the directors/ employees as an incentive to motivate them and make them contribute better to the company. Since loyal employees are now considered to be the key factor in ensuring the success of the company, retaining them for the long term by compensating their efforts by way of issuing shares to them has become popularly accepted as workers' participation in management. Employee stock Option Scheme (ESOP) and Sweat Equity Shares are two common methods of issuing shares by companies to their directors/ officers or employees.

1. Employees Stock Option Plan (ESOP)

An employee stock ownership plan (ESOP) gives workers ownership interest in the company. It allows employees an opportunity to buy shares of the employer company usually at prices lower than the market prices.

As per Section 2(37) of the Companies Act, 2013, the employee stock option means the option provided to the directors, employees, or officers of the company or its holding or subsidiary company, which gives the right or benefit to subscribe or purchase the shares of the company at a predetermined price on a future date. The subscribed capital is raised by the issue of shares under ESOP. It is a right given to employees to exercise their option to purchase the shares at a predetermined price on a

future date. The consideration for such a purchase will have to be paid in cash and the shares so obtained will not be transferable during the lock-in period as determined by the company.

2. Sweat Equity

Sweat equity shares mean shares issued by a company to its directors or employees for non-cash consideration or at a discount for making rights available like intellectual property rights providing know-how or providing any value additions in any form. Sweat equity shares refer to shares issued to directors or employees for their contribution towards the business venture. It is non-monetary and is issued to compensate for the physical labour, mental effort, inventions, technical know-how, and time contributed by the directors or employees. Sweat equity shares are directly allotted to the employees or directors, partly cash or partly noncash, free for their contributions or at a discounted price. As per Companies (Share Capital and Debentures) Rules, the sweat equity issued is subjected to a three-year lock-in period, during which it cannot be sold or transferred by its holders.

1.1.6.4 Issue of shares to existing shareholders

Every time a company needs funds for further investment, they can rely on sources of financing such as the issue of equity or preference shares, the issue of debentures, or borrowing money as long-term loans, or rely on their accumulated profits by capitalizing such retained earnings. Instead of approaching the general public or primary every time with a new issue of shares they can raise capital from existing equity shareholders by a rights issue of shares or by capitalizing profits through the issue of bonus shares to existing equity shareholders.

1. Rights Issue

A rights issue is an invitation to existing shareholders to purchase additional new shares in the company. When the company wants to raise additional funds without involving any public, it may issue the shares to its existing shareholders at a concessional price on a pre-determined date, in proportion to their existing shareholding in the company.

A rights issue is directly offered to all existing shareholders of the Company in proportion to their current holding. The company also set a time limit for the shareholder to buy the shares. Companies pursue Rights Issues as an avenue to raise funds for various reasons, ranging from expansion or acquisitions to paying down debts. As per the Companies Act the shareholders have a pre-emptive right which provides the existing shareholders the right to subscribe for any additional shares issued by the company. This right ensures that existing shareholders can ensure the current proportion of shareholding in the company. If existing shareholders are not offered the new shares and if it is given to other people, then the percentage ownership of existing shareholders in the company gets diluted. The right offered by the company may be exercised by the existing shareholders by paying money and buying such shares or the

rights may simply be ignored in which case the rights get lapsed. Yet another option for existing shareholders is to renounce the right to an agreed price in favour of third parties who will pay and buy the shares from the company. A right issued may be made as an exclusive issue to existing shareholders or it may be a composite issue where it is a part of a public issue with a certain number of shares declared as a rights issue.

2. Bonus Issue

A company may convert its retained earnings partially or fully into capital by issuing shares, known as bonus shares, free to existing shareholders. Bonus shares are additional shares given free to the existing shareholders based on the number of shares held by them. The company will not collect money to raise capital from the issue of bonus shares but raises subscribed capital through the capitalization of profits. Since the profits that have been retained without giving dividends to shareholders are now used for giving free shares to existing shareholders, bonus shares are also known as scrip dividends or stock dividends. The issue of bonus shares simply increases the number of shares held by shareholders without resulting in a cash inflow to the company. However, the wealth of the shareholders increases to the extent of the market value of bonus shares received free of cost from the company. The issue of bonus shares is made out of the company's free reserves or securities premium collected at the time of the earlier issue of shares.

3. Composite Issue

A composite issue is one in which an already listed company offers shares on the public-cum-rights basis and makes concurrent allotment of the shares. Means issuing shares to existing shareholders and general public .

1.1.7 Minimum subscription

It is the minimum amount that, in the opinion of directors, must be raised to meet the needs of business operations of the company relating to:

- the price of any property purchased, or to be purchased, which has to be met wholly or partly out of the proceeds of issue;
- preliminary expenses payable by the company and any commission payable in connection with the issue of shares;
- the repayment of any money borrowed by the company for the above two matters;
- working capital;
- and any other expenditure required for the usual conduct of business operations.

It is to be noted that the 'minimum subscription' of capital cannot be less than 90% of the issued amount according to SEBI (Disclosure and Investor Protection) Guidelines, 2000 [6.3.8.1 and 6.3.8.2]. If this condition is not satisfied, the company shall forthwith refund the entire subscription amount received. If a delay occurs beyond 8 days from the date of closure of the subscription list, the company shall be liable to pay the

amount with interest at the rate of 15% [Section 73(2)].

Minimum subscription refers to the minimum amount that a company should raise at the time of issuing capital. The requirement for minimum subscription applies to all companies which raise funds from the public. The company may successfully procure the amount of minimum subscription. In such circumstances, the company is allowed to retain the capital, which has been collected from the investors. Alternatively, the company may not be able to obtain the minimum subscription successfully. Hence, according to the Companies Act, there is an inadequacy in the minimum subscription. In such cases, the company should refund the application deposit. The provisions relating to minimum subscription are available in Section 39 of the Companies Act.

The Government of India observed that when public companies opted for the issue of capital, the public response may be inadequate. On account of the poor public response, the confidence of the investors in the regulatory mechanism may diminish. Hence, in keeping with the expectations of the investors, the issue of capital should be halted. Cancellation of the issue should be performed if the public does not have the minimum subscription. The objective of Section 39 is to introduce a prohibition on the allotment of securities. As per the section, the allotment should be prohibited when the minimum subscription requirement is not fulfilled.

The provisions relating to minimum subscription should be applied whether a company makes an issue of debt or equity securities. The requirement for a minimum subscription is determined through a ceiling limit. The Government of India (GoI) has fixed the ceiling limit as ninety percent. The ceiling limit should be applied to the total capital issued by the company. The company should collect at least ninety percent of the issued amount. In case the value accumulated amounts to less than ninety percent of the capital issued, the entire amount should be refunded.

Recap

- ◊ Share Capital
 - Share capital refers to the total amount of capital a company raises by issuing shares to investors.
- ◊ Phases of Capital
 - The phases of capital include authorized capital, issued capital, subscribed capital, called-up capital, and paid-up capital.
- ◊ Difference between Reserve Capital and Capital Reserve
 - Reserve Capital is part of uncalled capital for winding-up situations, while Capital Reserve is created from non-operational profits and used for specific purposes.

- ◊ Shares and Types of Shares
 - Shares represent ownership in a company, and their types include equity shares and preference shares.
- ◊ Equity and Redeemable Preference Shares
 - Equity shares carry voting rights and dividends based on profits, while redeemable preference shares have a fixed return and are repaid after a specific period.
- ◊ Convertible Cumulative Preference Shares
 - These are preference shares with cumulative dividends that can be converted into equity shares after a predetermined time.
- ◊ Sweat Equity Shares
 - These are shares issued to employees or directors as a reward for their contributions to the company.
- ◊ Employees Stock Option Plan (ESOP)
 - ESOP allows employees to purchase company shares at a discounted price, encouraging ownership and loyalty.
- ◊ Private Placement of Shares
 - Private placement is the issuance of shares to a select group of investors rather than the general public.
- ◊ Issues of Shares
 - Share issues involve various methods such as public issues, rights issues, or private placements to raise funds.
- ◊ Bonus Issue
 - A bonus issue involves issuing additional shares to existing shareholders without any cost, derived from company reserves.
- ◊ Right Issue
 - A rights issue offers existing shareholders the opportunity to purchase additional shares before offering them to others.
- ◊ Subscription of Shares
 - Subscription refers to the process by which investors apply for and agree to purchase shares in a company.
- ◊ Procedures
 - This refers to the step-by-step processes involved in the issuance, subscription, and allotment of shares.
- ◊ Minimum Subscription
 - Minimum subscription is the threshold amount of shares that must be subscribed to make the share issuance valid as per legal requirements.

Objective Questions

1. What is the primary difference between Reserve Capital and Capital Reserve?
 - (A) Reserve Capital is part of the authorized capital, while Capital Reserve is created from profits.
 - (B) Reserve Capital is created from profits, while Capital Reserve is part of the authorized capital.
 - (C) Both are the same.
 - (D) Reserve Capital is mandatory, while Capital Reserve is optional.
2. Which type of shares are issued to employees at a discount to incentivize them?
 - (A) Sweat Equity Shares
 - (B) Preference Shares
 - (C) Equity Shares
 - (D) Redeemable Shares
3. What does ESOP stand for?
 - (A) Employee Stock Option Plan
 - (B) Equity Share Option Plan
 - (C) Employee Stock Ownership Plan
 - (D) Employee Savings Option Plan
4. Which of the following is NOT a type of share?
 - (A) Redeemable Preference Shares
 - (B) Convertible Cumulative Preference Shares
 - (C) Sweat Equity Shares
 - (D) Bonus Shares
5. What is the minimum subscription requirement for shares as per company law?
 - (A) 50% of the issued capital
 - (B) 75% of the issued capital
 - (C) 90% of the issued capital
 - (D) 100% of the issued capital
6. Private Placement of Shares refers to shares issued to:
 - (A) The general public

- (B) A selected group of investors
- (C) Only employees of the company
- (D) Government institutions

7. Bonus shares are issued to:

- (A) Reward employees
- (B) Increase working capital
- (C) Shareholders as free shares out of reserves
- (D) Raise funds from new investors

8. Which of these shares have voting rights?

- (A) Preference Shares
- (B) Redeemable Shares
- (C) Equity Shares
- (D) Convertible Cumulative Preference Shares

9. Convertible Cumulative Preference Shares can be converted into:

- (A) Equity Shares
- (B) Preference Shares
- (C) Bonus Shares
- (D) Reserve Capital

10. Right Issue of Shares is offered to:

- (A) The public
- (B) Existing shareholders
- (C) Employees under ESOP
- (D) Institutional investors

Answers

1. Reserve Capital is part of the authorized capital, while Capital Reserve is created from profits.
2. Sweat Equity Shares
3. Employee Stock Option Plan
4. Bonus Shares
5. 90% of the issued capital

6. A selected group of investors
7. Shareholders as free shares out of reserves
8. Equity Shares
9. Equity Shares
10. Existing shareholders

Self-Assessment Questions

- ◊ Distinguish between stocks and shares
- ◊ Equity shares represent real ownership in the company. Elucidate.
- ◊ How is DVR different from ordinary equity shares?
- ◊ How are preference shares different from equity shares?
- ◊ What is meant by a prior claim on profits and assets?
- ◊ Does convertibility add attraction to preference shares?
- ◊ Distinguish between cumulative and non-cumulative preference shares.
- ◊ Private placement of shares is preferential allotment of equity shares. Comment.
- ◊ How does QIP differ from IPP?
- ◊ What is IPO? Is it limited only to the issue of a private limited company that converts to a public limited company?
- ◊ What is meant by FPO?
- ◊ Write a short note on ESOP. Why is it provided by companies?
- ◊ What is sweat equity?
- ◊ What do you mean by the pre-emptive right of shareholders?
- ◊ Rights issue preserves the holding proportion of existing shareholders. Elucidate.

Assignments

1. X, Y, Ltd. was registered with an authorized capital of 2, 00, 000 shares of ₹10 each. 1, 40, 000 shares were issued to the public. The public subscribed for 1, 00, 000 shares. The company called up ₹7 per share. All the money called up was duly received. Show the amounts of various types of share capital.
[Authorised capital ₹20, 00, 000; Issued capital ₹14, 00, 000; Subscribed capital ₹10, 00, 000; Called up capital ₹7, 00, 000]
2. Discuss the role of the Employees Stock Option Plan (ESOP) and Sweat Equity Shares in employee motivation and company growth.
3. Explain the different phases of capital in a company and their significance in financial management.
4. Differentiate between Reserve Capital and Capital Reserve with suitable examples. Why is it important for companies to maintain these reserves?
5. Compare and contrast equity shares and redeemable preference shares in terms of rights, returns, and redemption
6. Elaborate the concept of Bonus Issue, and how does it impact the company's financial structure? How does it differ from a Rights Issue?

Reference

- ◊ Asish K Bhattacharjee, Tata McGraw Hill, *Indian Accounting Standards*
- ◊ Dr. B D Agarwal - *Advanced Financial Accounting*
- ◊ Israr Shaikh and Rajesh Makkar, Lexis Nexis. *Accounting Standards*
- ◊ Jain S.P and Narang K.L. *Corporate Accounting*, Kalyani Publishers, New Delhi
- ◊ Maheswari S.N. and Maheswari S.K. *Corporate Accounting*, Vikas Publishing House, New Delhi
- ◊ Mukherjee A. and Hanif M. *Corporate Accounting*, Tata McGraw-Hill Publishing Co.Ltd. New Delhi

Suggested Reading

1. Kothari,C.R.(2020). *Company law and Secretarial practice* (24th ed Kalyani Publishers.
2. Institute of Chartered Accountants of India(2020) *share issue and listing requirements*.
3. Shukla M C, Grewal T. S., and Gupta S.C. *Advanced Accounts* S. Chand & Co. Ltd., New Delhi, Revised Edition 2013, ISBN 81-219-0278-1, pp 1020-22.



Unit

Issue of shares and forfeiture and reissue of shares

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ familiarise with the Issue of shares at par and premium
- ◊ learn about the Treatment of Fraction shares
- ◊ get an idea about Calls in arrears and calls in advances
- ◊ grasp the concept of Pro-rata allotment
- ◊ able to do the accounting treatments of forfeiture of shares
- ◊ comprehension of the reissue of shares and accounting treatments

Prerequisites

A company may raise capital by issuing equity shares, shares with differential voting rights, or preference shares. Various channels of approaching investors who wish to invest their savings in shares of companies include private placement, public issue, issue to directors/ employees or existing shareholders, or a combination of the above known as composite issues. We now focus our discussion on accounting of the issue of shares, especially the procedures and statutory requirements for the public issue of shares.

Keywords

Shares at par and premium, Fraction shares, Pro-rata allotment, forfeiture and reissue of shares

Discussion

1.2.1 INTRODUCTION

A salient characteristic of the capital of a company is that the amount on its shares can be gradually collected in easy instalments spread over some time depending upon its growing financial requirement. The first instalment is collected along with the application and is thus, known as application money, the second on allotment (termed as allotment money), and the remaining instalments are termed as first call, second call, and so on. The word final is suffixed to the last instalment. However, this in no way prevents a company from calling the full amount on shares right at the time of application.

Offer Document

Companies raising capital from the primary market by way of an initial public offer (IPO) or follow-on public offer (FPO) need to comply with the stipulations of the Companies Act 2013 and amendments made from time to time that are applicable. A company needs to issue an ‘Offer document’ which contains all the relevant information about the company, promoters, projects, financial details, objects of raising the money, terms of the issue, etc., and is used for inviting subscriptions to the issue being made by the issuer. An ‘Offer Document’ is called a “Prospectus” in case of a public issue and a “Letter of Offer” in case of a rights issue. Though various types of prospectuses exist technically, in practical terms they call for applications from the public in terms of the number of shares they are interested in buying.

This document called prospectus is registered with the Registrar of Companies (RoC) before the issue opens in case of a fixed price issue and after the closure of the issue in case of a book-built issue. The details of the class of shares and several shares now available for subscription, the price payable or that can be bid from the price band specified, and how much amount has to be paid, whether in instalments or as a one-time payment, etc. will be informed through the prospectus.

Pricing of Issues

SEBI does not play any role in price fixation, even after the abolishment of the office of the erstwhile regulator called “Controller of Capital Issues.” The issuer or issuing company decides the price in consultation with the merchant banker based on market demand. The offer document should have full disclosures of the parameters such as earnings per share (EPS), price-earnings (PE) multiple, return on net worth, etc. which are taken into account by the Merchant Banker and the issuer for deciding the price. An issue can be classified into a Fixed Price issue or book-built issue, based on Pricing,

Fixed Price Issue

A “Fixed price issue” is an issue where the issuer decides the issue price at the outset and mentions it in the Offer Document. Under such an issue, the company going public determines a fixed price at which its shares are offered to investors. The investors know the share price before the company collects such capital from the primary market. The company knows the demand for the shares from the markets is only when the issue is closed.

Book built Issue

Book building refers to the process by which the issuer through a merchant banker attempts to determine the price at which shares can be offered. It is the method of price discovery where investor demand for shares is generated and recorded before arriving at an issue price.

“Book Built issue” refers to an issue where the price of an issue, disclosed in the red herring prospectus as a floor price or price band, is discovered based on demand received from the prospective investors at various price levels.

Price band

In the process of price discovery, known as book building, a floor and ceiling price limit or price band within which the bids can move is disclosed. The price band is an auction pricing technique where the issuer indicates an upper and lower price limit, within which buyers place bids as the desired price at which he/ she would like to buy. Thus, the price band is a range of prices within which investors can bid. The spread between the floor and the ceiling of the price band shall not be more than 20%.

“Cut-off” option

The actual discovered issue price can be any price in the price band or any price above the floor price and hence the issue price is coined as the “Cut off price”. The cut-off option is an option available for retail individual investors who apply for securities worth up to Rs 2, 00, 000/- only. Small retail investors can opt for this cut-off while bidding to indicate their willingness to subscribe to shares at any price discovered within the price band. The cut-off bids always remain valid for allotment even if the price bid by the applicant is less than the discovered price.

If a specific price, without a cut-off option, bid by the applicant is lower than the price discovered, he will not get an allotment of shares. For example, if the price band is Rs. 200 to Rs 210 and if the applicant bids a price of say, Rs. 204 it means that he is willing to buy shares at any discovered price of Rs. 204 or less. If the issuer/ merchant banker discovers a price of Rs. 207 based on demand, then the applicant who has bid Rs. 204 will not get allotment. However, if the applicant has marked the cut-off option while bidding instead of at Rs. 204, he will still be eligible for allotment even if the discovered price is Rs. 207.

Minimum Subscription

Minimum subscription refers to the minimum amount that a company should raise at the time of issuing capital. The requirement for minimum subscription applies to all companies which raise funds from the public. The contexts under which new companies and existing companies are brought under the purview of statutory requirements of minimum subscription need to be explored as follows.

In the case of newly registered companies, a minimum capital has to be raised from the first issue of shares to cover the capital expenditure necessary such as the purchase of property and fixed assets, preliminary expenses in the form of underwriting commission, and brokerage on the issue, working capital and any form of repayment of debts borrowed to meet the above. The board of directors may fix such minimum subscription to be collected on the issue of shares to comply with the requirement of obtaining a certificate of commencement of business. This provision in the Companies Act ensures that only companies with sufficient capital are permitted to commence business.

Yet another statutory requirement of minimum subscription is stipulated by the Securities and Exchange Board of India (SEBI). This applies to all the public and rights issues. SEBI stipulates that if 90% of the issue, including the devolvement of underwriters and guarantors, is not subscribed for by the public then the whole issue becomes void and the application money or whatever is collected from the applicant should be refunded.

1.2.2 Issue of Shares

A salient characteristic of the capital of a company is that the amount on its shares can be gradually collected in easy instalments spread over some time depending upon its growing financial requirement. The first instalment is collected along with the application and is thus, known as application money, the second on allotment (termed as allotment money), and the remaining installments are termed as first call, second call, and so on. The word final is suffixed to the last instalment. However, this in no way prevents a company from calling the full amount on shares right at the time of application.

The important steps in the procedure of sharing issues are:

- Issue of Prospectus: The company first issues the prospectus to the public. The prospectus is an invitation to the public that a new company has come into existence and needs funds for doing business. It contains complete information about the company and how the money is to be collected from the prospective investors.
- Receipt of Applications: When a prospectus is issued to the public, prospective investors intending to subscribe to the share capital of the company would make an application along with the application money and deposit the same with a scheduled bank as specified in the prospectus. The company has to get a minimum subscription within 120 days from the date of the issue of the prospectus. If the company fails to receive the same within the said period, the company cannot proceed for the allotment

of shares and application money should be returned within 130 days of the date of issue of prospectus.

- Allotment of Shares: If a minimum subscription has been received, the company may proceed with the allotment of shares after fulfilling certain other legal formalities. Letters of allotment are sent to those to whom the shares have been allotted, and letters of regret to those to whom no allotment has been made. When allotment is made, it results in a valid contract between the company and the applicants who now become the shareholders of the company.

Shares of a company are issued either at par or at a premium. Shares are to be issued at par when their issue price is exactly equal to their nominal value according to the terms and conditions of the issue. When the shares of a company are issued more than its nominal value (face value), the excess amount is called the premium.

Irrespective of the fact that shares are issued at par or at a premium, the share capital of a company as stated earlier, may be collected in installments payable at different stages.

1.2.3 Accounting Treatment

On application:

The amount of money paid in various installments represents the contribution to share capital and should ultimately be credited to share capital. However, for the sake of convenience, initially, individual accounts are opened for each instalment. All money received along with the application is deposited with a scheduled bank in a separate account opened for the purpose. The journal entry is as follows:

Bank A/c Dr.

To Share Application A/c (Amount received on application for — shares
@ Rs. _____ per share)

On allotment: When a minimum subscription has been received and certain legal formalities on the allotment of shares have been duly complied with, the directors of the company proceed to make the allotment of shares.

The allotment of shares implies a contract between the company and the applicants who now become the allottees and assume the status of shareholders or members.

The journal entries about the allotment of shares are as follows:

1. For Transfer of Application Money

Share Application A/c Dr.

To Share Capital A/c

(Application money on _____ Shares allotted/ transferred to Share Capital)

2. For Money Refunded on Rejected Application

Share Application A/c Dr.

To Bank A/c (Application money returned on rejected application for ___ shares)

3. For Amount Due on Allotment

Share Allotment A/c Dr.

To Share Capital A/c

4. For Adjustment of Excess Application Money

Share Application A/c Dr.

To Share Allotment A/c (Application Money on ___ Shares @ Rs ___ per shares adjusted to the amount due on allotment).

5. For Receipt of Allotment Money

Bank A/c Dr.

To Share Allotment A/c (Allotment money received on ___ Shares @ Rs. ___ per share Combined Account)

Note: - The journal entries (2) and (4) can also be combined as follows: Share Application A/c To Share Allotment A/c To Bank A/c (Excess application money adjusted to share allotment and balance refunded)

On Calls: Calls play a vital role in making shares fully paid up and in realizing the full amount of shares from the shareholders. In the event of shares not being fully called up till the completion of allotment, the directors have the authority to ask for the remaining amount on shares as and when they decide about the same. It is also possible that the timing of the payment of calls by the shareholders is determined at the time of the share issue itself and given in the prospectus.

Two points are important regarding the calls on shares. First, the amount on any call should not exceed 25% of the face value of shares. Second, there must be an interval of at least one month between the making of two calls unless otherwise provided by the articles of association of the company.

When a call is made and the amount of the same is received, the journal entries are as given below:

1. For Call Amount Due

Share Call A/c Dr.

To Share Capital A/c (Call money due on ___ Shares @ Rs. ___ per share)

2. For Receipt of Call Amount

Bank A/c Dr.

To Share Call A/c (Call money received)

word/words First, Second, or Third must be added between the words “Share” and ‘Call’ in the Share Call account depending upon the identity of the call made. For

example, in the case of the first call, it will be termed as ‘Share First Call Account’, in the case of the second call it will be ‘Share Second Call Account’, and so on. Another point to be noted is that the words ‘and Final’ will also be added to the last call, say, if the second call is the last call it will be termed as ‘Second and Final Call’ and if it is the third call which is the last call, it will be termed as ‘Third and Final Call’. It is also possible that the whole balance after allotment may be collected in one call only. In that case, the first call itself shall be termed as the ‘First and Final Call’.

1.2.3.1 Acceptance of Application Deposit

The application deposit payable on security should be more than five percent of the nominal value. Also, the company should not collect the application deposit in cash. The company may receive cheques or demand drafts for the payment of the application deposit. In such cases, the company should ensure that the cheques or demand drafts received are not post-dated instruments.

The funds collected by the company through an application deposit should be maintained in a separate bank account. The funds should be used only for the purposes mentioned in the prospectus. A company is not allowed to make use of capital funds towards the settlement of short-term credit obligations or revenue expenditures. The company may have working capital needs that require immediate disbursement of funds. In such cases, the company should ensure that capital funds are not deployed towards the disbursement. Thus, funds deposited by the investors should only be used to purchase separately distinguishable assets.

The application deposit may be less than the face value of the capital issued. In such cases, the ceiling limit of ninety percent should be applied to the number of applications sold. Cheques submitted to the company for paying the application deposit may not be successfully cleared. In such cases, the ceiling limit should be calculated after excluding the value of cheques which are not cleared. The ceiling limit should be applied after the defaulting subscribers have been excluded. A defaulting subscriber is a person who has paid the application deposit but has not made any subsequent contribution toward the capital.

The company may make a statement concerning minimum subscription in the prospectus. The statement may indicate a lower ceiling limit than ninety percent. In such cases, the statement will not be valid. Hence, the ceiling limit of ninety percent will continue to apply to the company. Alternatively, the company may indicate a ceiling limit that is higher than ninety percent. In such cases, the company is bound by the higher ceiling.

1.2.3.2 Refund of Application Deposit

- A company can commence allotment of securities only after the targeted minimum subscription is fulfilled. There may be a failure on the part of the company to reach the targeted minimum subscription. In such circumstances, the liability to make a refund will arise for the company. The Act requires

that in case of a failure to reach the minimum subscription, the application deposit should be refunded to the extent of one hundred percent. In case the company fails to refund the application deposit, the affected person may file a suit against the company. The maximum time limit for filing a lawsuit is three years.

- The time limit allowed for the collection of the minimum subscription is one hundred and twenty days. The period should be calculated from the date of opening of the issue. Also, the minimum subscription should be collected within thirty days from the date of issue of the prospectus. The time limits mentioned are applicable only for receipt of the minimum subscription. Hence, allotment of securities can be made even after completion of the time limit.
- In case the minimum subscription is not reached, the application deposit should be refunded. The refund should be made within fifteen days from the date of closure of the issue. In case there is a delay beyond fifteen days, the applicants should be repaid with interest at the rate of fifteen percent per annum. The directors of the company should also bear the liability to meet the interest obligation. The refund should be made directly to the bank account of the applicant.
- In case there is any default in complying with the above provisions, the company and the defaulting officers should pay a fine of one thousand rupees per day. The penalty will be calculated for the number of days for which the company has committed the default. However, the maximum amount of fine payable cannot exceed one lakh rupees.

1.2.4. Issue of Shares for Consideration

Shares are one of the most important instruments to raise capital at all stages of business. The issue of shares seems to be a simple process and most of the people know about it in its general form only. But the picture is not as it seems to be. There are various means and purposes for issuing shares. There are many purposes for which they're issued. In this article, we will understand the concept of the issue of shares for consideration (other than cash).

Means of Issue of Shares

There are 2 generally two means of the issue of shares:

- For Cash
- For Consideration Other than Cash

1.2.4.1 Issue of Shares for Cash

In the case of the issue of shares for cash, the company provides the shares to the investor in exchange for cash as consideration. It is the most general means of the issue of shares. Such kind of issuing is done for the general public. The Company calls such total cash consideration in certain parts or installments

1.2.4.2 Issue of shares for consideration other than cash

When an asset is acquired by a company, the payment of the asset price can be made by the issue of shares or in cash to the vendor. Moreover, when shares are given against the purchase price, it is known as the 'Issue of shares for consideration other than cash'. In this case, shares are not open to the general public.

As the term clears itself, the issue of shares for consideration other than cash means shares of the company are issued to somebody for anything that is not cash.

1. In case of Purchase of Assets

Shares issued for consideration other than cash, to purchase Asset:

2. In Case of the Purchase of a Business

When a company purchases the business of another company, it takes over the assets as well as the liabilities of the company at a predetermined price. Moreover, the difference in the prices of the assets and liabilities which is taken over is called 'Net Assets'. Net asset may be transferred to capital reserve account or Good will a/c based on conditions.

Condition 1- When assets taken over is less than the liabilities, the difference is transfer to Goodwill account.

Sundry assets Dr.
Goodwill a/c Dr.
To sundry liabilities a/c
To Share capital a/c

Condition 2- when the assets taken over is greater than liabilities, the difference in net assets is transfer to capital reserve account.

Sundry assets Dr.
To sundry liabilities a/c
To Share capital a/c
To capital reserve a/c

1.2.5 Calls in Arrears

It may happen that shareholders do not pay the call amount on the due date. When

any shareholder fails to pay the amount due on allotment or on any of the calls, such amount is known as ‘Calls in Arrears’/‘Unpaid Calls’. Calls in Arrears represent the debit balance of all the call accounts. Such amount shall appear as a ‘Note to Accounts (Refer to Chapter 3). However, where a company maintains a ‘Calls in Arrears’ Account, it needs to pass the following additional journal entry:

Calls in Arrears A/c Dr.

To Share First Call Account A/c

To Share Second and Final Call Account A/c (Calls in arrears brought into account)

The Articles of Association of a company may empower the directors to charge interest at a stipulated rate on calls in arrears. If the articles are silent in this regard, the rule contained in Table F shall be applicable which states that the interest at a rate not exceeding 10% p.a. shall have to be paid on all unpaid amounts on shares for the period intervening between the day fixed for payment and the time of actual payment thereof.

On receipt of the call amount together with interest, the amount of interest shall be credited to the interest account while call money shall be credited to the respective call account or to calls in arrears account. When the shareholder makes the payment of calls in arrears together with interest, the entry will be as follows:

Bank A/c Dr.

To Calls in Arrears A/c

To Interest on Calls in Arrears A/c (Calls in arrears received with interest)

Note: If nothing is specified, there is no need to take the interest on calls in arrears account and record the above entry

1.2.6 Calls in Advance

Sometimes shareholders pay a part or the whole of the amount of the calls not yet made. The amount so received from the shareholders is known as “Calls in Advance”.

The amount received in advance is a liability of the company and should be credited to the ‘Call in Advance Account.’ The amount received will be adjusted towards the payment of calls as and when they become due. Table F of the Companies Act provides for the payment of interest on calls in advance at a rate not exceeding 12% per annum.

The following journal entry is recorded for the amount of calls received in advance.

Bank A/c Dr.

To Calls in Advance A/c (Amount received on call in advance)

On the due date of the calls, the amount of ‘Calls in Advance’ is adjusted by the following entry:

Calls in Advance A/c Dr.

To Particular Call A/c (Calls in advance adjusted with the call money due)

The balance in the ‘Calls in Advance’ account is shown as a separate item under the title Equity and Liabilities in the company’s balance sheet under the head ‘current liabilities’, as sub-head ‘others current liabilities’. It is not added to the amount of paid-up capital.

As ‘Calls in Advance’ is a liability of the company, it is under obligation, if provided by the Articles, to pay interest on such amount from the date of its receipt up to the date when an appropriate call is due for payment. A stipulation is generally made in the Articles regarding the rate at which interest is payable. However, if Articles are silent on this account, Table F is applicable which provides for interest on calls in advance at a rate not exceeding 12% per annum.

1.2.7 Over Subscription

There are instances when applications for more shares of a company are received than the number offered to the public for subscription. This usually happens in respect of shares issued by well-managed and financially strong companies and is said to be a case of ‘Over Subscription’.

In such a condition, three alternatives are available to the directors to deal with the situation:

1. they can accept some applications in full and reject others;
2. they can make a pro-rata allotment to all; and
3. they can adopt a combination of the above two alternatives which happens to be the most common course adopted in practice.

The problem of over-subscription is resolved with the allotment of shares. Therefore, from the accounting point of view, it is better to place the situation of over-subscription within the total frame of application and allotment, i.e., receipt of application amount, amount due on the allotment, and its receipt from the shareholders, and the same has been observed in the pattern of entries.

First Alternative: When the directors decide to fully accept some applications and reject others, the application money received on rejected applications is fully refunded. For example, a company invited applications for 20,000 shares and received applications for 25,000 shares. The directors rejected the applications for 5,000 shares which are more than the required number and refunded their application money in full. In this case, the journal entries on application and allotment will be as follows:

The journal entries on application and allotment according to this alternative are as follows:

1. Bank A/c Dr.

To Share Application A/c

(Money received on application for 25, 000 shares @ Rs. _ per share)

2 Share Application A/c Dr.

To Share Capital A/c

To Bank A/c

(Transfer of application for money 20, 000 for shares allotted and money refunded on applications for 5, 000 shares rejected)

3 Share Allotment A/c Dr.

To Share Capital A/c

(Amount due on the allotment of 20, 000 shares @ Rs. _ per share)

4 Bank A/c Dr.

To Share Allotment A/c

(Allotment money received)

Second Alternative: When the directors opt to make a proportionate allotment to all applicants (called 'pro-rata' allotment), the excess application money received is normally adjusted towards the amount due on allotment. In case, the excess application money received is more than the amount due on allotment of shares, such excess amount may either be refunded or credited to calls in advance.

For example, in the event of applications for 20, 000 shares being invited and those received are for 25, 000 shares, it is decided to allot shares in the ratio of 4:5 to all applicants. It is a case of pro-rata allotment and the excess application money received on 5, 000 shares would be adjusted towards the amount due on the allotment of 20, 000 shares. In this case, the journal entries on application and allotment will be as follows

1 Bank A/c Dr.

To Share Application A/c

(Application money received on 25, 000 shares @ Rs. _ per Share)

2 Share Application A/c Dr

To Share Capital A/c

To Share Allotment A/c

(Transfer of application money to share capital and the excess application money on 5, 000 shares credited to share allotment account)

3 Share Allotment A/c Dr.

To Share Capital A/c

(Amount due on allotment of 25, 000 shares @ Rs. _ per share)

4 Bank A/c Dr.

To Share Allotment A/c

(Allotment money received after adjusting the amount already received as excess application money)

Third Alternative: When the application for some shares is rejected outrightly; and pro-rata allotment is made to the remaining applicants, the money on rejected

applications is refunded and the excess application money received from applicants to whom pro-rata allotment has been made is adjusted towards the amount due on the allotment of shares allotted.

For example, a company invited applications for 10, 000 shares and received applications for 15, 000 shares. The directors decided to reject the applications for 2, 500 shares outright and to make a pro-rata allotment of 10, 000 shares to the applicants for the remaining 12, 500 shares so that four shares are allotted for every five shares applied. In this case, the money on applications for 2, 500 shares rejected would be refunded fully, and that on the remaining 2, 500 shares (12, 500 shares – 10, 000 shares) would be adjusted against the allotment amount due on 10, 000 shares allotted and credited to the share allotment account, the journal entries on application and allotment recorded as follows:

1 Bank A/c Dr.

To Share Application A/c

(Money received on application for 15, 000 shares @ Rs. _ per share)

2 Share Application A/c Dr.

To Share Capital A/c

To Share Allotment A/c

To Bank A/c

(Transfer of application money to share capital, and the excess application amount of pro-rata allottees credited to share allotment and the amount on rejected applications refunded)

3 Share Allotment A/c Dr.

To Share Capital A/c

(Amount due on the Allotment of 10, 000 shares @ Rs. _ per share)

4 Bank A/c Dr.

To Share Allotment A/c (Allotment money received after adjusting the amount already received as excess application money)

1.2.8 Under Subscription

Under subscription is a situation where number of shares applied for is less than the number for which applications have been invited for subscription. For example, a company offered 2 lakh shares for subscription to the public but the applications were received for 1, 90, 000 shares, only. In such a situation, the allotment will be confirmed to 1, 90, 000 shares and entries shall be made accordingly. However, as stated earlier, it must be ensured that the company has received the minimum subscriptions and the company will have to refund the entire subscription amount received.

1.2.8.1 Issue of Shares at a Premium

It is quite common for the shares of financially strong and well-managed companies to be issued at a premium, i.e. at an amount more than the nominal or par value of shares. Thus, when a share of the nominal value of Rs. 100 is issued at Rs. 105, it is said to have been issued at a premium of 5 percent.

When the issue of shares is at a premium, the amount of premium may technically be called at any stage of the issue of shares. However, the premium is generally called with the amount due on allotment, sometimes with the application money and rarely with the call money. The premium amount is credited to a separate account called 'Securities Premium Account' and is shown under the title 'Equity and Liabilities' of the company's balance sheet under the head 'Reserves and Surpluses'. It can be used only for the following five purposes:

- a. to issue fully paid bonus shares to the extent not exceeding the unissued share capital of the company;
- b. to write off the preliminary expenses of the company;
- c. to write off the expenses of, or commission paid, or discount allowed on any securities of the company; and
- d. to pay a premium on the redemption of preference shares or debentures of the company.
- e. Purchase of its shares (i.e., buyback of shares)

The journal entries for shares issued at a premium are as follows:

1. For Premium Amount called with Application money

- a. Bank A/c Dr.
To Share Application A/c
(Money received on application for — shares @ Rs. — per share including premium)
- b. Share Application A/c Dr.
To Share Capital A/c
To Securities Premium Reserve A/c
(Transfer of application money to share capital and securities premium account)

2. Premium Amount called with Allotment Money

- a.. Share Allotment A/c Dr.
To Share Capital A/c
To Securities Premium Reserve A/c
(Amount due on allotment of shares @ Rs — per share including premium)
- b. Bank A/c Dr.
To Share Allotment A/c
(Allotment money received including premium)

3. Premium Amount called with Call Money

a. Share Application A/c

To Share Capital Reserve A/c

To Securities Premium A/c

(Amount due on 1st/2nd call @Rs— per share including premium)

b. Bank A/c Dr.

To Share Call A/c

(Call money received including premium)

Illustration 1

Jupiter Company Limited issued 35, 000 equity shares of Rs. 10 each at a premium of Rs.2 payable as follows:

On Application Rs. 3

On Allotment Rs. 5 (including premium)

Balance on First and Final Call

The issue was fully subscribed. All the money was duly received. Record journal entries in the books of the Company

Solution:

Books of Jupiter Company Limited Journal

Date	Particulars	L.F	Debit Amount	Credit Amount
	Bank A/c Dr.		105000	
	To Equity Share Application A/c (Money received on applications for 35, 000 shares @ Rs. 3 per share)			105000
	Equity Share Application A/c Dr.		105000	
	To Equity Share Capital A/c (Transfer of application money on allotment to share capital)			105000
	Equity Share Allotment A/c Dr.		175000	
	To Equity Share Capital A/c			105000
	To Securities Premium Reserve A/c (Amount due on allotment of 35, 000 shares @ Rs. 5 per share including premium)			70000
	Bank A/c Dr.		175000	
	To Equity Share Allotment A/c			175000

(Money received including premium)		
Equity Share First and Final Call A/c Dr.	140000	
To Equity Share Capital A/c		140000
(Amount due on First and Final Call of Rs. 4 per share on 35, 000 shares)		
Bank A/c Dr.	140000	
To Equity Share First and Final Call A/c		140000
(Money received on First and Final Call)		

1.2.9 Forfeiture of Shares

When shareholders fail to pay calls, the company, if empowered by its articles, may forfeit the share. The Company's Act does not contain any specific provisions regarding forfeiture of shares. The power to forfeit shares must be provided in the Articles of Association of the company. If a shareholder has not paid any call on the day fixed for payment thereof and fails to pay it even after his attention is drawn to it by the secretary by registered notice, the Board of Directors passes a resolution to the effect that such shares be forfeited. Shares once forfeited become the property of the company and may be sold on such terms as directors think fit.

Forfeiture of shares brings about compulsory termination of membership and the company takes away the shares from members by way of plenty for non-payment of allotment and/or call money.

The effect of forfeiture of shares is that the defaulting shareholder loses all his rights in shares and ceases to be a member. The name of the shareholder is removed from the Register of Members and the amount already paid by him/her is forfeited. He loses all privileges and rights of membership.

1.2.9.1 Journal Entries

Following Journal Entry is passed at the time of forfeiture of shares.

Share Capital Account Dr. (with the called amount on such shares as capital)

Security Premium Account Dr. (if not received)

 To Unpaid Calls Account (with an amount which became due but not paid)

 To Shares Forfeited Account (with the amount already received on such shares)

On forfeiture, the Share Capital Account has been debited as it reduces the share capital, and calls due but not received will be credited to cancel their debit balance standing in the books. The premium received on the original issue of shares cannot be cancelled. Securities Premium not received on the issue of shares will be cancelled

by debiting the securities Premium Account with the forfeiture entry. The balance of shares capital will be maintained until all forfeited shares are reissued.

Illustration

A limited company has an authorised capital of ₹2, 50, 000 in ₹10 shares. Of these 4000 shares were issued as fully paid in payment of the building purchased and the public subscribed for 8, 000 shares, and during the first year ₹5 per share was called payable ₹2 on application, ₹1 on the allotment, ₹1 on the first call and ₹1 on the second call. The amounts received in respect of these shares were as follows:

On 6, 000 shares the full amount called on 500 shares ₹3 per share.

On 1, 250 shares ₹4 per share and on 250 shares ₹2 per share

The director forfeited the shares on which less than ₹4 had been paid. Show Journal Entries in the books of the company.

Solution

Building Account	Dr.	40,000
To Share Capital Account		40,000
(Being issue of 4, 000 fully paid shares of ₹10 each for the purchase of the building)		
Bank Account	Dr.	16,000
To Share Application Account		16,000
(Being application money received on 8, 000 shares @ ₹2 per share)		
Share Application Account	Dr.	16,000
To Share Capital A/c		16,000
(Being Application money received)		
Share Allotment A/c	Dr.	8,000
To Share Capital A/c		8,000
(Being allotment money due on 8, 000 shares @ ₹1 per share)		
Bank A/c	Dr.	7,750
To Share Allotment A/c		7,750
(Being Allotment money received)		
Share First Call Account	Dr.	8,000
To Share Capital A/c		8,000
(Being the amount due on the first call on 8, 000 shares @ ₹1 per share)		
Bank A/c	Dr.	7,250
To Share First Call Account		7,250
(Being amount received on account of first call on 7, 250 shares of ₹1 per share)		

Share Second Call Account	Dr.	8,000
To Share Capital Account		8,000
(Being the amount due on the second call on 8,000 shares ₹1 per share)		
Bank A/c	Dr.	6,000
To Share the Second Call Account		6,000
(Being amount received on account of the second call on 6,000 shares @ ₹1 per share)		
Share Capital Account	Dr.	3,750
To Share Allotment		250
To Share First Call Account		750
To Share Second Call Account		750
To Share Forfeiture Account		2,000
(Being for forfeiture of 750 shares on which less than ₹4 had been paid)		

1.2.10 Reissue of All Forfeited Shares

Forfeited shares may be reissued by the company directors for any amount but if such shares are issued at a discount, then the amount of discount should not exceed the actual amount received on forfeited shares plus the original discount on reissued shares, If any. The purchaser of forfeited reissued shares is liable for payment of all future calls duly made by the Company.

The following journal entry on such reissue is passed:

Bank A/c	Dr. (Amount received on such reissue)
Shares Forfeited A/c	Dr. (loss on the reissue of shares called capital loss)
To Share Capital A/c	(with face value of shares)
To Securities Premium A/c	(If shares are reissued at a premium)

Illustration

A Company invited the public to subscribe to 1,00,000 Equity Shares of ₹10 each at a premium of ₹1 per share payable on the allotment. The payment was to be made as follows:

On application ₹ 3; on allotment ₹ 3; on first call ₹ 3 and on final call ₹ 2.

Applications were received for 1,30,000 shares; applications for 20,000 shares were rejected and allotment was made proportionately to the remaining applicants. Both the calls were made and all the moneys were received except the final call on 3,000 shares were forfeited after due notice. Later all these shares were issued as fully paid at ₹8.50 per share. Pass journal entries.

Solution

Bank A/c Dr.	3,90,000
To Equity Share Application A/c	3,90,000
(Application money received for 1,30,000 shares @₹3 per share)	
Equity Share Application A/c Dr.	3,90,000
To Equity Share Capital A/c	3,00,000
To Bank A/c	60,000
To Share Allotment A/c	30,000
(Application money of 1,00,000 shares transferred to share capital A/c and the balance returned to applicants and used for share allotment A/c)	
Equity Share Allotment A/c Dr.	3,00,000
To Equity Share Capital A/c	2,00,000
To Securities Premium A/c	1,00,000
(Allotment money due on 1,00,000 shares)	
Bank A/c Dr.	2,70,000
To Equity Share Allotment	2,70,000
(Receipt of the amount due on allotment)	
Equity Share First Call A/c Dr.	3,00,000
To Equity Share Capital A/c	3,00,000
(Being receipt of the amount due on the first call)	
Bank A/c Dr.	3,00,000
To First Call A/c	3,00,000
Equity Share Second & Final Call A/c Dr.	2,00,000
To Equity Share Capital A/c	2,00,000
(Amount due on second and final call)	
Bank A/c Dr.	1,94,000
To Equity Share Second and Final Call A/c	1,94,000
(Receipt of the amount due on the second and final call except on 3,000 shares)	
Equity Share Capital A/c Dr	30,000
To Equity Share Second & Final Call A/c	6,000
To Shares Forfeiture A/c	24,000
(Being receipt of the amount due on the second & final call except on 3,000 shares)	
Bank A/c Dr.	25,500
Share Forfeited A/c Dr.	4,500
To Equity Share Capital A/c	30,000
(Reissue of 3,000 shares @₹8.50 per share)	
Shares Forfeited A/c Dr.	19,500

To Capital Reserve A/c 19,500
 (Balance of shares forfeited A/c being capital profit transferred to Capital Reserve A/c)

1.2.11 Surrender of Shares

After the allotment of shares, sometimes a shareholder is not able to pay further calls and returns his shares to the company for cancellation. Such voluntary return of shares to the company by the shareholder himself is called surrender of shares. Surrender of shares has no separate accounting treatment but it will be like that of forfeiture of shares. The same entries (as are passed in case of forfeiture of shares) will be passed in case of surrender of shares.

1.2.11.1 Distinction between Surrender of Shares and Forfeiture of Shares

No.	Surrender of Shares	Forfeiture of Share
1	It is at the initiative of the shareholders concerned	It is the initiative of the company.
2	In this case, the procedure for the reduction of share capital as provided in section 100 of the Companies Act should be followed.	No such procedure is followed for the forfeiture of shares.
3	The shareholder is stopped from questioning the validity of the surrender of shares.	The shareholder can challenge the defects in the notice for forfeiture of shares in case of forfeiture of shares.
4	The company is saved from the formalities of serving notice and waiting till the period of notice is over.	The forfeiture is possible only when the Articles of Association of a company empowers the Board of Directors to do so

Recap

- ◊ Issue at Par: Shares are issued at their face value (e.g., ₹10 share issued at ₹10).
- ◊ Issue at Premium: Shares are issued above face value (e.g., ₹10 share issued at ₹15, with ₹5 premium recorded in the Securities Premium Reserve).
- ◊ Calls in Arrears: When shareholders fail to pay due amounts on their shares. The company may charge interest.
- ◊ Calls in Advance: When shareholders pay in excess of the required call amount before demand. Interest may be given.

- ◊ Pro -rata allotment - • Happens when share applications exceed available shares. Shares are allotted proportionally (e.g., If a company receives applications for 1, 00, 000 shares but only issues 50, 000, allotment is in a 1:2 ratio).
- ◊ Forfeiture of share - When a shareholder fails to pay call money, the company forfeits (cancels) their shares. The amount paid is not refunded, and the shares can be reissued later.
- ◊ Reissue of share - Forfeited shares are reissued at par, premium, or discount. The discount cannot exceed the forfeited amount. Reissue Example: If a share forfeited at ₹8 is reissued at ₹6, the loss of ₹2 is adjusted from the Forfeited Shares Account.

Objective Questions

1. There are two types of shares that a company registered in India issues, i.e., 1. Preference Shares, and 2. Equity Shares, is it true or false?
2. The preference shares are that part of share capital that only enjoys a preferential right regarding the payment of dividends. Is it true or false?
3. Share Application Account is a
4. The minimum share application money is
5. Right shares are those shares which are
6. Public limited companies cannot issue
7. The portion of uncalled capital that can be called up only on the liquidation of the company is called
8. If a limited company has adopted 'Table F', it is required to pay interest on calls in advance at the rate of
9. Premium on the issue of shares can be used for
10. Subject to the permission allowed by the Central Government, the maximum allowable discount on equity shares is
11. Preference shareholders are _____?
12. What is the name of the situation where the number of shares applied for is less than the number for which applications have been invited for subscription?
13. When applications for more shares of a company are received than the number offered to the public for subscription, such a situation is called?
14. The situation in which a shareholder fails to pay the amount due on allotment or any of the calls is called?
15. The amount received in advance from the shareholders is known as?

Answers

1. True
2. False
3. Nominal Account
4. 5% of the face value of shares
5. First offered to the existing shareholders
6. Deferred Shares
7. Reserve capital
8. 12%
9. Issue of bonus shares
10. 10%
11. Owners of the company (In partial sense only)
12. Under subscription
13. Over Subscription'
14. Calls in Arrears or Unpaid Calls
15. Calls in Advance

Self-Assessment Questions

1. What are the different types of shares?
2. Short note on Pre-rata allotment?
3. Explain the journal entries for re-issue of shares?
4. Explain the accounting treatment for forfeiture of share?
5. Security premium on issue of shares can be used for what purposes?

Assignments

1. A company was formed with a capital of ₹15,00,000 in shares of ₹10 each. It offered to the public 1,00,000 shares payable ₹1 per share on application, ₹2 per share on the allotment, and ₹3 per share on the first call. The balance of ₹4 per share is to be called only in case of necessity. Applications were received for 90,000 shares and the shares were accordingly allotted. All the money was duly received except allotment money on 200 shares and the first call on 500 shares.

Journalise the transactions and prepare the Balance sheet.
[Calls in Arrears ₹1,900; B/S total ₹5,38,100]
2. A company issues 10,000 equity shares at ₹10 each, with a premium of ₹5 per share. Explain the journal entries for this transaction. What are the advantages and disadvantages of issuing shares at a premium?

(Security premium – $10000*5 = 50000$)
3. Why do companies forfeit shares? What are the accounting treatments for forfeiture? If a company forfeits 5, 000 shares due to non-payment of call money and later reissues them at a discount, how would the company record this transaction?
4. "Reissued forfeited shares often benefit the company." Do you agree or disagree? Support your answer with accounting entries and real-world examples.

Suggested Reading

1. Bhattacharyya, A. K. (2021). *Financial Accounting for Business Managers*. PHI Learning Pvt. Ltd.
2. Gupta, R. L., & Radhaswamy, M. (2019). *Advanced Accountancy: Vol. I*. Sultan Chand & Sons.
3. Jain, S. P., & Narang, K. L. (2020). *Advanced Accountancy: Corporate Accounting*. Kalyani Publishers.
4. Maheshwari, S. N., & Maheshwari, S. K. (2021). *Corporate Accounting*. Vikas Publishing House.
5. Shukla, M. C., Grewal, T. S., & Gupta, S. C. (2022). *Advanced Accounts*. S. Chand Publishing.
6. Tulsian, P. C. (2020). *Financial Accounting*. Pearson Education India.

Reference

- ◊ Asish K Bhattacharjee, Tata McGraw Hill, *Indian Accounting Standards*
- ◊ Dr. B D Agarwal - *Advanced Financial Accounting*
- ◊ Israr Shaikh and Rajesh Makkar, Lexis Nexis. *Accounting Standards*
- ◊ Jain S.P and Narang K.L. *Corporate Accounting*, Kalyani Publishers, New Delhi
- ◊ Maheswari S.N. and Maheswari S.K. *Corporate Accounting*, Vikas Publishing House, New Delhi
- ◊ Mukherjee A. and Hanif M. *Corporate Accounting*, Tata McGraw-Hill Publishing Co.Ltd. New Delhi
- ◊ Nirmal Gupta and ChhaviSharma. *Corporate Accounting Theory and Practice*, Ane Books India, Delhi.
- ◊ P C Thulsian - *Advanced Corporate Accounting*
- ◊ Paul. K.R. *Accountancy*, New Central Book Agency Pvt. Ltd. Kolkata
- ◊ Pillai R.S N, Bhagavathi and Uma S. *Fundamentals of Advanced Accounting*, S Chand & Co. Ltd., New Delhi
- ◊ Rawat D S—*Taxman Accounting Standards*
- ◊ RL Gupta and Radhaswamy- *Advanced Accounting*
- ◊ Shukla M C, Grewal T.S. and Gupta S.C. *Advanced Accounts*. Chand& Co. Ltd., New Delhi
- ◊ Vijayakumar M.P, Snow White, Chennai - *Accounting Standards*

2
BLOCK

ACCOUNTING FOR DEBENTURES

Introduction to Debentures

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ state the meaning of debenture and explain the difference between debentures and shares;
- ◊ describe various types of debentures;
- ◊ familiarize the difference between shares and debentures

Prerequisites

ABC Company Ltd. began operations in the year 2020. In the beginning, the company raised its capital using the issue of shares. Later, the company decided to extend and develop the business on a large scale. An additional amount of capital is required to run a business effectively and successfully. However, the funds raised by the issue of shares are seldom adequate to meet the long-term financial needs of a company. Thus, the company has decided to raise funds through other means than the issue of share capital because of its limitations, like residual claim on investment, high cost, dividend at the discretion of the directors, gradual dilution of shareholders' control over the business, manipulation by a few shareholders, and issue of equity shares not getting tax-deduction, etc. Hence, ABC Company Ltd. turned to raising long-term funds through debentures. Let us discuss the debenture.

Keywords

Debentures, Bond, Features of Debentures, Types of Debentures, Distinguish between Shares and Debentures

Discussion

2.1.1 Meaning and definition of debentures

The word ‘debenture’ has been derived from the Latin word ‘debere’ which means to borrow. A debenture is a written instrument that acknowledge debt and bear company’s seal. It outlines a contract for the repayment of the principal amount at specified intervals and includes fixed interest payments, typically semi-annually or annually. The holder of a debenture, known as the debenture holder is a preferential creditor. Companies that intend to raise funds without compromising ownership may issue debenture as means of long-term debt financing.

Section 2 (30) of The Companies Act, 2013, defines debenture as “Debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the company’s assets or not”

Bonds are also instruments of debt. Traditionally, bonds were issued by the government, but now they are also issued by semi-government and non-governmental organizations. The terms ‘debenture’ and ‘bonds’ are now being used interchangeably. However, the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934 and such other instruments, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company, shall not be treated as debenture.

2.1.2 Features of Debentures

- a. **Acknowledgment of debt:** Debenture is a written document that acknowledges debt. It is an instrument used by organisations to raise long-term debt. The agreement between company and debenture holder is known as debenture certificate, which can be presented as a proof in court at the time of winding up of a company.
- b. **Fixed Rate:** The interest paid for debentures are fixed, which will be mentioned in the certificate. This rate is called “Coupon Rate”. Interest on debenture is payable even if there is a loss. Thus, debenture holders become the company's creditors carrying a fixed interest rate.
- c. **Redemption:** Unlike equity, debentures are repaid by the company on the date of maturity. Date of maturity will be mentioned in the debenture certificate. This process is known as redemption.
- d. **Secured:** Debentures are secured, because it involves collateral. Collateral can be any asset of the company mentioned in the debenture certificate, against which the debenture holder will have a claim.
- e. **Tax-deduction:** Interest payable on a debenture is a charge against profit and hence it is a tax-deductible expenditure.
- f. **No voting power:** Debenture holders do not enjoy any voting right

2.1.3 Types of Debentures

A company may issue different debentures that can be categorised based on Security, Redemption, Convertibility, Coupon rate, and Negotiability.

2.1.3.1 On the basis of Security

- a. **Secured Debentures:** Secured debentures are those that have a claim against the company's asset in the event of any default. The charge may be fixed or floating. A fixed charge is created on a specific asset whereas a floating charge is on the general assets of the company. Such charge is to be registered with the Registrar of companies (R O C)

For example: A city might use future property tax receipts to secure a bond while companies might use their factories as bond securities. Secured debentures have less risk associated with them than unsecured one. A factory or office building is a typical example of a fixed charge asset in a secured debenture.

- b. **Unsecured Debentures:** Unsecured debentures are those that are issued without providing any claim for the debenture holder on the assets of a company. Unsecured debentures do not have a specific charge on the assets of the company. However, a floating charge may be created on these debentures by default. Normally, these kinds of debentures are not issued. Because the debenture holder will not be able to make any claims against the assets, when company makes any default.

2.1.3.2 On the basis of redemption

- a. **Redeemable Debentures:** Redeemable debentures are those that are redeemable at the end of a specified period, either in a lump sum or in instalments over the company's lifetime. Debentures can be redeemed either at par or at premium. From the point of view of redeemable debenture company issues debenture, for a specific period of time (maximum period of 10 years from the date of issue).
- b. **Irredeemable Debentures:** Irredeemable debentures are also known as Perpetual Debentures because the company does not give any undertaking for the repayment of money borrowed by issuing such debentures. These debentures are repayable on the winding-up of a company or on the expiry of a long period.

2.1.3.3 On the basis of convertibility

- a. **Convertible Debentures:** Debentures which are convertible into equity shares or in any other security either at the option of the company or the debenture holders are called convertible debentures.
- b. **Non-Convertible Debentures:** The debentures which cannot be converted into shares or in any other securities are called non-convertible debentures. Most debentures issued by companies fall in this category.
- c. **Partly Convertible:** Debentures that cannot be fully converted into equity are known as partly convertible debentures. Only a fixed portion of such debentures

can be converted to equity by the debenture holders, whereas the rest will remain as debentures until maturity or redemption.

2.1.3.4 On the basis of Negotiability

Debentures issued by the company may be negotiable or non-negotiable.

- a. **Bearer Debentures:** These debentures are payable to bearer of the debentures and easily transferable by mere delivery and the company does not have any record of the debenture holder and interest rates. These debentures are also known as unregistered debentures. Usually, coupons are attached with these debentures and interest is paid to the person who produces coupons.
- b. **Registered/order Debentures:** These debentures cannot be transferred simply by delivering debenture certificates; instead, they must be transferred in accordance with the Companies Act 2013 by completing transfer deeds and having the transfer recorded by the firm. Debentures that have been registered are not negotiable instruments.

An individual whose name appears on both the debenture certificate and the register of debenture holders maintained by the company, is referred to as a registered holder of a debenture. When principal and interest are due on these debentures, they are payable to the registered holders.

2.1.3.5 On the basis of Coupon Rate

- a. **Specific Coupon Rate Debentures:** These debentures are issued with a specified rate of interest, which is called the coupon rate. The specified rate may either be fixed or floating. The floating interest rate is usually tagged with the bank rate.

Suppose you bought a bond of face value Rs 2,000 and the coupon rate is 10 percent. Every year, you'll get Rs 200 (10 percent of Rs 2,000), which boils down to an effective rate of interest of 10 per cent.

- b. **Zero Coupon Rate Debentures:** These debentures do not carry a specific rate of interest. In order to compensate the investors, such debentures are issued at substantial discount and the difference between the nominal value and the issue price is treated as the amount of interest related to the duration of the debentures.

2.1.4 Distinguish between Shares and Debentures

There are some significant differences between shares and debentures as follows:

BASICS	DEBENTURE	SHARES
Ownership	It is a debt taken by the company hence Debenture holders are the lenders of the company	It is the capital of the company, so Shareholders are the owners of the company

Return	The return on debenture is known as interest. The rate of return on debenture is predetermined irrespective of whether the company earns profit or not	The return on share is called dividend. Dividend is paid only when the company makes profit, which may fluctuate yearly.
Repayment	Debentures are issued specifically for a period and repayable after the expiry of that period.	Shares are not returned during the lifetime of the company, except for the preference share which is redeemed on the due date.
Voting right	Debenture holders have no voting rights	Shareholders have voting right
Security	Debentures are generally secured and carry a fixed or floating charge over the assets of the company.	Shares are not secured by any charge.
Convertibility	Debentures can be converted into shares	Shares cannot be converted into debentures
Mortgages	Asset of a company mortgaged in favour of debenture holders.	Asset of the company cannot be mortgaged in favour of shareholders.
Purchase	A company can purchase its own debenture from the market without any conditions.	A company can buy-back its own shares, but upon fulfilment of certain conditions
Priority as to repayment during winding-up	Payment of debenture is made before the repayment of share capital.	Payment of share capital is made after the repayment of debentures.

Recap

- ◊ **Debenture** is an acknowledgment of debt issued to the person lending money.
- ◊ The holder of debenture is known as **debenture holders**.
- ◊ Debenture has fixed rate of interest known as **coupon rate**, which is paid to the debenture holder periodically.
- ◊ Debentures can be **convertible** and **non - convertible**

- ◊ Debenture holders are **creditors** of the company, and they do not possess any voting right.
- ◊ Debentures can be **redeemable** and **irredeemable**
- ◊ **Redeemable debentures** are to be repaid in full on the date of maturity
- ◊ **Irredeemable debentures** are to be repaid in full only at the winding up of the company

Objective Questions

1. Debentures redeemed before maturity are called
2. Debentures issued against a claim on the asset of a company is called
3. Debentures that cannot be redeemed during the lifetime of the company are called.
4. Irredeemable debentures are otherwise known as
5. Debentures that can be converted to shares are known as
6. Debentures that can be transferred by mere delivery is known as
7. The fixed interest rate paid by the company on the face value of debenture is known as
8. Debentures that can be transferred according to Companies Act 2013 is known as?

Answers

1. Redeemable debentures
2. Secured debentures
3. Irredeemable debentures
4. Perpetual debentures
5. Convertible debentures
6. Bearer debentures
7. Coupon rate
8. Registered debentures

Self-Assessment Questions

- ◊ Define debentures
- ◊ ‘Debentures are different from bonds. Comment.
- ◊ What are the different types of debentures?
- ◊ Debenture holders do not have voting rights. Explain.
- ◊ Write a short note on debentures based on security.
- ◊ Differentiate between debentures and shares
- ◊ Write a short note on debentures that are negotiable.
- ◊ Write a short note on debentures that are convertible

Assignments

1. Explain the need and significance of issuing debentures.
2. “Debentures are preferred over shares at the time of winding up”. Explain.

Suggested Reading

1. Brealey, R. A., Myers, S. C., Allen, F., & Mohanty, P. (2020). *Principles of corporate finance* (12th ed.). McGraw-Hill Education.
2. Damodaran, A. (2012). *Investment valuation: Tools and techniques for determining the value of any asset* (3rd ed.). Wiley.
3. Pandey, I. M. (2021). *Financial management* (12th ed.). Pearson Education.
4. Ross, S. A., Westerfield, R. W., Jaffe, J., & Jordan, B. D. (2019). *Corporate finance* (12th ed.). McGraw-Hill Education.
5. Van Horne, J. C., & Wachowicz, J. M. (2008). *Fundamentals of financial management* (13th ed.). Pearson Education.

Reference

- ◊ Khan, M. Y., & Jain, P. K. (2018). *Financial management: Text, problems, and cases* (8th ed.). McGraw-Hill.
- ◊ SEBI. (2021). *Guidelines for issuance of debentures in India*. Securities and Exchange Board of India. Retrieved from <https://www.sebi.gov.in>



Issue of Debentures

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ record the journal entries for the issue of debentures at par, at a discount and at a premium
- ◊ explain the concept of debentures issued for consideration other than cash and collateral security, and the accounting thereof

Prerequisites

You have studied that the share capital is the major source of finance of the company. Such capital is raised by issuing shares. 'Share holders' are the persons who hold the shares and they are the owners of the company. Every company may need additional amount of capital for a long period. Thus, company sometimes raise loan from the public. The total amount of loan may be divided into small units of denominations and it can sell them to the public. Each unit of loan is known as a 'debenture' and holder of such debenture is called as 'Debenture Holder'. The entire amount raised is loan for the company. In this unit, we shall learn about issue of debentures and accounting treatment.

Keywords

Issue of Debentures, Types of issue of debentures, Over subscription, Fraction Debentures, Debenture Discount, Interest on Debentures

Discussion

2.2.1 Issue of Debentures

The procedure for issuing debentures is similar to that of issuing stock. Prospective investors submit applications for debentures based on the company's prospectus. The company may ask for payment in full or in instalments for application, allotment, and numerous calls. Debentures can be issued at par, at a discount, or at a premium. Application fees are returned when applications are rejected. In the event of a partial allotment, the remaining application money is adjusted towards subsequent calls. Issue of debenture can be made for consideration or price. Debentures can be issued either for consideration in cash or other than cash or as collateral security. The accounting treatment for issue of debentures is discussed in this unit.

2.2.2 Debentures issued for cash

Debentures issued for consideration in cash can be categorised into following:

1. Debentures issued at par and redeemable at par or at a discount
2. Debentures issued at a discount and redeemable at par or at discount
3. Debentures issued at premium and redeemable at par or at discount
4. Debentures issued at par and redeemable at premium.
5. Debentures issued at a discount and redeemable at premium.
6. Debentures issued at premium and redeemable at premium

2.2.2.1 Issued at par and redeemable at par

When debentures are issued at par, the issue price will be equal to par value. The journal entries will be as follows:

a) For receipt of application money:

Bank A/c Dr.

To, Debenture application A/c

b) For transfer of application money to debentures account:

Debenture application A/c Dr.

To ...% Debenture account

Illustration 1

Sankar Ltd. issued 50,000 9% debentures of ₹50 each, payable on application as specified in the prospectus and redeemable at par after three years from the date of issue. Record the required journal entries for the issue of these debentures in the books of Sankar Ltd.

Date	Particulars	L.F	Debit Amount (₹)	Credit Amount (₹)
	Bank A/c Dr. To Debenture application A/c(Debenture application money received)		25,00,000	25,00,000
	Debenture A/c Dr. To 9% Debenture A/c (Application money transferred to 9% debentures account consequent upon allotment)		25,00,000	25,00,000

2.2.2.2 Debentures issued at discount and redeemable at par or at discount

When debentures are issued at a discount, the issue price is lower than their nominal value. The difference between the issue price and the par value is treated as a loss on the issue of debentures, which is amortised over the debenture period. The journal entries for such an issue are as follows:

a) For receipt of application money

Bank A/c Dr.
To Debenture Application A/c

b) At the time of making allotment

Debenture Application A/c Dr.
Discount on issue of debenture A/c Dr.
To ...% Debentures A/c

Illustration 2

Sunshine Ltd. issued 10, 000, 9% debentures of ₹100 each at a 10% discount, redeemable at par at the end of the 10th year. The payment terms were ₹40 on application and ₹50 on allotment. Record the necessary journal entries for the issue of these debentures.

Date	Particulars	L.F	Debit Amount (₹)	Credit Amount (₹)
	Bank A/c Dr. To Debenture application A/c (Debenture application money received)		4,00,000	4,00,000
	Debenture A/c Dr. To 9% Debenture A/c (Application money transferred to 8% debentures account consequent upon allotment)		4,00,000	4,00,000

	Debenture allotment A/c Dr Discount on issue of debentures A/c Dr To 9% Debentures A/c (Amount due on allotment)		5, 00, 000 1, 00, 000	6, 00, 000
	Bank A/c Dr To Debenture Allotment A/c (Money received consequent upon allotment)		5, 00, 000	5, 00, 000

2.2.2.3 Debenture Issued at Premium and Redeemable at par or at discount

When debentures are issued at a premium, the issue price exceeds the nominal value. The premium amount is credited to the securities premium account. The corresponding journal entries for the accounting treatment of such an issued are as follows:

When premium amount is received at the time of application:

a) For receipt of application money

Bank A/c Dr.

To Debenture Application A/c

b) For transfer of application money at the time of allotment

Debenture application A/c Dr.

To .% Debenture A/c

To Securities Premium A/c

When debentures are issued at par or at premium but redeemed at a discount, the company benefits by paying a lesser amount. However, as per the conservatism principle, this gain is not recorded at the time of issue. The application of the securities premium on debentures is governed by Section 52 of the Companies Act, 2013.

Illustration 3

Kaveri Chemicals Ltd. issued 1, 00, 000 10% debentures of ₹50 each at a 10% premium. Payment terms were ₹25 on application, with the balance payable on allotment. The debentures are redeemable at par after five years. All allotment, money, including the premium, was called and fully received. Prepare the necessary journal entries considering the premium was included in the application money.

Date	Particulars	L.F	Debit Amount (₹)	Credit Amount (₹)
	Bank A/c Dr. To Debenture application A/c (Debenture application money received)		25,00,000	25,00,000

	Debenture A/c To 10% Debenture A/c To Securities premium A/c (Application money transferred to 10% debentures account and securities premium account consequent upon allotment)	Dr.	25,00,000	20,00,000 5,00,000
	Debenture allotment A/c To 10% Debentures A/c (Call made consequent upon allotment)	Dr	30,00,000	30,00,000
	Bank A/c To Debenture Allotment A/c (Call made consequent upon allotment money received)	Dr	30,00,000	30,00,000

2.2.2.4 Debentures issued at par and redeemable at a premium

When debentures are redeemed at a premium, an additional entry must be made at the time of their issue and allotment. This entry is necessary to account for the premium payable upon redemption. The Debenture Redemption Premium Account is a personal account that represents a liability for the company regarding the premium payable at redemption. In this scenario, the issue price is the same as the par value, but the redemption value is higher than the debenture's face value at the time of allotment. The following journal entries should be made in this case:

a) For receipt of application money

Bank A/c Dr.
To Debenture application A/c

b) At the time of making allotment

a. Transfer of application money to debenture account

Debenture Application A/c Dr.
To ...% Debenture A/c

b. Call made consequent upon allotment

Bank A/c Dr.
Loss on issue of debenture A/c Dr.
To ...% Debenture A/c
To Debenture redemption premium A/c

Illustration 4

New Age Ltd. issued 2,00,000, 10% debentures of ₹100 payable as follows:

On application ₹30
On allotment ₹70

The debentures were fully subscribed and all the money was duly received. As per the terms of issue, debentures are redeemable at ₹110 per debenture. Record necessary entries regarding issue of debentures.

Date	Particulars	L.F	Debit Amount (₹)	Credit Amount (₹)
	Bank A/c Dr. To Debenture application A/c (Debenture application money received)		60,00,000	60,00,000
	Debenture Application A/c Dr. To 10% Debenture A/c (Application money transferred to 10% debentures account consequent upon allotment)		60,00,000	60,00,000
	Debenture allotment A/c Dr Loss on issue of Debentures A/c Dr To 12% Debenture A/c To Debentures redemption premium A/c (Call made upon allotment of debentures at par and entry for debenture redeemable at premium)		60,00,000 20,00,000	60,00,000 20,00,000
	Bank A/c Dr To Debenture Allotment A/c (Call made consequent upon allotment money received)		60,00,000	60,00,000

2.2.2.5 Debentures issued at discount and redeemable at premium

When debentures are issued at a discount and redeemable at a premium, the issue price is less than the par value, while the redemption value is greater than the par value. The difference between the redemption price and the issue price is considered a discount or loss on the issue of debentures. For example, consider a 5% debenture with a par value of ₹100 that is issued at a discount of ₹5 and is redeemable at a premium of ₹2 per debenture. In this case, the amount of loss would be calculated as ₹102 (redemption value) minus ₹95 (issue price), resulting in a loss of ₹7. This amount is treated as a loss on the issue. It is important to note that the premium on the debentures is also credited by ₹2.

a) For the receipt of application money

Bank A/c Dr.

To Debenture application

At the time of making allotment

Transfer of application money to debenture acco

Expenditure application A/c

ii. Call made consequent upon allotment of debentures at discount and

Debenture allotment A/c Dr.
 Discount/loss on issue of debenture A/c Dr.¹
 To .% Debenture A/c
 To Debenture redemption premium A/c

c) For receipt of call made on allotment

Bank A/c Dr.
 To Debenture allotment A/c

Illustration 5

Digitech Ltd. issued 150 9% debentures of ₹100 each at a discount of 6%, redeemable at a premium of 5% after 3 years payable as: ₹50 on application and ₹44 on allotment. Give journal entries.

Date	Particulars	L.F	Debit Amount (₹)	Credit Amount (₹)
	Bank A/c Dr. To Debenture application A/c (Debenture application money received)		7,500	7,500
	Debenture Application A/c Dr. To 9% Debenture A/c (Application money transferred to 9% debentures account consequent upon allotment)		7,500	7,500
	Debenture allotment A/c Dr Loss on issue of Debentures A/c Dr To 9% Debenture A/c To Debentures redemption premium A/c (Call made consequent upon allotment of debenture issued at discount and redeemable at premium)		6,600 1,650	7,500 750
	Bank A/c Dr To Debenture Allotment A/c (Call made consequent upon allotment money received)		6,600	6,600

Calculations:

Loss on issue of debentures = (Amount of discount on issue + Premium payable on redemption) x No: of debentures

2 Amount equal to the discount on issue of debenture plus premium on redemption of debenture.

$$\begin{aligned}
 &= (6\% \text{ of } ₹100 + 5\% \text{ of } ₹100) \times 150 \\
 &= (₹6 + ₹5) \times 150 \\
 &= 1650
 \end{aligned}$$

2.2.2.6 Debentures issued at premium and redeemable at premium

In this situation, the issue price of the debentures is higher than their par value, and the redemption value is also above par value. The premium received when the debentures are issued is credited to the Securities Premium Account, while the premium paid at the time of redemption is recorded as a loss at the time of the issuance of the debentures. For example, consider a 10% debenture with a par value of ₹1,000 that is issued at a premium of ₹100 and is redeemable at a premium of ₹50 per debenture. In this case, ₹100 would be credited to the Securities Premium Account, and ₹50 would be noted as the loss to be accounted for at the time of issuance. It is important to mention that the premium on debentures is also credited by ₹50.

(a) For the receipt of application money

Bank A/c	Dr.
To Debenture application A/c	

(b) At the time of making allotment

a. Transfer of application money to debenture account

Debenture application A/c	Dr.
To ...% Debentures A/c	

b. Call made consequent upon allotment of debenture at premium and redeemable at premium

Bank A/c	Dr.
----------	-----

Loss on issue of Debentures A/c	Dr.
---------------------------------	-----

To Securities premium A/c	Dr.
---------------------------	-----

To Premium on redemption of debentures A/c	Dr.
--	-----

The debenture application a/c and debenture allotment a/c are closed after the allotment of debentures.

2.2.2.7 Debenture payable in instalments

Just like shares, money payable on debentures may be paid in full with application or by instalments. Accounting entries will vary to some extent in either case

Debenture payable in full on application

When the total amount due on debentures is payable in full at the time of application, it is common practice to open a separate Debentures Application Account for each class of debentures, such as a 10% Debentures Application Account or a 12% Debentures Application Account. These accounts track the funds received from applicants for the

Illustration 6

Naturals Ltd. issued 10, 000 12% debentures of ₹10 each at par payable in full on application by 1st April. Applications were received for 11, 000 debentures. Debentures were allotted on 7th April. Excess money was refunded on the same date. Give journal entries.

Date	Particulars	L.F	Debit Amount (₹)	Credit Amount (₹)
April 1	Bank A/c Dr. To Debenture application A/c (Debenture application money received)		11,0000	11,0000
April 7	Debentures Application A/c Dr. To Bank A/c (Money on 10, 000 debentures refunded as per Board's Resolution)		10, 000	10,000
April 7	Debenture application A/c Dr. To Debenture A/c (Being the allotment of 1, 00, 000 debentures of 100 each at par, as per Board's Resolution)		1,00, 000	1,00,000

Debenture issued at a premium: A company issues debentures at a premium when the market interest rate is lower than the interest rate on the debentures. When debentures are issued at a premium, they are sold at a price higher than their nominal value. For instance, if a debenture with a nominal value of ₹100 is issued at a 10% premium, the company will receive ₹110. Investors, however, will receive slightly less interest than the stated rate due to the premium.

Section 52(2) of the companies Act 2013 deals with the use of the amount received as premium on securities: The amount received as premium on securities is restricted to the following purposes only

- Issuing fully paid bonus shares to the existing shareholders;
- Writing off any preliminary expenses of the company;
- To write off any expenses or commission paid or discount allowed on any issue of securities or debentures of the company;
- To provide for the premium payable on the redemption of any redeemable preference shares or any debentures of the company;
- For use of buy back of shares

For example, on a 12% debenture with a nominal value of ₹100 issued at a 10%

premium, the investor will earn ₹12 per annum on their investment of ₹110. As a result, the effective rate of interest on the investment is calculated as follows: $(12/110) \times 100 = 10.91\%$. The accounting treatment for such situations is outlined below:

a) When cash is received

Bank A/c	Dr.
	To Debenture application A/c

(Being money received on ... debentures @ ₹... each including a premium of ₹....)

b) When excess money is refunded

Debentures application A/c	Dr.
	To % Bank A/c

(Being refund on money on ... debentures @ ₹... each as per Board's Resolution No... Dated.)

c) When the debentures are allotted

Debentures application A/c	Dr.
	To ..% Debentures A/c
	To Securities premium A/c

(Being the allotment of ... debentures, premium as per Board's Resolution No... dated...)

Debentures issued at a discount: The Companies Act allows debentures to be issued at any price, including at a discount, which is common. For example, a ₹100 debenture at a 10% discount is issued for ₹90. This raises the effective interest rate; for 125 debentures of ₹100 issued at a 10% discount, the company pays ₹12 interest on ₹90, resulting in a true interest of 13.33%. Debentures are typically issued at a discount when market interest rates exceed the debenture rate. The nominal value is credited to the debenture account, and the discount is recorded separately, amortized over 3-5 years without exceeding the debenture tenure. Discount on issue of debentures to be written off within 12 months of the balance sheet date or the period of operating cycle is shown under 'Other Current Assets' and the part which is to be written off after 12 months is shown under 'Other Non-current Assets'

The companies Act 2013 does not impose any restrictions upon the issue of debentures at a discount.

Illustration 7

a) When cash is received

Bank A/c	Dr. (Actual cash received)
----------	----------------------------

To Debentures Application A/c

(Being money received on ... debentures @ ₹... each)

b) When excess money is refunded

(Being excess money on ... debentures refunded as per Board's Resolution No... dated ...)

c) When the debentures are allotted

Debentures application A/c Dr.(Actual cash received)

Discount on issue of debentures A/c Dr.(Discount on debentures)

To Debentures A/c (Nominal value of debentures)

(Being the allotment of Debentures of ₹ ... each @ ₹... each as per Board's Resolution No... dated ...)

Illustration 8

XYZ Ltd issued 10,000 9% debentures of ₹10 each at a discount of 10% payable in application by 31st July, 2024. Applications were received for 12,000 debentures. Debentures were allotted on 9th August, 2024. Excess money was refunded on the same date. Give journal entries and prepare necessary ledger accounts.

Date 2022	Particulars	L.F	Debit Amount (₹)	Credit Amount (₹)
July 31	Bank A/c Dr. To Debenture application A/c (Debenture application money received)		10,8000	10,8000
August 9	Debentures Application A/c Dr. To Bank A/c (Excess money refunded)		18,000	18,000
August 9	Debenture application A/c Dr. Discount on issue of debentures A/c Dr. To 9% Debenture A/c (Being the allotment of 1, 00, 000 debentures of 100 each at a discount of 10 per debenture as per Board's Resolution)		9,0000 10,000	1,00,000

Bank Account

Date	Particulars	Amount	Date	Particulars	Amount
31.7.2022	To 9% Debentures application A/c	1, 08, 000	9.8.2022	By 12% Debentures Application A/c	18,000
			9.8.2022	By Balance c/d	90,000
		1, 08, 000			1, 08, 000

9% Debentures account

9% Debentures account					
Date	Particulars	Amount	Date	Particulars	Amount
31.7.2022	To Balance c/d	1, 00, 000	9.8.2022	By 9% Debentures Application A/c	90,000
			9.8.2022	By Discount on issue of debentures A/c	10,000
		1, 00, 000			1,00,000

Debentures Application Account

Date	Particulars	Amount	Date	Particulars	Amount
9.8.2022	To Bank A/c	18,000	31.7.2022	By Bank A/c	1,08,000
9.8.2022	To 12% Debentures A/c	90,000			
		1,08,000			1,08,000

Discount on Issue of Debentures Account

Discount on Issue of Debentures Account					
Date	Particulars	Amount	Date	Particulars	Amount
9.8.2022	To 9% Debentures application A/c	10,000	30.7.2022	By Balance c/d	10,000
		10,000			10,000

2.2.3 Debenture issued for consideration other than cash

When debentures are issued to vendors as part of the purchase consideration, this is known as the issue of debentures for consideration other than cash. The journal entries in this case will be:

(i) For purchase of assets

Sundry assets A/c Dr.

To Sundry liabilities A/c

To Vendors A/c

(ii) For issuing debentures for payment of purchase consideration

2.2.4 Debentures Issued as Collateral Security

When debentures are issued as subsidiary or secondary security in addition to the primary security for a loan or bank overdraft, this type of debenture is known as collateral security. The main objective of issuing collateral security is to provide the bank with additional protection. If the company fails to repay the loan and the main security is insufficient, the bank has the right to sell the debentures in the market or keep them for its own purposes. If the company successfully repays the loan, the bank will return the debentures issued as collateral security to the company.

Debentures issued as collateral security can be managed in two ways:

- (i) **First Method:** When debentures are issued as collateral security, no entry in the company's books is required. Debentures only come to life when a debt is not paid back. It is disclosed under the head Secured loans in the Equity and Liabilities part of the Balance Sheet.
- (ii) **Second Method:** Following Journal Entry can be passed for the issue of debentures as collateral security:

Debenture Suspense Account

To Debentures Account

At the time when loan is paid to the lender, this entry will be reversed to cancel or nullify the effect of entry already passed. In Balance sheet, such debentures are disclosed separately from the other debentures.

Illustration 9

AB Ltd borrowed rupee 30,00,000 from a bank at an annual interest rate of 12% and deposited 14% debentures of the face value of 45,00,000 as collateral security. Pass the journal entries regarding the issue of debentures as collateral security and also show the above items in the company's Balance sheet

In the Book of AB Ltd.

JOURNAL

Debenture Suspense A/c Dr	45,00,000	
To Debentures A/c		45,00,000
(14% Debenture issued to the Bank as collateral security)		

BALANCE SHEET OF AB LTD

Particulars	Notes No.	Amount	Amount
Equity and Liabilities			
1. Non-Current liabilities			
Long term borrowings	1	30,00,000	
Total		30,00,000	
Assets			
2. Non- Current assets			
Other non-current assets			
3. Current assets			
Cash and cash equivalent		30,00,000	
Total		30,00,000	
Notes to accounts		Amount	Amount
1. Long term Borrowings			
Secured loan			30,00,000
AB Ltd loan			
14% Debentures		45,00,000	
Debenture suspense Account			
(Issue of 14% debentures)		45,00,000	

Note: "Loss on Issue of Debentures" and "Discount on Issue of Debentures" are capital losses that will appear on the Balance Sheet as intangible assets. These accounts will be written down against the Profit and Loss Account or the Security Premium Account, whichever comes first.

The terms "premium on debenture account" and "premium on redemption of debenture account" are not interchangeable. When debentures are issued at a premium, the Premium on Debentures Account is raised, whereas the Premium on Redemption of Debentures Account is only raised if the debentures are to be redeemed at a premium. The former reflects a capital profit and is recorded under the heading Reserves and Surplus, while the latter represents a liability provision to be paid at the time of the transaction

Recap

- ◊ A debt can be issued for cash or other than cash.
- ◊ Acting as collateral security
- ◊ Issue debentures at a par, at a premium or at a discount.
- ◊ Sometimes debenture application money exceeds par value
- ◊ Capital losses include loss on debenture issuance and discount on debenture issuance

Objective Questions

1. When debenture is issued at discount how is the difference between issue price & parvalue treated ?
2. Where does issue price exceeds the nominal value of debentures?
3. What liability does Debentures Dedemption Account 'Present'?
4. What do you call a debenture when it is issued as security against loan or Bank DD?
5. On the issue of debentures as a collateral security, which account is credited?
6. Which account is credited with the issue of debentures as a collateral security?
7. When debentures are to be redeemed at a premium, an extra has to be paid at the time of issue of the debentures. Which account should be credited in this entry?

Answers

1. Treated as loss on issue of debentures
2. Debentures issued at premium
3. Premium payable on redemption

4. Callateral security
5. Debenture Account
6. Debentures Suspense Account
7. Debenture Redemption premium Account

Self-Assessment Questions

- ◊ What is the nature of the premium on redemption of a debenture account?
Ans: Personal Account
- ◊ Lotus Ltd. issued 1, 50, 000 8% debentures of ₹150 each at a premium of 5% payable fully on application and redeemable at premium of ₹10. Give necessary journal entries at the time of issue of debentures.
- ◊ Herbal Chemicals Ltd. issued 10, 00, 000, 10% debentures of ₹50 each at a premium of 10% as ₹25 on application and balance on allotment. Debentures are redeemable at par after 6 years. All the money due on allotment was called up and received. Give journal entries when premium money is included with allotment money
- ◊ Vignesh Ltd issued 60, 000 10% debentures of ₹100 each at a premium of 10% payable in full on application by 1st March, 2024. The issue was fully subscribed and debentures were allotted on 9th March 2024. Give journal entries including cash transactions.

Assignments

1. Explain the different modes of issuing debentures.
2. On 1st May 2024 Ivory Ltd issued 10, 000 12% debentures of ₹10 each at a discount of 5% redeemable on 30th June 2029. Issue was oversubscribed by 2, 000 debentures and the money was refunded. Interest is paid annually on 31st March. You are required to prepare:
 - a. Journal entries at the time of issue of debentures.
 - b. Discount on issue of debenture account
 - c. Interest account and debenture holder account.

Suggested Reading

1. Brealey, R. A., Myers, S. C., Allen, F., & Mohanty, P. (2020). *Principles of corporate finance* (12th ed.). McGraw-Hill Education.
2. Kieso, D. E., Weygandt, J. J., & Warfield, T. D. (2022). *Intermediate accounting* (18th ed.). Wiley.
3. Khan, M. Y., & Jain, P. K. (2018). *Financial management: Text, problems, and cases* (8th ed.). McGraw-Hill.
4. Mukherjee, A., & Hanif, M. (2019). *Corporate accounting* (3rd ed.). McGraw-Hill Education.
5. Pandey, I. M. (2021). *Financial management* (12th ed.). Pearson Education.
6. Ross, S. A., Westerfield, R. W., Jaffe, J., & Jordan, B. D. (2019). *Corporate finance* (12th ed.). McGraw-Hill Education.
7. Tulsian, P. C. (2020). *Financial accounting* (2nd ed.). Pearson Education.

Reference

- ◊ ICAI. (2021). *Accounting standards and guidelines on issue of debentures*. Institute of Chartered Accountants of India.
- ◊ SEBI. (2021). *Regulations for corporate debenture issuance in India*. Securities and Exchange Board of India. Retrieved from <https://www.sebi.gov.in>
- ◊ Sharma, R. (2020). *Practical approach to journal entries in financial accounting*. Taxmann Publications.
- ◊ Gupta, R. L., & Radhaswamy, M. (2019). *Advanced accountancy* (Vol. 1). Sultan Chand & Sons.

Unit

Redemption of Debentures

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ get an overview of the debenture redemption process.
- ◊ identify the requirements for establishing a Debenture Redemption Reserve and Debenture Redemption Fund.
- ◊ gain knowledge about the various debenture redemption methods;
- ◊ recognize the debenture redemption accounting treatment;
- ◊ solve problems regarding debenture redemption.

Prerequisites

We have discussed the issue of Debentures in the previous units. Debentures are said to be issued at par when a shareholder is required to pay the face value of debentures to the company. For example, in ABC company, when debentures of rupees 10 are issued at rupees 10, these are said to be issued at face value. When shares are said to be issued at a premium, it means the shareholder is required to pay more than the face value to the company. In this unit we are going to discuss the term redemption, the method of redemption, and the accounting treatment related to the redemption of debentures. Debentures are usually redeemable, but a company may also issue irredeemable debentures. Redeemable debentures may be redeemed after a fixed number of years or at any time after a certain number of years has elapsed since their issue. A Company may also purchase its debenture in the open Market and when debentures are quoted at a Discount on the stock Exchange.

Keywords

Redemption of a Debentures, Sources of redemption of Debentures, Methods of redeeming Debentures, Own Debentures, Interest on Own Debentures, DRR, Interest on Debenture, Discount on Debentures

Discussion

2.3.1 Redemption of Debentures

Meaning:

"Redemption" is derived from the Latin word "redimere." This term is made up of two words: 're(d)' and 'emere.' 'Re (d)' indicates "back, " while "emere" signifies "purchase." The act of purchasing something that was previously sold is hence the critical meaning of redemption. The phrase "redemption" in accounting refers to the repayment of a debt or security's principal amount at or before maturity. Thus, redemption of debentures simply means repayment of debentures. It is the discharging of the liability on account of debentures. They may be redeemed at par or at premium.

Under section 71 (1) of the Companies Act, 2013, a company may issue debentures with option to convert such debentures into shares, either wholly or partly at the time of redemption.

Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, should be approved by a special resolution passed at a duly convened general meeting.

Section 71 (2) further provides that no company can issue any debentures which carry any voting rights.

Section 71 (4) provides that where debentures are issued by a company, the company should create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account should not be utilised by the company for any purpose other than the redemption of debentures.

2.3.1.1 Basic Provisions

If a charge has been placed on any asset or the entire company's assets, the nature of the charge, the asset (s) charged are described therein because the charge isn't legal unless it's registered with the registrar, the registrar's certificate is printed on the bond. When it comes to mortgage debentures, it's also common to set up a trusteeship in the name of one or more people. The trustees of debenture holders have all of the powers of a mortgagee and can act in any way they see fit to protect the debenture holders' interests.

As per the rule 18(2) of the Companies (Share capital & Debentures) Rule, 2014, the company shall appoint debenture trustees as required under sub-section (5) of section 71 of the Companies Act 2013, after complying with certain conditions mentioned in the rule.

2.3.1.2 Situations for Redemption of Debentures

Debentures are usually redeemable in cash or equity after a time period. Redeemable debentures may be redeemed during the lifetime of the issuing company. A company may also purchase its debentures, as and when convenient, in the open market and when debentures are quoted at a discount on the Stock Exchange, it may be profitable for the company to purchase and cancel them.

2.3.1.3 Sources of Redemption of Debentures

When a company issues Debentures it usually mentions the terms on which they will be redeemed on their maturity. Redemption of debentures means discharge of liability on account of debentures by repayment made to debenture holders. Debentures can be redeemed either at par or at a premium.

1. Out of fresh issue of shares/ debentures
2. By utilisation of a part of capital
3. By utilisation of accumulated profits
4. By conversion into shares/ debentures
5. Out of proceeds from sales of fixed assets
6. By purchase of own debentures

2.3.2 Methods of Redeeming Debentures

As we know, debentures are debt instruments, hence when their period expires, the debenture holders are paid back their principal amount. This process of discharging the company's debt is known as the redemption of debentures. Redemption of debentures must be done according to the terms of issue of debentures and any deviation therefrom will be treated as a default by the company. There are four ways by which the debentures can be redeemed:

2.3.2.1 Redemption of Debentures by Lump-sum Method

Under this method, the entire number of debentures is redeemed after the expiry as per the terms of the issue. In other words, the entire amount of the debenture is paid in one lump-sum to the debenture holders, as per the conditions of the issue, at the end of the life of the debenture.

2.3.2.2 Redemption by payment in instalments

Under payment in instalments method, normally redemption of debentures is made in instalments on the specified date during the tenure of the debentures. The total amount of debenture liability is divided by the number of years. It is to note that the actual debentures redeemable are identified by means of drawing the requisite number of lots out of debentures outstanding for Payment.

2.3.2.3 Purchase in open market

When a company purchases its own debentures for the purposes of cancellations, such an act of purchasing and cancelling the debentures constitutes redemption of debentures by purchase in the open market.

2.3.2.4 Conversion into shares or new debentures

If the company issues fully or partly convertible debentures that company can redeem its debentures by converting them into shares as per the terms of issue. In some cases, companies may issue new class of debentures or convert debentures into shares in consultation with debenture holders eligible for redemption. If the debenture holders find that the offer is beneficial to them, they may accept the offer and exercise their right of converting their debentures into shares or new class of debentures.

Debenture Redemption Reserve Account

When a company issues debentures, it may be required to establish a Debenture Redemption Reserve account using profits available for dividend distribution. The funds credited to this account can only be used for the purpose of redeeming debentures. This arrangement ensures that the company will have sufficient liquid assets available for the redemption of debentures when they come due. Each year, an appropriate amount is transferred from profits to the Debenture Redemption Reserve, and the investments made from this reserve are referred to as Debenture Redemption Reserve Investments (or Debenture Redemption Fund). In the final year or at the time of debenture redemption, the Debenture Redemption Reserve investments are liquidated, and the proceeds are used for the redemption of the debentures. The journal entries for redeeming debentures using profits are as follows:

1. After allotment of debentures

a) For setting aside the fixed amount of profit for redemption

Surplus/profit and loss Account Dr.

To Debenture redemption reserve A/c

b) For investing the amount set aside for redemption

Debenture Redemption Investment A\c Dr

To Bank A/c

c) For receipt of interest on debenture redemption reserve investments
Bank A/c Dr.

To Interest on debenture redemption investment A/c

d) **For transfer of interest on debenture redemption investments (DRRI)**

Interest on debenture redemption reserve investment A/c Dr.

To Profit and loss A/c

2. At the time of redemption of debentures

a) **For encashment of debenture redemption reserve investments**

Bank A/c Dr.

To Debenture Redemption Reserve investment, A/c

b) **For Amount due to debenture holders on redemption**

Debentures A/c Dr.

To Debenture holder's A/c

c) **For Payment to debenture holders**

Debentures holder's A/c Dr.

To Bank A/c

d) **After redemption of debentures, DRR should be transferred to general reserve**

DRR A/c Dr.

To General Reserve

Illustration 1

The following balance appeared in the books of a company as on December 31, 2023.

6% Mortgage 10, 000 debenture of ₹100 each.

Debenture redemption reserve (for redemption of debentures ₹50, 000

Investments in deposits with a scheduled bank, free from any charge or lien ₹1, 50, 000 at interest 4% per annum receivable on 31st December every year.

Bank balance with the company is ₹9, 00, 000

The interest on debentures had been paid up to December 31 2023.

On February 28, 2024 the investments were realised at par and the debentures were paid off at 101, together with accrued interest. Prepare the necessary ledger accounts.

6% Mortgage debentures account

2024	Particular	Amount	2024	Particulars	Amount
Feb.28	To Debenture holder's A/c	10,00,000	Jan.1	By Balance c/d	10,00,000

Premium on redemption of debentures account

2024	Particular	Amount	2024	Particulars	Amount
Feb.28	To Debenture holder's A/c	10,000	Feb.28	By Profit and loss, A/c	10,000

Debentures redemption reserve investment account

2024	Particular	Amount	2024	Particulars	Amount
Jan.1	To Balance c/d	1, 50, 000	Feb.28	By Bank	1, 50, 000

Debenture interest account

2024	Particular	Amount	2024	Particulars	Amount
Feb.28	To Bank (10, 000 x 100 x 6% x 2/12)	10, 000	Feb.28	By Profit and Loss, A/c	10, 000

Bank A/c

2024	Particular	Amount	2024	Particulars	Amount
Jan.21	To Balance c/d	9, 00, 000	Feb.28	By Debenture holders (10, 000 x 101)	10,10,000
Feb 28	To Interest on debentures redemption investments (1, 50, 000 x 4% x 2/12)	1000			
	To Debentures redemption reserve investment, A/c	1, 50, 000		By Debenture Interest A/c	10, 000
		10, 51, 000		By Balance c/d	31,000
					10,51,000

Debenture redemption reserve account

2024	Particular	Amount	2024	Particulars	Amount
Feb.28	To General reserve note	1, 00, 000	Jan.1	By Balance b/d	50,000
		1, 00, 000	Jan.1	By Profit & Loss b/f	50, 000
					1, 00, 000

Recap

- ◊ **Redemption of Debentures** – Paying back the debenture holders their principal amount on maturity or before.
- ◊ **Sources of Redemption of Debentures** – Funds used to repay debentures, including **profits, fresh issue of shares/debentures, sinking fund, or Debenture Redemption Reserve (DRR)**.
- ◊ **Methods of Redeeming Debentures** – Different ways to repay debentures, such as **lump-sum payment, installment method, purchase from the market, conversion into shares, and sinking fund method**.
- ◊ **Own Debentures** – Debentures purchased back by the company from the open market, either for cancellation or investment purposes.
- ◊ **Interest on Own Debentures** – When a company holds its **own debentures, any interest paid is an internal transfer and is not an expense** for the company.
- ◊ **Debenture Redemption Reserve (DRR)** – A **statutory reserve** created by companies to ensure funds are available for debenture repayment.
- ◊ **Interest on Debenture** – The **fixed return** paid to debenture holders as compensation for lending money to the company.
- ◊ **Discount on Debentures** – When debentures are **issued at a price lower than their face value**, the difference is considered a **loss for the company** and is gradually written off.

Objective Questions

1. A debenture that is redeemable (payable) at a fixed and specified period of time is called
2. At the time of liquidation, who will get the first priority at the time of repayment?
3. From where is interest paid on debentures charged?
4. When debentures are issued at par and are redeemable at a premium, the loss on such an issue is debited to which account?
5. The excess value of net assets over purchase consideration at the time of the purchase of a business is credited to which account?
6. In which account is the balance of the redemption fund account transferred?
7. Why does a company purchase its own debentures on the open market?

Answers

1. Maturity period
2. Debenture holder
3. Charge for profit
4. Loss on issue of debentures to account
5. Capital Reserve
6. General Reserve
7. For cancellation or investment.

Self-Assessment Questions

- ◊ Explain what is meant by redemption of debentures
- ◊ Write a short note on debenture redemption reserve.
- ◊ DK Ltd issued ₹4, 00, 000, 10% debentures on 1.04.2020. on 31.3.21, the company decided to redeem ₹40, 000, debentures. Give journal entries for the redemption of debentures.
- ◊ X Ltd. decided to redeem ₹50, 000, debentures at a premium of 10%. Give journal entries for redemption of the debentures.

Assignments

1. Explain the process of redemption of debentures and the modes of redeeming debentures.

Suggested Reading

1. **Batra, G. S. (2021).** *Handbook of corporate finance and debenture management.* New Age International Publishers
2. **Damodaran, A. (2016).** *Investment valuation: Tools and techniques for determining the value of any asset* (3rd ed.). Wiley.

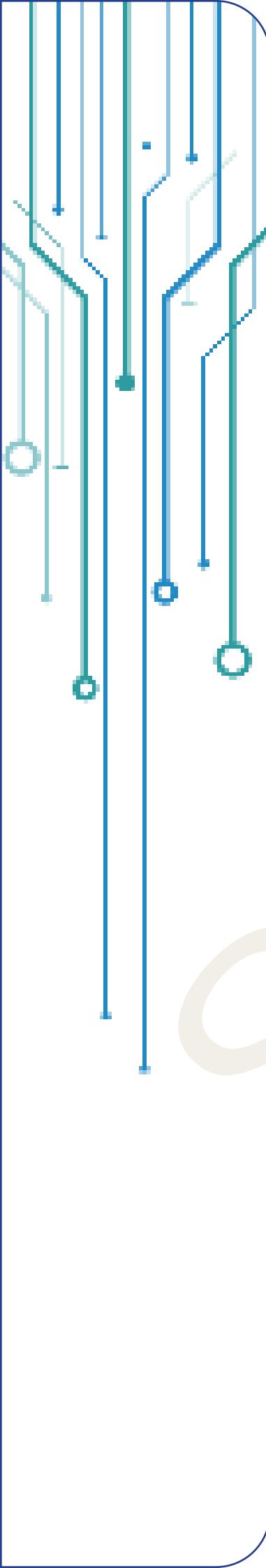
3. **Reserve Bank of India (RBI). (2021).** *Guidelines on debenture redemption for financial institutions.* Retrieved from <https://www.rbi.org.in>

Reference

- ◊ ICAI. (2022). *Guidance note on accounting for debenture redemption reserve and debenture redemption investment.* Institute of Chartered Accountants of India.
- ◊ Khan, M. Y., & Jain, P. K. (2018). *Financial management: Text, problems, and cases* (8th ed.). McGraw-Hill.
- ◊ **SEBI. (2022).** *Regulatory framework for corporate debenture redemption in India.* Securities and Exchange Board of India. Retrieved from <https://www.sebi.gov.in>
- ◊ **Gupta, R. L., & Radhaswamy, M. (2019).** *Advanced accountancy* (Vol. 1). Sultan Chand & Sons.

3
BLOCK

FINAL ACCOUNTS OF COMPANIES



Unit 1

Final Accounts

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ get an overview of the concept of a company
- ◊ explain the different types of companies
- ◊ familiarise with the statutory records to be maintained by companies

Prerequisites

One of the key challenges faced by sole proprietorships and partnerships is the limitation in accessing adequate funds, coupled with the burden of unlimited liability. As businesses expand and require substantial capital, these traditional forms of organisation often fall short.

To address these limitations, the company form of organisation emerged as a more suitable structure, offering advantages like limited liability and easier access to larger pools of capital.

This section provides a foundational understanding of companies, exploring their definition, various types, and the essential statutory records that companies must maintain. This foundational knowledge is essential for understanding the preparation and presentation of the final accounts of companies.

Keywords

Company, Types, Final Accounts, Statutory Books

Discussion

3.1.1 Meaning & Definition of a Company

A Company is a voluntary and autonomous association of persons with capital divided into numerous transferable shares formed to carry out a particular purpose in common. It is an artificial person created by law to achieve the object for which it is formed. Section 2(20) of the Companies Act, 2013 “company” means a company incorporated under this Act or any previous Company law. Commonly a company may be defined as “A registered association which is an artificial legal person, having an independent legal entity with perpetual succession, a common seal for its signatures a common capital comprised of transferable shares and carrying limited liability”. An existing company means a company formed and registered under any of the former Companies Acts.

A company is an artificial person, invisible, intangible and existing only in the contemplation of law. It can hold, purchase or sell both movable and immovable property, incur and pay debts, open a bank account in its own name and sue and be sued in the same manner as an individual. Law creates it and law only can dissolve it. Its existence is altogether independent of the life of its members. Members may come and go but the company would go on forever. Transferability of shares has given perpetual succession to a company. Death, insanity or insolvency of a member or any member will not affect the existence of the company at all.

A company is a legal entity quite distinct and separate from the persons who are its members. A company can buy its own shares under certain conditions. A shareholder is not the agent of the company. He cannot incur any debt so as to bind the company. Shareholders cannot bind the company by their acts. The same person can be a shareholder and a creditor of the company. The ownership is separated from management because a joint stock company is managed by a Board of Directors elected by the shareholders (i.e. Owners).

The never-ending human desire to grow and grow further has given rise to the expansion of business activities, which in turn has necessitated the need to increase the scale of operations so as to provide goods and services to the ever-increasing needs of the growing population of consumers. Large amount of money, modern technology, large human contribution etc. is required for it, which is not possible to arrange under partnership or proprietorship. To overcome this difficulty, the concept of ‘Company’ or ‘Corporation’ came into existence. As a form of organisation, the word ‘company’ implies a group of people who voluntarily agree to form a company.

The word ‘company’ is derived from the Latin word ‘com’ i.e. with or together and ‘panis’ i.e. bread. Originally the word referred to an association of persons or merchant men discussing matters and taking food together.

According to Prof. L .H Harey: "A company is an artificial person created by law, having separate entity, with a perpetual succession and common seal".

3.1.2 Characteristics of a Joint Stock Company

We have seen many definitions of a company, from the above definitions following are the characteristics of a joint stock company

1) Artificial person

A joint stock company is an artificial person as it does not possess any physical attributes of a natural person and it is created by law.

2) Separate legal entity

Being an artificial person, a company has its own legal entity separate from its members. It can own assets or property, enter into valid contracts, sue or can be sued by anyone in the court of law. Its shareholders cannot be held liable for any conduct of the company.

3) Perpetual existence

A company continues to exist as long as it is fulfilling all the conditions prescribed by the law. The death, insolvency, insanity or retirement of a shareholder won't affect the existence of a company.

4) Limited liability

Shareholders of a joint stock company are only liable to the extent of face value of shares they hold in a company and not more than that. The liability of shareholders is limited to the extent of amount guaranteed or face value of shares.

5) Common seal

Being an artificial person a joint stock company cannot sign any documents, thus this common seal is company's signature (representative) while dealing with outsiders. Any document having common seal and the signature of authorised signatory is binding on the company.

6) Transferability of shares

Members of a company can freely transfer their shares through authorised stock exchange, or as per the guidelines of SEBI.

7) Capital

A joint stock company can raise huge amount of capital by issuing shares.

8) Management

A joint stock company is managed by the elected representatives of shareholders.

called Directors. It has a democratic management.

9) Membership

To form a private limited company minimum number of members prescribed in the Companies Act is 2 and the maximum number is 200, whereas in the case of public company, the minimum number of members is 7 and there is no limit to the maximum number.

3.1.3 Classification of Companies

Entrepreneurs can incorporate different types of companies under the Companies Act, 2013 ('Act') in India to conduct their business and provide a legal structure for the business .

The different types of companies are as follows.

On the basis of Incorporation : There are two ways in which companies may be incorporated, which are as follows:

- Statutory Companies: A company formed by passing a Special Act in the Parliament is called a Statutory Company or Statutory Corporation.
- Registered Companies: Those companies which are incorporated under the Companies Act, 2013 or under any previous company law.

Chartered companies were formed by Royal charters. The powers and the nature of businesses of a chartered company are defined by the charter which incorporates. After India got independence-chartered companies do not exist in India E.g. Bank of England (1694), East India company (1600)

On the basis of Liability: Under this category there are three types of companies:

- Company Limited by Shares: As per Companies Act 2013 Section 2(22)A Company limited by shares may be defined as a "registered company" whether public or private company, having the liability of its members limited by its shares, if any, unpaid on the shares respectively held by them. In other words, a member of a company limited by shares is required to pay only the nominal amount of shares held by him and nothing more. If the shares are fully paid-up, he has nothing more to pay.
- Company Limited by Guarantee: A Company Limited by Guarantee is a registered company having the liability of its members limited by its Memorandum to such an amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up.
- An Unlimited Liability Company: As per Section 2(92) of the Companies Act 2013, an Unlimited Company is a company not having any limit on the liability of its members. Thus, the maximum liability of the members of such a company in the event of its being wound up, might stretch up to the full extent of their

properties to meet the obligations of the company by contributing to its assets. However the member of an unlimited company are not liable directly to the creditors of the company in the case of partners of a firm.

On the basis of Ownership : Under this category there are three types of companies:

Private Company[Section2(68)]-A Private Company is a type of company that operates with certain restrictions to maintain greater control among a smaller group of shareholders. According to Section 2(68) of the Companies Act, 2013, a private company limits its number of shareholders to 200 and restricts the transfer of its shares. Additionally, it is prohibited from inviting the public to subscribe to its securities, meaning it cannot raise funds by offering shares or debentures to the general public. The company must have at least two members and two directors, and it is required to include "Private Limited" at the end of its name.

Public Company- is a company that does not have the restrictions imposed on private companies. It can have an unlimited number of shareholders and is allowed to invite the public to subscribe to its shares and other securities. Public companies are typically larger and more transparent in their operations, often listed on stock exchanges, allowing public investors to buy and sell shares. To be formed, a public company requires a minimum of seven members who must subscribe their names to a memorandum and fulfill the necessary registration requirements.

One Person Company (OPC) – Section 2(62) of the Companies Act 2013 defines a “one person company” as a company that has only one person as its member. It is a new class of company which can be incorporated by a single person. Furthermore, members of a company are nothing but subscribers to its or its shareholders. Entrepreneurs whose business lie in early stages prefer to create OPCs instead of sole proprietorship business because of the several advantages that OPC offers.

Other forms of Companies- Apart from the above mentioned, there are some other forms of companies such as:

- a. Associations not for profit having license under Section 8 of the Companies Act, 2013 or under any previous company law;
- b. Government Companies; Section2(45)
- c. Foreign Companies; Section 2(42)
- d. Holding and Subsidiary Companies; Section 2(46)
- e. Associate Companies/Joint Venture Companies Section 2(6)
- f. Investment Companies (Section 186)
- g. Producer Companies (Section378 A and B)
- h. Dormant Companies (Section 455)
- i. Nidhi Companies (Section 406)
- j. Non-Banking financial companies (NBFC)

3.1.3 Statutory Records

It is a requirement of the Companies Act 2013 that all companies maintain up-to-date statutory registers that can be maintained in electronic format also. Certain guidelines under the Companies Act are required to be followed for the maintenance of the registers and records in electronic format.

List of Statutory Registers

- Register of renewed and duplicate share certificates- As per Share Capital and Debentures Rules, 2014.
- Register of Sweat Equity Shares- As per Share Capital and Debentures Rule, 2014.
- Register of Charges and Instrument of charges- As per Companies (Registration of Charges) Rule, 2014.
- Register of bought back Securities- As per share capital and Debentures Rules, 2014.
- Register of deposits- As per Companies (Acceptance of deposits) Rules, 2014.
- Register of members- As per Rules of the Companies (Management and Administration) Rules, 2014
- Register of any other security holders.
- Register of Debenture-holders
- Index of members-As per Companies management and administration) Rules, 2014.
- Copies of Annual Returns-As per Companies (Management and Administration) Rules, 2014.
- Minutes Book of Board of Directors and Committees of the Board- As per Companies (Management and Administration) Rules, 2014.
- Attendance Registers for the meeting of Board and committee-As per Secretarial Standards-SS-1
- Minutes of General Meetings and Creditors meeting-As per Companies (Management and Administration) Rules, 2014.
- Register of directors and key managerial personnel including details of securities held by them – As per Companies Rules, 2014.
- Register of loans/guarantee/security and investments
- Register of investment in shares or securities not held in the name of the company.

- Register Contracts, with Directors, Companies, and Firms in which Directors are interested.
- Contracts entered into by the company for the appointment of a Manager or Managing Director

Company is thus, a distinct legal entity created by law to achieve specific purposes, characterized by its ability to own property, incur debts, and perpetuate its existence independent of its members.

Recap

- ◊ Company- voluntary and autonomous association persons.
- ◊ Capital of a company- divided into numerous transferable shares.
- ◊ Chartered Company- Company created by the grant of a charter by the Crown.
- ◊ Statutory Companies-Company formed by passing a Special Act in the Parliament.
- ◊ Registered Companies-Incorporated under the Companies Act, 2013 or under any previous company law.
- ◊ Company Limited by Shares- Liability of its members limited by its shares.
- ◊ Company Limited by Guarantee- Liability of its members limited by the amount agreed by the members to be contributed at the time of winding up.
- ◊ Unlimited liability Company-Company not having any limit on the liability of its members.
- ◊ Statutory Records- Requirement of the Companies Act 2013 that all companies maintain up-to-date statutory registers that can be maintained in electronic format also.

Objective Questions

1. What is the legal definition of a company according to Section 2(20) of the Companies Act, 2013?
2. What kind of person is a company in the eyes of the law?
3. What characteristic of a company ensures its existence continues despite changes in membership?
4. From which Latin words is the term 'company' derived?
5. What type of company is formed by a grant of a charter by the Crown?
6. How many shareholders can a private company have according to Section 2(68) of the Companies Act, 2013?
7. What is the minimum number of members required to form a public company?
8. Who defined a company as "an artificial person created by law with a perpetual succession and a common seal"?
9. Which type of company has its liability limited by the unpaid amount on shares held by its members?
10. What type of company has no limit on the liability of its members?

Answers

1. A company incorporated under the Companies Act, 2013 or under any previous company law
2. An artificial person
3. Perpetual succession.
4. 'Com' meaning 'with' or 'together' and 'panis' meaning 'bread'.
5. Chartered Company.
6. 200
7. 7
8. Prof. L .H. Haney
9. Company limited by shares
10. Unlimited liability company

Self-Assessment Questions

- ◊ Explain the different classifications of companies based on ownership.
- ◊ What are the key distinctions between a Public Company and a Private Company?
- ◊ Define a company as per Section 2(20) of the Companies Act, 2013.
- ◊ What is meant by ‘perpetual succession’ in the context of a company?
- ◊ List the three ways in which companies may be incorporated.
- ◊ What distinguishes a ‘Chartered Company’ from a ‘Statutory Company’?
- ◊ Explain the liability of members in a company limited by shares.
- ◊ What are the key characteristics of a Private Company as per Section 2(68) of the Companies Act, 2013?

Assignments

1. Evaluate the reasons for the emergence of the concept of a company as a business organization. What challenges in other forms of business led to the development of the corporate form?
2. Discuss the importance of the ‘Register of Members’ and ‘Index of Members’ for a company. How do these records contribute to the company’s legal and administrative processes?
3. Illustrate the differences between a company limited by shares and a company limited by guarantee. Provide examples of situations where each type of company might be preferred.
4. Examine the role of a company’s Board of Directors. How is the concept of ‘ownership divorced from management’ implemented in a joint-stock company?

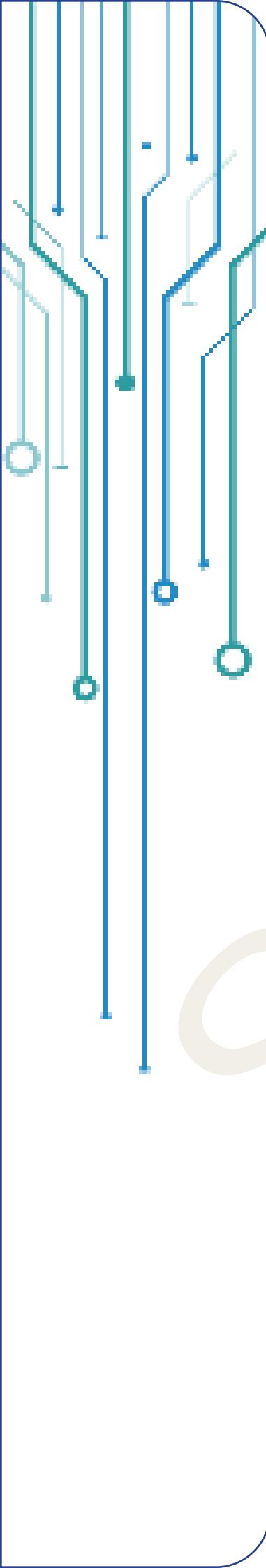
Suggested Reading

1. Chandra, P. (2021). Corporate Financial Management (5th ed.). McGraw-Hill Education.
2. Ghosh, T. P. (2020). Company Law and Practice (2nd ed.). Taxmann Publications.

3. Ramaiya, A. (2023). Guide to the Companies Act (20th ed.). LexisNexis.
4. Sharma, J. P. (2021). An Easy Approach to Corporate Laws (5th ed.). Ane Books Pvt. Ltd.
5. Singh, A. (2021). Company Law: Principles and Practice (4th ed.). Eastern Book Company.

Reference

- ◊ Jain S.P and Narang K.L. (2018). Corporate Accounting, Kalyani Publishers, New Delhi
- ◊ Maheswari S.N. and Maheswari S.K. (2018). Corporate Accounting, Vikas Publishing House, New Delhi
- ◊ Mukherjee A. and Hanif M. (2017). Corporate Accounting, Tata McGraw-Hill Publishing Co.Ltd. New Delhi
- ◊ P C Thulsian. (2014). Advanced Corporate Accounting. S Chand and Company Limited.
- ◊ Shukla M C, Grewal T.S. & Gupta S.C.(2017) Advanced Accounts S.Chand & Co. Ltd., New Delhi
- ◊ RL Gupta & Radhaswamy. (2013). Advanced Accounting. Sultan Chand & Sons



Unit 2

Preparation of Final Accounts

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ identify and categorise assets and liabilities into non-current and current sections
- ◊ develop the ability to prepare a balance sheet using the provided financial data
- ◊ recognize the key components of a Profit and Loss Account, including revenue, expenses, and profit calculation
- ◊ prepare a Profit and Loss Account from the given financial data, including the calculation of profit or loss for a given period

Prerequisites

The preparation and presentation of financial statements are crucial in providing a clear financial picture of a company. Among these, the Balance Sheet and the statement of Profit and Loss are the essential components that offer insights into a company's financial health and operational performance. The Balance Sheet reflects the company's financial position at a specific point in time, detailing its assets, liabilities, and equity. It is structured to show how the company's resources (assets) are financed through debt (liabilities) and shareholders' equity.

The Statement of Profit and Loss provides a summary of the company's revenues, expenses, and profits over a particular accounting period. It reveals how the company generates its revenue and manages its costs, ultimately reflecting the net income or loss for the period. These statements are vital for stakeholders, including investors, creditors, and

management, as they help in assessing the company's profitability, liquidity, and overall financial stability. This unit deals with the preparation of final accounts of a company.

Keywords

Balance sheet, Profit and Loss account, Non-current assets and liabilities, Current assets and liabilities

Discussion

3.2.1 Final Accounts

Final accounts, also called financial statements are organised compilations of financial data, systematically gathered and categorised according to accounting principles, to evaluate an enterprise's financial standing in terms of profitability, operational efficiency, short-term and long-term solvency, and growth potential. They serve as the primary and formal method by which a company's management communicates financial information, along with specific quantitative details, to the public.

These statements are structured representations of an enterprise's financial position, performance, and cash flows, and are relied upon by many users as a key source of financial information. As such, financial statements must be prepared and presented to meet the needs of these users, who generally depend on them for making informed economic decisions. Although certain users may have the ability to request additional information beyond what is presented in the financial statements, this does not diminish the importance of the financial statements for the general user. Financial statements provide crucial information that reflects the results of management's stewardship and accountability for the resources entrusted to them. The main components of a company's consolidated financial statements include Balance Sheet, Statement of Profit and Loss account, Cash flow statement, Statement of changes in equity, and Annexures. The present unit focus only on Balance Sheet and Statement of Profit and Loss.

The following are the key terms to be understood while preparing the final accounts of a company:

- i. **Non-Current Assets:** It includes long-term resources owned by the company that are not expected to be converted into cash within the next year. This includes Property, Plant & Equipment (PPE), Intangible Assets (like goodwill and patents), Investment Property, and Capital Work in Progress.
- ii. **Current Assets:** It includes the short-term assets that are expected to be converted

into cash or consumed within the business cycle, usually one year. Examples include Inventories, Trade Receivables, Cash and Cash Equivalents, and Current Tax Assets.

- iii. Non-Current Liabilities: It includes long-term financial obligations that are not due within the next year, such as Long-term Borrowings, Deferred Tax Liabilities, and Provisions for Contingencies.
- iv. Current Liabilities: It includes the obligations that the company is expected to settle within the business cycle, usually within a year. This includes Short-term Borrowings, Trade Payables, and Current Tax Liabilities.
- v. Share Capital: The amount invested by the shareholders in the company is called the share capital. It is divided into Equity Share Capital (common stock) and Other Share Capital.
- vi. Reserves and Surplus: It includes the accumulated profits that have not been distributed to shareholders as dividends. This may include General Reserves, Capital Reserves, and Retained Earnings.
- vii. Revenue from Operations: It includes the income earned from the core business activities of the company, such as sales of goods and services.
- viii. Other Income: It includes the income earned from non-core business activities, such as interest received, dividends, and rental income.
- ix. Profit Before Tax (PBT): The profit earned by the company before deducting income tax. It is calculated by subtracting total expenses from total revenue.
- x. Profit After Tax (PAT): The profit available after the company has accounted for all taxes.
- xi. Earnings Per Share (EPS): It is a measure of the profitability of a company, calculated as the net profit attributable to equity shareholders divided by the number of equity shares outstanding.

$$EPS = \frac{\text{Profit available to equity share holders}}{\text{No. of equity shares}}$$

- xii. Depreciation and Amortization: Depreciation is the systematic allocation of the cost of a tangible asset over its useful life. Amortization is the systematic allocation of the cost of an intangible asset over its useful life.
- xiii. Provisions-Provisions are liabilities of uncertain timing or amount. Companies must make provisions for anticipated liabilities or losses, such as Provision for Bad Debts or Provision for Depreciation.
- xiv. Contingent Liabilities-Contingent liabilities are potential obligations that may arise depending on the outcome of a future event. These are not recognised in the balance sheet but disclosed in the notes to accounts.

xv. Deferred Tax-Deferred tax refers to a difference between the tax expenses recognised in the financial statements and the amount of tax payable to the tax authorities. This difference arises due to the timing differences between how income and expenses are recognised for accounting purposes and how they are recognised for tax purposes.

NEW FORMAT OF VERTICAL BALANCE SHEET (WITH MAJOR HEADINGS AND SUBHEADINGS) Balance sheet

Name of Company.....

Balance Sheet as at.....

(Rupees in...)

Particulars	Note No	Figures as at end of the current reporting period.	Figures as at end of the previous reporting period
I EQUITY AND LIABILITIES			
(1) Shareholders' funds			
(a) Share capital		xxx	xxx
(b) Reserves and surplus		xxx	xxx
(c) Money received against share warrants		xxx	xxx
(2) Share application money pending allotment		xxx	xxx
(3) Non-current liabilities			
(i) Long term Borrowings		xxx	xxx
(ii) Deferred tax liabilities (Net)		xxx	xxx
(iii) Other long term Liabilities		xxx	xxx
(iv) Long -term provisions		xxx	xxx
(4) Current Liabilities			
(i) Short term Borrowings		xxx	xxx
(ii) Trade payables		xxx	xxx
(iii) Other current liabilities		xxx	xxx
(iv) Short term provisions		xxx	xxx
Total (1+2+3+4)		xxx	xxx
II ASSETS			
(1) Non -current assets			
(a) Fixed assets		xxx	xxx
(i) Tangible assets		xxx	xxx
(ii) Intangible assets		xxx	xxx
(iii) Capital work in progress		xxx	xxx
(b) Non- current investments		xxx	xxx
(c) Deferred tax assets (Net)		xxx	xxx
(d) Long term loans and advances		xxx	xxx

	(e) Other non -current assets	xxx	xxx
(2)	Current assets		
	(a) Current investments	xxx	xxx
	(b) Inventories	xxx	xxx
	(c) Trade receivables	xxx	xxx
	(d) Cash and cash equivalents	xxx	xxx
	(e) Short term loans and advances	xxx	xxx
	(f) Other current assets	xxx	xxx
	Total(1+2)	xxx	xxx

Illustration 3.2.1

From the following information, prepare the balance sheet of ABC Ltd. as on 31 March 2021 as per Schedule III of Companies Act

Particulars	₹
Advances to employees	3,00,000
Cash at Bank	3,14,320
Furniture	7,50,000
Premises	39,09,940
Patents	10,00,000
Discount on issue of shares	25,000
Trade receivables	3,66,240
Advance tax	50,000
8% Govt bonds	3,36,000
Stock in trade	3,55,600
Equity share capital	50,00,000
Capital reserve	60,000
Loan from SBI	8,00,000
Provisions for Employees welfare Fund	6,00,000
Proposed dividend	1,64,000
Short term loan from bank	4,90,200
Unpaid dividend	64,800
Profit and loss A/c	42,980
Bills payable	85,100
Sundry creditors	1,00,020

Solution:

Balance sheet of ABC Ltd as on 31 March 2021

	Particulars	No:	₹
I	EQUITY AND LIABILITIES		
1.	Shareholders' funds		
	(a) Share capital		50,00,000
	(b) Reserves and surplus	1	1,02,980
(2)	Share application money pending allotment		Nil
(3)	Non-current liabilities		
	i Long term Borrowings		8,00,000
	ii Long term provisions		6,00,000
(4)	Current Liabilities		
	i short term Borrowings		4,90,200
	ii Trade payables	2	1,85,120
	iii Other current liabilities		64,800
	iv short term provisions		1,64,000
	TOTAL		74,07,100
II	ASSETS		
1.	Non - Current assts		
	(a) Fixed assts		
	(1) Tangible Assets	3	46,59,940
	Intangible assets		10,00,000
	Other non- current assets		25,000
2.	Current assets		
	(a) Current investments		3,36,000
	(b) Inventories		3,55,600
	(c) Trade receivables		3,66,240
	(d) Cash and cash equivalents		3,14,320
	(e) Short term loans and advances		3,00,000
	(f) Other current assets		50,000
	TOTAL		74,07,100

Notes to the financial statement-

1. Reserve and surplus

Capital reserve	=	60,000
Profit & Loss A/C (Cr balance)	=	42,980
Total	=	1,02,980

2. Trade Payables

Sundry creditors	=	1,00,020
Bills payable	=	85,100
Total	=	1,85,120

3. Tangible fixed assets	
Premises	= 39, 09, 940
Furniture and Fixtures	= 7, 50, 000
Total	= 46, 59, 940

3.2.3 Profit and Loss Account

The profit or loss incurred by a company during a particular period is reflected in the Statement of Profit and Loss of a company. It provides a detailed summary of a company's revenues, expenses, and profits or losses over a specific period. It also depicts the Earnings Per Share (EPS) of the company, which is classified into Basic EPS and Diluted EPS. Basic EPS is calculated using the net profit available to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted EPS accounts for all potential shares that could be created from convertible securities, stock options, and other financial instruments that may dilute the earnings per share. The format and content of the Profit and loss account are governed by Part II of Schedule III of the Companies Act, 2013. The following table shows the format of the Statement of profit or loss of a company:

Format of Statement of Profit and Loss

Name of the Company.....

Profit and Loss Statement for the year ended.....

(Rupees in.....

Particulars	Note No.	Figures for the current reporting period	Figures for the previous reporting period
I. Revenue from operations		xxx	xxx
II. Other income		xxx	xxx
III. Total Revenue (1+2)		xxx	xxx
IV. Expenses:		xxx	xxx
Cost of material consumed			
Purchase of stock in trade			
Changes in inventories of finished goods			
Work-in-progress and Stock in trade			
Employee benefit expense			
Finance costs			
Depreciation and amortization expense			
Other expenses			
Total expenses			
V. Profit before exceptional and extraordinary items and tax (III - IV)		xxx	xxx
VI. Exceptional items		xxx	xxx

VII. Profit before extraordinary items and tax(V - VI)		xxx	xxx
VIII. Extraordinary items		xxx	xxx
IX. Profit before tax(VII - VIII)		xxx	xxx
X. Tax expenses:		xxx	xxx
a) Current tax		xxx	xxx
b) Deferred tax		xxx	xxx
XI. Profit (loss) for the period from continuing operations (IX-X)		xxx	xxx
XII. Profit (loss) from discontinuing operations		xxx	xxx
XIII. Tax expense of discontinuing operations		xxx	xxx
XIV. Profit /Loss from discontinuing operations (after tax)(XII – XIII)		xxx	xxx
XV. Profit (Loss) for the period (XI + XIV)		xxx	xxx
XVI. Earning per equity share:		xxx	xxx
a) Basic		xxx	xxx
b) Diluted		xxx	xxx

Illustration 3.2.2

From the following figures relating to XYZ Ltd. for the year ended 31 March 2020, prepare a statement of profit or loss along with the accompanying notes.

Sales		15,50,000
Equity share capital		8,00,000
Outstanding wages		6,000
Premises		1,60,000
P.F contribution		86,000
Machinery		6,00,000
Tax expense for the year	60, 000	
Sales return		50,000
Rent	40, 200	
Depreciation on machinery		18,000
Interest on loan		16,000
Bonus to employees		20,000
Bad debts		3,800
Salaries		1,14,000
Opening stock		40,000
Materials consumed		8,00,000

Depreciation on premises		8,000
Closing stock		1,20,000

Solution

XYZ Ltd
Statement of Profit and loss as on 31st March 2020

	Notes No.	Figures for year ending 31-3-2020
(i) Revenue from operations	1	15,00,000
(ii) Other income –		nil
(iii) Total revenue		15,00,000
(iv) Expenses		
a) Cost of material consumed		8,00,000
b) Purchase of stock in trade		0
c) Changes in inventories	2	
(Closing stock – opening stock)		80,000
d) Employee benefit expense	3	2,26,000
e) Finance cost		16,000
f) Depreciation and amortization	4	26,000
g) Other expense	5	44,000
Total expenses		11,92,000
Profit before exceptional and extraordinary items and tax (iii - iv)		3,08,000
Exceptional items		-
Profit before extraordinary items and tax		3,08,000
Extraordinary items		-
Profit before tax		3,08,000
Tax expenses for the current year		(60,000)
Profit (loss) for the period from continuing operations		24,8,000
Profit (loss) from discontinuing operations		nil
Tax expense of discontinuing operations		-
Profit /Loss from discontinuing operations (after tax)		-
Profit (Loss) for the period		2,48,000
Earning per equity share:		
a) Basic		-
b) Diluted		-

Notes: Forming part of the statement of Profit & Loss

1. Revenue from operation

Sales	15, 50, 000
Less sales return	<u>50, 000</u>
Net sales	15, 00, 000
2. Change in inventories	
Closing stock	1, 20, 000
Less Opening stock	<u>40, 000</u>
Total	(80, 000)
3. Employee benefit expense	
Salaries	1, 14, 000
PF contribution	86, 000
Bonus to employees	20, 000
Out standing wages	<u>6000</u>
Total	2, 26, 000
4. Depreciation and amortization	
Depreciation on premises	8, 000
Depreciation on machinery	<u>18, 000</u>
Total	26, 000
5. Other expense	
Rent	40, 200
Bad debts	<u>3, 800</u>
Total	44, 000

In the given question, the face value per share is not given. Hence EPS is not calculated.

Recap

- ◊ Final accounts- Depicts the financial position and profit or loss of a company
- ◊ Components of Consolidated financial statements- Balance Sheet, Statement of Profit and Loss, Cash Flow Statement, Statement of Changes in Equity, Annexures
- ◊ Non-Current Assets- Long-term assets
- ◊ Current Assets- Short-term assets
- ◊ Revenue from Operations- Income from core business activities.
- ◊ Contingent Liabilities- Potential obligations dependent on future events, disclosed in notes.
- ◊ Deferred Tax- Timing differences between accounting and tax expenses.
- ◊ Earnings Per Share (EPS): Profitability measure; Basic and Diluted

EPS.

- ◊ Balance Sheet- Depicts a company's financial position on a specific date.
- ◊ Profit and Loss Account- Shows a company's revenues, expenses, and profit or loss over a specific period.

Objective Questions

1. What is the term for long-term resources not expected to be converted into cash within the next year?
2. Which term refers to short-term assets expected to be converted into cash within one year?
3. What are long-term financial obligations that are not due within the next year called?
4. What is the term for obligations expected to be settled within the business cycle, usually within a year?
5. What is the amount invested by shareholders in the company known as?
6. What refers to income earned from core business activities?
7. What is the profit available after accounting for all taxes?
8. What measures profitability and is calculated as net profit divided by the number of equity shares outstanding?
9. What are potential obligations that may arise depending on the outcome of a future event called?
10. What refers to the difference between tax expenses recognised in financial statements and the amount payable to tax authorities?
11. Which statement provides a detailed summary of a company's revenues, expenses, and profits or losses over a specific period?
12. Which financial statement depicts the financial position of a company as of a specific date?

Answers

1. Non-Current Assets
2. Current Assets
3. Non-Current Liabilities
4. Current Liabilities
5. Share Capital
6. Revenue from Operations
7. Profit After Tax (PAT)
8. Earnings Per Share (EPS)Contingent Liabilities
9. Contingent Liabilities
10. Deferred Tax
11. Statement of Profit and Loss
12. Balance Sheet

Self-Assessment Questions

1. What are non-current assets? Provide two examples.
2. What is the difference between Profit Before Tax (PBT) and Profit After Tax (PAT)?
3. How is Earnings Per Share (EPS) calculated?
4. Explain the preparation and presentation of the Balance Sheet and Profit and Loss Account as per Schedule III of the Companies Act, 2013. Discuss the key elements that must be included in these statements.
5. Critically assess the importance of Earnings Per Share (EPS) as a performance metric. Compare Basic EPS and Diluted EPS, and explain their relevance to investors.
6. Differentiate between Depreciation and Amortization.
7. Explain the term 'Current Liabilities' with an example.
8. What are contingent liabilities and how are they disclosed in financial statements of a company?

Assignments

- From the following particulars presented by Thilak for the year ended 31st March, 2017, prepare profit and loss account.

Particulars	₹	Particulars	₹
Gross profit	1,00,000	Interest received	6,000
Rent paid	22,000	Bad debts	2,000
Salaries	10,000	Provision for bad debts (1-4-2016)	4,000
Commission (Cr.)	12,000	Sundry debtors	40,000
Discount received	2,000	Buildings	80,000
Insurance premium paid	8,000		

Adjustments:

- Outstanding salaries amounted to Rs. 4,000
- Rent paid for 11 months
- Interest due but not received amounted to Rs. 2,000
- Prepaid insurance amounted to Rs. 2,000
- Depreciate buildings by 10%
- Further bad debts amounted to Rs. 3,000 and make a provision for bad debts @ 5% on sundry debtors
- Commission received in advance amounted to Rs. 2,000

(ANSWER – Net profit = Rs 65,100)

- Analyse the significance of ‘perpetual succession’ and ‘common seal’ in the context of a company’s operations and legal standing.
- From the following particulars, prepare the balance sheet of Madhu, for the year ended 31st March, 2018.

Particulars	₹	Particulars	₹
Capital	2,00,000	Sundry creditors	40,000
Drawings	40,000	Bills payable	20,000
Cash in hand	15,000	Goodwill	60,000
Loan from bank	40,000	Sundry debtors	80,000
Bank overdraft	20,000	Land and building	50,000
Investments	20,000	Vehicles	80,000
Bills receivable	10,000	Cash at bank	25,000

The following adjustments were made at the time of preparing final accounts:

- Outstanding liabilities: Salaries-Rs. 10,000, Wages- Rs.20,000, Interest on Bank

Over draft - Rs 3000 and Interest on bank loan - Rs. Rs. 6000

- ii. Provide interest on capital @ 10% p.a.
- iii. Bad debts amounted to Rs. 10,000 and make provision for Bad debts@ 10% on Sundry debtors.
- iv. Closing stock amounted to Rs. 1,20,000.
- v. Depreciate vehicles @ 10% p.a.

Net profit for the year amounted to Rs. 96,000 after considering all the above adjustments.

Ans: Balance Sheet. Total: Rs. 4,35,000.

4. Explore the concept of 'Government Companies' and 'Foreign Companies'. How do these differ from other types of companies, and what unique challenges do they face in terms of regulation and compliance?
5. The following balances were extracted from the books of Thomas as on 31st March, 2018

Particulars	₹	Particulars	₹
Purchases	75,000	Capital	60,000
Returns inward	2,000	Creditors	30,000
Opening stock	10,000	Sales	1,20,000
Freight inwards	4,000	Returns outward	1,000
Wages	2,000		
Investments	10,000		
Bank charges	1,000		
Land	30,000		
Machinery	30,000		
Building	25,000		
Cash at bank	18,000		
Cash in hand	4,000		
	2,11,000		
			2,11,000

Additional information:

- i. Closing stock Rs. 9,000
- ii. Provide depreciation @ 10% on machinery
- iii. Interest accrued on investment Rs. 2,000

Prepare trading account, Profit and Loss Account and Balance Sheet

(Answers – Net profit Rs 35000, Balance sheet total Rs.1,25,000)

Suggested Reading

1. Gupta, R.L. & Gupta, V.K. (2017). Corporate Accounting. New Delhi: Sultan Chand & Sons.
2. Khandelwal, G. & Dhingra, S. (2016). Corporate Accounting and Financial Management. New Delhi: PHI Learning Pvt Ltd.
3. Monga, J. R. (2015). Financial accounting. Mayur Paperbacks.
4. Singh, S., & Kapoor, P. (2018). Corporate accounting and financial reporting. S. Chand Publishing.

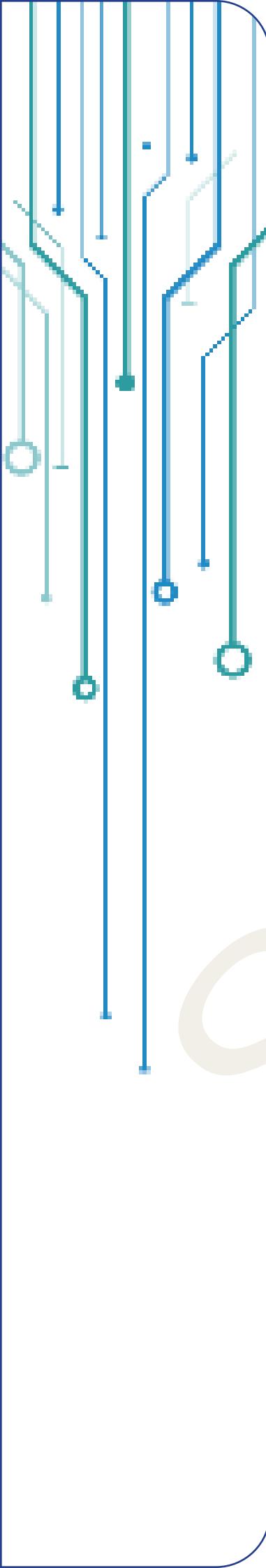
Reference

- ◊ Jain S.P and Narang K.L. (2018). Corporate Accounting, Kalyani Publishers, New Delhi
- ◊ Maheswari S.N. and Maheswari S.K. (2018). Corporate Accounting, Vikas Publishing House, New Delhi
- ◊ Mukherjee A. and Hanif M. (2017). Corporate Accounting, Tata McGraw-Hill Publishing Co.Ltd. New Delhi
- ◊ P C Thulsian. (2014). Advanced Corporate Accounting. S Chand and Company Limited.
- ◊ Shukla M C, Grewal T.S. & Gupta S.C.(2017) Advanced Accounts S.Chand & Co. Ltd., New Delhi
- ◊ RL Gupta & Radhaswamy. (2013). Advanced Accounting. Sultan Chand & Sons

4

BLOCK

AUDITING



Unit 1

Basic Concepts of Auditing

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ understand the meaning, nature, scope, and significance of auditing.
- ◊ differentiate Audit and Investigation
- ◊ explain who is an Auditor and the qualification and qualities.
- ◊ learn the different types of audits and their merits and demerits
- ◊ gain insights on important terms namely audit engagement, audit program, audit working papers, audit notebook, and audit evidence

Prerequisites

Auditing evolved and grew rapidly after the industrial revolution in the 18th century. With the growth of Joint stock companies the ownership and management became separate. With the increase in the size of companies and the volume of transactions the main objective of audit shifted to ascertaining whether the accounts were true and fair rather than true and correct.

Mr. Vignesh worked in the Middle East for many years before returning to Kerala, where he used his lifetime savings to start a supermarket in Kollam. He employed about 100 staff across various departments, delegating all operations to them. Initially, the business ran smoothly, and he placed a great deal of trust in his employees. However, he later encountered severe financial problems and was forced to close the business, leaving him with substantial debt. An investigation revealed that his employees had stolen cash and goods and manipulated the accounting records.

This situation might have been avoided if he had implemented regular auditing procedures. Auditing involves a critical examination of a business's books, accounts, and other documents by an independent, qualified person. The purpose is to ensure the accuracy and authenticity of the accounts and to confirm that the balance sheet and profit and loss account accurately reflect the business's financial position and performance. In conclusion it can be said that auditing has come a long way from hearing of accounts to taking the help of computers to examine computerized accounts.

Keywords

Auditing, Nature, Scope, Features, Objectives, Types of audits.

Discussion

4.1.1 Meaning of Auditing

Auditing was instigated from the Latin word "audire". In ancient days, the person responsible for maintaining accounts has gotten it certified as correct by an independent person. For this purpose, he has to explain the details of accounts before an expert and the expert heard it carefully and certifies the correctness of the accounts. The person hearing the details of accounts is called Auditor. That is why the term auditing originated from the term audire which means to hear.

Auditing is a critical examination of books of accounts and other documents of a business so as to assure the accuracy and authenticity of books of accounts. Auditing is basically related to the inspection of books of accounts which is prepared by the accountant. It is done by an outsider usually at the end of the accounting year or periodically. It is an intelligent and critical test of the accuracy, adequacy, and dependability of accounting data and accounting statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view financial position and profit or loss of the business.

4.1.2 Definition of Auditing

As per the General Guidelines on Internal Auditing issued by ICAI, "auditing is defined as a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report.

Spicer and Pegler, defined auditing as , "Auditing is such an examination of books, accounts and vouchers of a business as will enable the auditor to satisfy himself that

the balance sheet is properly drawn up, so as to give a true and fair view of the state of affairs of the business and whether the profit and loss account gives a true and fair view of the profit or loss of the financial period, according to the best of the information and explanation given to him and as shown by the books, and if not, in what respect he is not satisfied.”

The analysis of the above definitions makes it clear that auditing is the process of examining the accuracy and authenticity of books of accounts with the help of supporting documents and making sure that books of accounts show a correct picture of the state of affairs of the business.

4.1.3 Scope of Auditing

Auditing is basically connected to the examination of books of accounts to test their authenticity and accuracy. The depth and width of auditing depend on the need. For example, if fraud is suspected, all cash transactions should be examined. Due to the immensity of transactions, the auditor cannot check all transactions, but he can adopt test checking if there is an effective internal check system in force. In recent years, the scope of audits has increased. It is related to the examination of books of account, evidence, bills, stock, and its physical verification, etc. An auditor not only check the books of account on the basis of evidence but also has to check the authenticity of documents. In short, the scope of audit covers the checking of books of accounts, valuation and physical verification of assets and liabilities, and checking of available evidence. Moreover, the legal requirements also decide the scope of the audit.

4.1.4 Nature of Auditing

The following are the features of auditing:

- i. Auditing is the process of systematic examination of books of accounts and other related documents of a business organisation.
- ii. The authenticity of transactions is checked with supporting documents of transactions entered in the books of accounts such as vouchers, bills, a carbon copy of receipts, counterfoils, vouchers etc.
- iii. Audit is carried out by an independent person or body of persons who are duly qualified for the job.
- iv. The preparation of books of accounts is not the responsibility of the auditor. The accounts are usually prepared by accountants or some other staff in the organization.
- v. Auditor should be a qualified chartered accountant in the case of a business where auditing is compulsory.
- vi. The scope of the audit is not only limited to mere checking of transactions but also sometimes extent to non-commercial transactions as in the case of investigation.
- vii. The auditor should satisfy himself and also certify the accuracy and authenticity of the profit/loss account and balance sheet.

- viii. If an auditor is not satisfied with the correctness of books of accounts, he should mention the matter in his report.
- ix. Audit involves the critical review of the system of accounting and internal control.
- x. The audit findings have to be communicated to those who have appointed the auditor. For example, in case of a company the audit report is made to the shareholders.

4.1.5 Objectives of Auditing

Accounts and Statements Verification

Evaluating the fairness & accuracy of books of accounts is the primary objective of Auditing. It checks each and every financial transaction thoroughly. It detects and prevents any fraud in the books of accounts.

Checking Accounting Policies

Every business needs to adhere to some accounting policies. Books of accounts are prepared and maintained according to these accounting policies. If a business has an effective accounting system efficiency of the concern can be increased to a great extent.

Error and Fraud Detection

Another important objective of auditing is to detect errors and frauds from the books of accounts. It is through auditing that helps managers to find out errors & frauds, which will help the management to take corrective action against these errors or frauds.

Improves Quality of Business Processes

Management can easily detect the errors and frauds, and they can take timely corrective action, so that they are not repeated again which will help the management to improve the quality of business processes & improves its efficiency. Similarly employees will be vigilant and work diligently due to threat of auditing and close monitoring.

Assurance to Investors

Investors are the back bone of any business .Auditing assures that the facts and figures shown in the financial statement is correct. Audited financial statements are considered trust worthy by investors. Auditing safeguard the interests of the shareholders because, for every shareholder, it is neither possible to inspect the books of account of the company nor to participate in the management actively.

Evaluation of Assets & Liabilities

Auditing evaluates in detail the financial statements of the business. This helps the business concern in confirming the true value of assets & liabilities of the organization. Based on these financial statements business concern can plan and achieve targets and goals.

4.1.6 Significance of Auditing

The significance of auditing can be listed in the following points:

- i. There are various stakeholders who are interested in the financial statements of a business. They may not have sufficient knowledge of financial activities. They rely on the auditor's independence and impartiality to ensure that audit opinion has been expressed to reflect the books of account. So, auditing helps to protect the interest of persons who are not directly connected with the day-to-day activities of the business such as shareholders, creditors, partners, bankers etc.
- ii. Credibility of financial statements depends upon the certificate issued by the auditor. Hence, the regulatory body has appointed only qualified person as an auditor to carry out the assignment of audit and report the true and fair view of the client entity's financial statements. Therefore, the stakeholders could rely on financial statements.
- iii. Internal audit is very helpful for preventing the commission of fraud from the very beginning. Because continuous analysis of the company's operations for maintaining internal controls will help to prevent and detect various fraudulent activities.
- iv. Auditors shall assess the risk of material misstatement in the audit of financial statements. The audit helps in identifying which products or divisions are most profitable and which would require the attention of management.
- v. The auditor has to present the status of assets and liabilities. The audit, therefore, helps to reduce misstatements in a company's records and reports. The employment of a strong audit mechanism reduces the variety of risks of an enterprise including its information risk, the risk of fraud, and misappropriation of assets. Further, it reduces the risk of under performance of management due to a lack of sufficient information on its operations.
- vi. Functioning of an effective audit system helps in the proper execution of internal control.
- vii. Auditing helps to maintain adequate business records. In turn, it increases the operational productivity of the business.
- viii. Internal auditors regularly review the design of the internal controls suggesting improvements all around it. They document any material deficiencies in the internal control by thorough investigation and report to the appropriate level of management as and when required.
- ix. The independence and objectivity aspects of the audit plan play a massive role. Hence, the auditor should be independent of influences that could make confusions in the professional judgment of the auditor.
- x. Audit professionals help in the design of an internal control system to detect and prevent fraud. If the company has an effective audit system, the reputation of such a system can alone prevent employees or vendors from attempting the scheme of fraud in the company. It makes employees more cautious and encourages on moral check.

- xi. Auditing helps to settle tax liability, refunds of tax, trade disputes, accounts at the time of retirement, or death of partners, liquidation of any company etc.
- xii. For getting government assistance and grants, audited statements are needed.

4.1.7 Auditor

The person who is assigned with the task of auditing is known as the auditor. Persons who are professionally qualified will be appointed as auditors. The auditor must submit a report based on the audit work undertaken. The auditor must examine that the balance sheet accurately reflects the company's financial position and that the profit and loss account presents a true and fair view of the company's financial performance for the period. The auditor should also ensure that the accounts have been prepared in compliance with the applicable legal requirements. If the auditor has any concerns or finds discrepancies, they will specify the areas where they are not satisfied. An auditor should possess the following qualities:

- a. An auditor must maintain integrity, be objective, and remain independent throughout the audit process.
- b. An auditor must be honest and must exercise reasonable care and skill before certifying anything as true.
- c. An auditor must be familiar with the legal framework governing the entity being audited.
- d. An auditor should have a strong understanding of fields related to auditing, such as accounting, economics, and mathematics.
- e. An auditor should be aware of the unique characteristics of the particular industry they are auditing.

4.1.8 Appointment of an Auditor

According to section 139 of the companies act 2013, appointment of auditors involves a structured set of rules and regulations. As per section 139(1) every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the member of the company at such meeting shall be such as may be prescribed.

As per Rule 3 of the companies (Audit & Auditors) Rules 2014, Before the appointment a written consent of such appointment and certificate shall be obtained from the Auditor.

4.1.9 Audit and Investigation

A comparison between audit and investigation is given in the table below:

Basis	Auditing	Investigation
Concept	Auditing is an independent and systematic examination of the evidence underlying the accounting or other data in accordance with the generally accepted auditing practices to ascertain the true and fair view of the financial statements of an enterprise.	An investigation may be defined as an examination of accounts and records with a view to ascertain any fact for some special purpose which varies from assignment to assignment.
Scope	Broader scope	Narrow scope
Aim	In audit, the accounts and records are verified as to their truth and fairness,	To achieve a particular purpose, such as assessing information for a prospective partner.
Procedure	Carried out following established auditing principles.	Involve more extensive auditing procedures tailored to uncover specific information.
Evidence	An auditor will evaluate the accounting records predominantly based on persuasive evidence (evidence that may cause a person to believe a fact).	An investigator can draw his conclusions only on the basis of substantial or sometimes conclusive evidence (Concrete evidence- Evidence that cannot be contradicted by any other evidence)
Approach	Auditors are careful and question things, but they don't assume anything is wrong.	Investigators start by thinking there might be a problem and then look for proof to see if they're right or wrong.
Periodicity	Regular exercise, typically conducted annually	Cover periods longer than a year, depending on the nature of the problem being investigated.

4.1.10 Types of Audits

There are different types of audits. The classification is based on nature of organisation, coverage, legal point of view, objectives, degree of independence and practicability. A concern can adopt a particular type of audit depending on any of the factors. The different types of audits are:

i. Continuous Audit

This type of audit is conducted by big business organisations where volume of transactions is large. Here, audit work is done along with the accounting work throughout the accounting year. At the end of the accounting year, majority of the audit work is over. It helps to publish the audited profit/loss account and balance sheet soon after closing the books of accounts at the end of the accounting period. Moreover, a detailed

examination of each and every transaction is possible because the auditor has more time at his disposal and therefore, this audit is more efficient.

The continuous audit is defined by R .C.Williams as “a continuous audit is one where the auditor or his staff is constantly engaged in checking the accounts during the whole period or where the auditor or his staff attends at regular or irregular intervals during the period”.

The continuous audit is conducted in the following circumstances:

- Where the volume of transactions are large.
- If there is no satisfactory system of internal check.
- In case the business requires monthly or quarterly audited financial statements and reports.
- Where it is necessary to publish audited accounts soon after closing the accounting year.

Advantages

- a. Auditor is frequently visiting the premises of the client and conducting detailed checking; therefore, errors and frauds can be easily detected.
- b. Since the auditor is frequently visiting the premises of the client, the staff of the client may be regular and vigilant.
- c. It is very easy to publish the audited accounts soon after closing the accounting year.
- d. Auditor has thorough and continuous touch with the business of the client. Therefore, he can understand the technical knowledge of the business and can give valuable advice for improving the efficiency of the business.
- e. It enhances the morality of the client's staff.
- f. The final work of the auditor is reduced because almost all audit work is completed during the accounting year itself.
- g. It helps to declare interim dividend because audited interim profit is available.

Disadvantages

- a. Frequent visit of the auditor and his staff may create interruption in the work of the client's staff.
- b. Continuous audit is more expensive because the auditor spent more time and charge more fees.
- c. There are some chances of altering audited books and accounts by some dishonest employees of clients because the audited accounts remain with them.
- d. Frequent visit of the auditor to the client's firm may create close contact with the staff and client, which results in unethical relationship between them and destroy the purpose of the audit.
- e. In the case of continuous audit, the work of the auditor is mechanical and monotonous.

- f. Audit work is not completed in one sitting, therefore, the curiosity and continuity in the work is lost

ii. Annual Audit

An annual audit is also called a complete audit or final audit or periodical audit. This type of audit is conducted by small concerns. Auditing is done at the end of the financial year after preparing the final accounts; namely Profit/Loss Account and Balance Sheet. The audit is completed in a continuous session where the accounts are handed over to the auditor and the auditor returns it to the client only after completing the audit work.

Advantages

- a. The work of the client staff is not interrupted because the audit work starts only after completing the accounting work.
- b. There is smooth flow of work because the entire audit work is completed in continuous single session.
- c. Less expensive
- d. There is no feeling of monotonous and mechanical working because there is continuous flow of work.
- e. There is no chance of collusion between accounting and audit staff.

Disadvantages

- a. Detailed checking is not possible because the auditor is spending only little time for completing the audit work.
- b. Detailed checking is not possible therefore, error and frauds cannot be completely located.
- c. This type of auditing is not suitable for big concerns.
- d. The auditor may rely upon the management in several cases.

iii. Interim Audit

An interim audit is the audit conducted in between two annual audits. This audit is done for the purpose of ascertaining the interim profit for declaring an interim dividend. It may also be conducted for fixing the price of shares, for settling accounts of partners at the time of admission, retirement, death, etc.

Advantages

- a. It facilitates the completion of the final audit earlier because most of the work is completed in the interim audit.
- b. It promotes moral check on clients' staff.
- c. It helps in the easy detection of errors and frauds.

Disadvantages

- a. Figures audited up to interim audit may be altered by the staff of the client.
- b. It is additional work and therefore expensive.

- c. Preparation of extensive notes on figures audited may result in an increase of additional workload.

iv. Statutory Audit

A statutory audit is the audit made compulsory as per statute or law. Auditing is not compulsory for all firms. For example, a sole trader is not needed to audit his accounts, if his turnover does not exceed rupees forty lakh. But for some organisations, auditing is compulsory. They are

- a. Companies registered under the Companies Act of 2013 or any of the previous Companies Act
- b. Banking Companies
- c. Co-operative societies
- d. Electricity Supply Companies
- e. Corporations set up by central or state government
- f. Registered Public Charitable Trust.

v. Cash Audit

Cash audit is the audit of all cash transactions with the help of supporting documents such as counterfoils of cash receipts, a carbon copy of cash receipts, vouchers, other documents and correspondence. It involves a detailed examination of an organization's cash transactions and balances to ensure accuracy, completeness, and compliance with accounting standards and internal controls. The primary purpose of a cash audit is to verify that the cash records are correct and to detect any discrepancies or irregularities.

vi. Balance Sheet Audit

The balance sheet audit is the audit of items of the balance sheet. It is mainly concerned with the valuation and verification of assets and liabilities. All assets and liabilities are checked in detail. A profit/loss account is an item appearing on the balance sheet. Therefore, for assuring the accuracy and authenticity of profit/loss, checking may be extended to items of profit/loss account also.

vii. Cost Audit

Cost audit is the examination of the cost accounting records of a company. According to the Institute of Management Accounts London, cost auditing is “the verification of the correctness of cost accounts and of the adherence to the cost accounting plan.”

In the words of Smith and Day, “cost audit is the detailed checking of costing system, technique and accounts to verify their correctness and to ensure adherence to the objectives of cost accountancy”.

A cost audit is an independent examination of costing records and other related documents of a company. It includes the verification of cost accounts and checking on

adherence of cost accounting plan, policies and techniques. It gives information to the management all data related to reducing cost of production, implementing economical cost of production and altering the cost accounting plan, if necessary.

viii. Partial Audit

Partial audit is the audit of some part transactions of the business based on the needs of the management. It is not accepted as regular audit and not admitted in case of business where auditing is legally compulsory. The audit is restricted to certain areas, such as payroll, inventory, or sales transactions. The scope of partial audit is determined by the needs of the stakeholders. A partial audit might be conducted to address specific concerns or issues, verify compliance in certain areas, or assess the effectiveness of internal controls related to particular transactions.

ix. Complete Audit

When all transactions are checked thoroughly from beginning to end, by detailed checking, it is called, complete audit. In case of complete audit, auditing will be more effective. A complete audit, also known as a full audit or comprehensive audit, is an extensive examination of an organisation's financial statements and records. It involves a thorough checking of all aspects of the organisation's financial activities to ensure accuracy, completeness, and compliance with relevant accounting standards and regulations.

x. Management Audit/ Efficiency Audit

Management audit is the audit of efficiency of management and it is an attempt to evaluate the various functions and process of the organisation to measure the efficacy of activities. According to American Institute of Management, "management audit is a diagnostic appraisal process for analyzing goals, plans, policies and activities in every phase of operation to turn over unsuspected weaknesses and to develop ideas for improvement in areas that has escaped management attention" Thus it emphasis on the existence of control system, compliance of rules and regulations, managerial decision process etc., for evaluating the performance of management.

xi. Internal audit

In big organisations, there may have a separate department for conducting internal audit. It is a critical review of records and operations of a business and is done by a specially allotted staff of the organisation. The internal auditor has to check for wastages. He should find out the weakness of the internal check and internal control system. The internal auditor has to assess the accuracy of records and the effectiveness of operations. He may or may not be a chartered accountant.

xii. Government Audit

Government audit is conducted by a separate department of Central Government called Comptroller and Auditor General of India. It was established as per Article

149 of the Constitution of India. Government audit is carried out in Government departments and statutory corporations. A professional chartered accountant may be appointed as the auditor of government companies by the Company Law Board as per the recommendation of Comptroller and Auditor General of India. The Government auditor make sure that the expenditure is duly authorized by a competent authority, incurred by a competent officer, payment has been made to proper person and duly acknowledged, the amount is charged in the appropriate heads, sum due are regularly recovered and sum received are properly credited.

xiii. Social Audit

A business uses the resources of society. Therefore, it has some responsibility towards the society also. The purpose of social audit is to examine what the organisation is doing for society. It is conducted to get information on the social performance of a business. The main difference between statutory audit and social audit is that statutory audit is related to the economic performance of the business whereas social audit is concerned with the social quality of the life of the organisation.

According to Simon Zadek “social audit is a means of assessing the social impact and ethical behaviour of an organisation in relation to its aim and those of his stakeholders. Stakeholders include all individuals and groups who are affected by, or can affect, the organisation”.

xiv. Tax Audit

Auditing is generally conducted for giving proper information to the shareholders. But some other stakeholders are interested in the correctness of the financial statements. The income tax act specifically included certain provisions for assessing income tax. So, auditing conducted for assessing income tax is called tax audit.

A tax audit can be defined as “an examination of financial records to assess the correctness of taxable profit to ensure compliance with the provisions of Income Tax Act and also ensure fulfilment of conditions for claiming deductions under the Income-tax Act”.

4.1.11. Preparation of an Audit

Auditing is the process of reviewing financial records, systems, and internal controls to ensure accuracy, compliance, and reliability. Proper preparation helps in conducting a smooth and efficient audit.

The first step is **pre-audit planning**. This involves defining the audit's scope and objectives, such as whether it is a statutory, internal, tax, forensic, or compliance audit. Reviewing previous audit reports helps identify past issues and corrective actions taken. An audit plan should then be established, outlining the timeline, key focus areas, and assigned responsibilities.

Next, gather all **required documents**. These include financial statements such as the

Balance Sheet, Income Statement, and Cash Flow Statement. Other important records include bank statements, invoices, purchase orders, and sales contracts. Additionally, company policies, internal control documents, and authorization procedures should be reviewed.

During the audit, the **risk assessment** process identifies high-risk areas and possible fraud indicators. Auditors test and verify transactions by checking records, comparing financial trends, and confirming balances with third parties like banks or creditors. A compliance review ensures that the company follows accounting standards (GAAP, IFRS) and regulatory laws.

After completing the audit, auditors prepare a **report summarizing findings and recommendations**. The report includes an opinion on the financial statements, such as an unqualified (clean) or qualified opinion. Auditors then discuss findings with management, addressing concerns and suggesting corrective actions. Once finalized, the report is submitted to stakeholders, and necessary changes are implemented.

The final step is a **post-audit review**, where auditors may follow up to check if recommended changes were applied. This helps improve financial reporting and compliance in future audits.

For a successful audit, companies should keep organized records, follow internal policies and regulations, maintain clear communication with auditors, and address potential issues before the audit begins.

4.1.12 Audit Engagement

Audit engagement is an agreement between the client and the auditor relating to the nature, scope, and purpose of the audit. At the beginning of an auditing the client and auditor agree on the services to be provided, the remuneration payable and the period during which the audit will be conducted. For this the auditor has to prepare an agreement that contains his terms and conditions. It also shows all of the work performed by him for a client. This letter is called an engagement letter which is sent to the client. If the client agrees with the terms specified in the letter, a person authorized to do so will signs the letter and returns a copy to the auditor. Hence, the parties indicate that an audit engagement has been initiated. This letter is useful for avoiding disputes in the future.

4.1.13 Audit Programme

Audit programme is a detailed plan of auditing. It contains the details of work to be done, instructions, and guidelines given to the audit staff related to how they proceed with the audit work. In the words of Megis, “an audit programme is a detailed plan of audit work to be performed, specifying the procedure to be followed in verification of each item in the financial statements and giving the estimated time required”.

Audit programme is prepared for the purpose of assuring each item has been checked, fixing responsibility to the audit clerk who has done a particular work, predetermining the starting and ending time of work etc. The audit programme contains the work

assigned to each clerk and they have to sign it as and when they complete the assigned work. Audit programme is drafted by the auditor. It is prepared before commencement of the audit and it clearly shows the procedure of audit work to be done.

Advantages

- a. Audit work can be completed within the stipulated time.
- b. Auditor can control and coordinate the work of audit staff simultaneously.
- c. Responsibility of each work can be fixed against the person doing it.
- d. It assures that no part of audit work has been omitted from checking.
- e. It gives clear guidance to the audit staff to perform the work.

Disadvantages

- a. If a particular work is not included in the audit programme, that part of work remains unchecked.
- b. It is not suitable to small business and therefore not feasible.
- c. The audit staff may loss interest and initiative of audit because the audit is going mechanically.

4.1.14 Audit working papers

Audit working papers are the papers and documents which contain all important details about the accounts which are under audit. They connect the relation between clients accounting records and the auditor's report. It exhibits true image of accounts of the business. The working papers show that the auditors followed the rules and guidelines that are widely accepted in the auditing profession. This means they did the audit properly and professionally.

The objectives for preparing working papers are:

- a. It assists the auditor to organise and coordinate the work of audit staff.
- b. It is the base for preparing auditor's report.
- c. It helps the auditor to draft audit plan for coming financial year.
- d. In case some negligence is charged against the auditor, he can produce audit working papers as evidence in the court of Law.
- e. Auditor can make sure that his staff had followed his instructions in the course of work.

Contents of Working Papers

An audit working paper includes the following:

- a. Rough trial balance
- b. Draft final accounts
- c. Details of investments
- d. Schedule of debtors and creditors, correspondence between the auditor and

debtors, creditors and bank.

Essentials of good working papers

A good working paper should contain the following details:

- a. It should be simple and easily understandable and self-explanatory.
- b. Properly arranged, filed, and numbered.
- c. Essential and relevant information needs to be included.
- d. There should be clarity in thought and expression.

The audit working papers are the property of the auditor. This document is very confidential and important. Therefore, it must be kept safe with high care and concern. If the audit work is in progress, it must be in the client's office under strict control. After completing the audit, it shall be kept under the custody of the auditor. The information in the working papers is confidential, if it is disclosed without the consent of the client, the auditor is deemed to be guilty of misconduct under the Chartered Accountant Act of 1949.

4.1.15 Audit Note Book

In the course of audit, the audit staff may come across many problems related to the work done. Therefore, they usually maintain a diary or notebook for recording notes on the doubts, errors, queries, and problems faced by him in the course of audit. The doubts which are not clarified by the client and the points to be discussed with the main auditor etc. are recorded in the audit notebook. An audit notebook includes the following points:

- a. The details of supporting documents missing. That is vouchers, receipts, bills, invoices etc. not produced.
- b. The starting and ending date of audit.
- c. Particulars of errors, fraud, and mistakes detected.
- d. Name, designation, functions, and responsibilities of principal officers of the company.
- e. Balances of various account, their totals etc.

4.1.16 Audit Evidence

An auditor is appointed to examine the books of accounts and other documents to express his opinion about the accuracy and authenticity of books of accounts. Hence, he should satisfy himself the accuracy and authenticity of transactions. For ensuring it, he has to examine all supporting documents such as vouchers, invoices, bills, correspondence etc. These supporting documents are called audit evidence. Audit evidence is defined as "any documents, material or other source which is available to substantiate any assertion made in financial statements or transactions recorded in the books of accounts".

The audit evidence can be classified into three- documentary evidence, physical

evidence and accounting system.

- a. Documentary Evidence- In order to establish authenticity and accuracy of transactions, there are certain supporting documents. These supporting documents such as vouchers, invoices, receipts, carbon copy of receipts, correspondence with various parties etc. are called documentary evidences.
- b. Physical Evidence- The auditor should satisfy himself the physical existence of tangible assets like cash, stock, land, building, plant and machinery etc.. The greatest evidence in case of these tangible assets is their physical existence. The auditor should physically examine and satisfy himself regarding their existence and value.
- c. Accounting System- Accounting system is just like a manufacturing process. We are introducing certain inputs like transactions, supporting evidences, vouchers etc., and will get the final product in the form of accounts balances. From the accounts, balances figures are shown in the financial statement. The auditor has to verify the figures of the financial statement and assure its correctness.

The object of an audit is to enable the auditor to express an opinion whether the financial statements are prepared, in conformity with recognised financial reporting framework such as GAAP and in all material respects. Information is material if its omission or misstatement could influence the economic decision of users.

The concept of true and fair view indicates that balance sheet and profit and loss account shows fairly actual financial position and financial result of that period. It is based on the auditor's judgement in the particular situations of the case. The term true and fair view has a wide range of meaning. Financial statements must conform to the financial reporting framework and be prepared in all material respects, ensuring they are understandable, comparable, relevant, and reliable.

Recap

- ◊ Auditing involves critical examination of books of accounts
- ◊ Auditing tests the authenticity and accuracy of books of accounts
- ◊ Auditor is a person who is assigned with the task of auditing
- ◊ Types of audits includes continuous, statutory, interim, partial, complete, cash, cost, annual, balance sheet, management, government, internal, social and tax audit.
- ◊ Audit engagement is agreement between the client and the auditor
- ◊ Audit programme is the detailed plan of auditing
- ◊ Audit working papers are the property of the auditor containing the details of accounts under audit.

- ◊ Audit notebook record the doubts, errors, queries, and problems in the course of audit.
- ◊ Audit evidences are the supporting documents to ensure accuracy and authenticity of transactions
- ◊ The audit evidence can be classified into three namely documentary evidence, physical evidence and accounting system

Objective Questions

1. What document confirms the initiation of an audit engagement?
2. What is the primary purpose of audit working papers?
3. Name of the audit conducted by the large concerns.
4. What is the name of an audit which is conducted by statute or law known as?
5. What is cash audit?
6. Under which audit is the valuation and verification of assets and liabilities were undertaken?
7. What should be recorded in an audit notebook?
8. Name the audit which examines costing records and other related documents?
9. What is a complete audit?
10. Name the audit which has been done by the Department of Controller and Audit General of India.
11. Which document is prepared before starting the audit to outline procedures?
12. Who will appoint an auditor of a Govt. Company?
13. Who will prepare the audit programme?

Answers

1. Audit engagement
2. To serve as a detailed plan for the audit process.
3. Continuous audit

4. Statutory audit
5. Audit of all cash transactions
6. Balance sheet audit
7. Doubts, errors, and queries encountered during the audit.
8. Cost audit
9. Audit from beginning to the end
10. Government audit
11. Audit programme
12. Central Govt.
13. The auditor and his audit assistants

Self-Assessment Questions

1. Explain the concept of an audit engagement and its importance in the auditing process.
2. What are the different types of audit?
3. Define auditing.
4. State the objectives of auditing.
5. Who is an auditor?
6. Differentiate between audit working papers and audit notebook.
7. What do you mean by audit evidence?
8. How does auditing differ from investigation?
9. What are the advantages and disadvantages of having a detailed audit program?

Assignments

1. Collect the annual reports of five public-sector companies and categorize them according to the types of audits.
2. Explain the importance of maintaining confidentiality in audit working papers. What are the potential consequences of unauthorised disclosure, and how should auditors ensure the security of their working papers?

3. Describe the role of documentary evidence in an audit. How does the auditor verify the authenticity and accuracy of transactions using documentary evidence, and what challenges might arise in obtaining and evaluating this evidence?
4. Explain the concept of 'true and fair view' in the context of financial statements. Why is this concept important, and how does it influence the auditor's opinion on the financial statements?

Suggested Reading

1. Jagadeesh, P. (1968). Auditing: Principles and practices. Chaithanya Publishing House.
2. Bhatia, R. C. (2005). Auditing. Vikas Publishing House.
3. Gupta, K. (1987). Contemporary auditing. Tata McGraw Hill Publishing Co.
4. Saxena, & Saravanavel. (2016). Practical auditing. Himalaya Publishing Co.
5. Sharma, R. (2006). Auditing. Lakshmi Narain Agarwal.

Reference

1. Institute of Chartered Accountants of India(2020) Auditing and Assurance Standards.
2. Sharman.A (2020). Auditing and Corporate Governance . The Chartered Accountant,68(10),34-40
3. Tulsian, P.C, Tulsian,B (2020) Auditing: Theory and Practice (24th ed). Taxmann Publications.

Internal Control

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ learn the concepts of internal control, internal check, and internal audit
- ◊ comprehend the role of internal control in managing the audit risk
- ◊ describe the meaning and objectives of internal check system
- ◊ differentiate between statutory auditors and Internal auditors, understanding their respective roles, responsibilities, and the contexts in which they operate

Prerequisites

Every day, businesses face various risks that require careful decision-making. Without proper safeguards, these decisions can lead to inefficiencies and errors. To protect their operations, companies implement internal control mechanisms, similar to how banks use checks and balances to safeguard financial transactions. For instance, in a retail business, inventory controls are put in place to prevent theft and ensure accurate stock levels. This might involve regular inventory counts, separation of duties among staff, and approval processes for large transactions. These internal checks and controls help organisations achieve their objectives by ensuring accuracy, preventing fraud, and maintaining operational integrity.

In this unit, we will focus on the concepts of internal control and internal checks in auditing, emphasizing how these systems are essential for maintaining accountability and efficiency within an organisation.

Keywords

Internal control, Internal check, Internal Audit, Statutory auditor, Internal auditor

Discussion

4.2.1 Internal Control

The entire control system adopted by the management to conduct the business efficiently and effectively is called internal control. It includes all administrative and financial control systems including internal checks and internal audit. In other words, internal control includes all control systems adopted in a business to run it efficiently.

Internal control ensures the reliability of financial reporting, enhances the effectiveness and efficiency of operations, and ensures compliance with relevant laws and regulations. The accounting control systems are standard costing, marginal costing, and budgetary control, self-balancing system, bank reconciliation, internal check and internal auditing. The administrative control systems are adopted for increasing the operational efficiency which includes statistical analysis, time study, motion study, performance report, quality control etc.

Objectives of internal control

The following are the key objectives of internal control:

- a. Ensuring compliance with applicable laws, regulations, and accounting standards to maintain operational integrity and avoid legal repercussions.
- b. Implementing controls to deter, prevent, and detect fraud, safeguarding the organisation's assets and reputation from loss, theft, or misuse.
- c. Identifying and assessing potential risks to the organisation and establishing controls to minimise their impact.
- d. Maximising the efficient utilisation of human, financial, and physical resources to enhance overall performance.
- e. Continuously evaluating and refining business processes to improve efficiency, productivity, and quality.
- f. Establishing systems to capture, process, and report accurate and reliable financial and operational data for informed decision-making.
- g. Defining and distributing tasks and responsibilities among different individuals to prevent errors, fraud, and abuse of power.
- h. Implementing performance metrics to assess organisational and individual performance, enabling timely corrective actions.
- i. Protecting physical assets through security measures such as access controls, surveillance, and alarms.

There are three types of internal control systems- preventive, detective, and corrective. As the name indicates, preventive internal control systems are proactive in nature. They prevent the occurrence of frauds, defects, and malpractices in the organisation. Whereas, the detective control systems focused on identifying the frauds and defects which have already been occurred in the organisation. The corrective controls are implemented to rectify errors or irregularities as soon as they are identified.

The whole work of auditor depends on the efficiency of internal control system. If there is a good system of internal control, the auditor can rely upon test checking. However, if there is any mistake, the auditor cannot escape from his liability. A well-functioning internal control system is instrumental in safeguarding organisational resources and ensuring operational efficiency. By establishing clear guidelines for resource allocation and utilisation, it prevents misuse and promotes accountability. Furthermore, such a system plays a crucial role in error prevention and detection, contributing to the production of reliable financial records. Ultimately, internal controls protect the organisation's assets from misappropriation and irregularities by fostering a secure work environment through the implementation of appropriate segregation of duties and delegation of responsibilities.

Internal check and internal audit are two sub-systems of internal control.

4.2.2 Internal Check

In a business, there are various steps of recording transactions such as recording the transaction in the journal, posting to the ledger, balancing of accounts, placing orders to suppliers, receiving cash from customers etc. If all these processes are allowed to be performed by the same person, chances of committing frauds and errors will be more. To avoid this problem, in large business organisations, the work is divided and internally arranged to each employee. No one is allowed to perform a work completely. This system of arrangement of work is called internal check system.

An internal check system is a method of organising the accounting system of a business concern or a factory by which the duties of various clerks are arranged in such a way that the work of one person is automatically checked by another. Thus, the possibility of fraud, error or irregularity is minimized.

According to FRM De Paula “An internal check means practically a continuous internal audit carried on by the staff itself by means of which the work of each individual is independently checked by other members of the staff”

An example of internal check system of a cash receipts will make it clear. As soon as cash is received from a customer, it is recorded by the cashier on the debit side of cash book, the transaction is posted by another clerk in customers account, it is cross checked by an officer and statement of account of the customer is prepared by another person. Here, no chances of errors or fraud is possible unless otherwise an understanding between all these employees.

Features of internal check

The following are the main features of internal check:

- a. Accounting work is divided among the employees.
- b. No employee is permitted to perform a single work from the commencement to end.
- c. Work of one employee is automatically checked by another employee.
- d. Work is distributed on the basis of competence and qualification of employees.
- e. This system is suitable to big business organisations.

Objects of internal check

- a. To make sure that no transaction is unrecorded.
- b. Early detection of errors and frauds.
- c. By introducing division of labour, the efficiency of employees can be improved.
- d. Prevent commission of errors and frauds because there is always checking of work of employees automatically.
- e. It avoids the misappropriation goods and cash.
- f. In case an error or fraud is committed, the responsibility can be fixed to the employee who has committed it.

Principles of Internal Check

While introducing a system of internal check, the following rules should be followed:

- a. No employee is allowed to perform a work completely.
- b. Division of labour should be adopted.
- c. Work should be divided on the basis of qualification and efficiency.
- d. Make sure that there is no overlapping of work.
- e. Responsibility of each employee should be fixed.
- f. The system should ensure that the efficiency is increased.
- g. The work of accounting department should be periodically reviewed.
- h. Self-balancing system should be introduced.
- i. Correspondence with debtors and creditors should be done under the supervision of a responsible officer.
- j. There should have a good system of keeping documents like vouchers, correspondence etc.
- k. Periodical physical stock verification is done by a person other than the employee who is in charge of stock.
- l. All cash receipt should be deposited into bank daily.
- m. Periodical cash and bank balance checking should be made.

- n. Employees should be transferred from one department to another without prior notice.
- o. Every employee is requested to go on leave for few days at least once in every year.
- p. There should have effective control over purchases, receipts and issue of goods from the department.

Advantages of Internal Check

Internal check has many advantages to the business, employees, other stakeholders and auditor. The main merits are:

- a. The efficiency of work is improved.
- b. Rational allocation of work among employees.
- c. It helps in detection and prevention of errors and frauds.
- d. The work of the auditor is reduced to a great extent.
- e. The auditor can rely upon test checking, therefore, it is possible to publish audited final accounts soon after closing the accounting year.
- f. It increases the profitability of business due to increase in efficiency.
- g. The owners can assure and rely upon the authenticity of accounts.

Limitations of Internal Check

- a. The system is expensive and not possible to be introduced in small business.
- b. The speed of work is important hence quality of work may be declined.
- c. Auditors might depend heavily on the internal check system's perceived efficiency, using test checking (sampling) rather than a thorough examination. This approach might miss errors or fraud, especially if those errors are not part of the sampled transactions.
- d. If there is an understanding between the employees, fraud can be easily committed.

Auditor's duty and Internal Check

There is no relationship between auditors liability and auditors duty in connection with internal check. Auditor is always liable if he is negligent. If there is an efficient system of internal check, the possibility of errors and frauds is minimum, hence, he can rely upon test checking. Test checking means checking a few transactions in random and if they are found correct, the auditor can presume that the remaining transactions are also be correct. If any error is detected, he should go to a detailed checking. In short, relying upon the efficiency of internal check system, auditor adopt test checking, he cannot escape from his liability, if there is any irregularity in auditing.

Table 4.2.1
Differences between Internal Check and Internal Control

Internal Check	Internal Control
Internal check is an arrangement of work in which the work of one employee is automatically checked by another person	It is the complete system of control measures introduced by the management to run the business
Internal check is only a part of internal control	It includes both internal check and internal audit
The scope of internal check is limited and narrow	The scope of internal audit cover a wide range of activities

4.2.3 Internal Audit

Internal audit is conducted by big organisations where the volume of transaction is large. It is conducted by a separate department in an organisation. It is a constant and systematic process of inspecting and reporting the operations and records of a concern. It is a continuous process of appraising the efficiency of operations and correctness of records.

Internal auditing is defined as “an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process”.

The internal auditor and external auditor are doing the same work of audit. The report of the internal auditor is submitted to the management. The report contains his opinion about the efficiency of internal check system, internal control system and suggestions for improvement. Moreover, his opinion regarding the system in operation and suggestion for improvement should also be mentioned. In short, he has to report to the management whether or not the policies, procedure and plans framed by them are properly implemented.

Table 4.2.2
Differences between Internal Audit and Internal Control

Internal Audit	Internal Control
It is a systematic and continuous process of checking and reporting records and operations of a business by the employees.	It is the complete system of control measures introduced by the management to run the business.
It is a part of internal control	It includes both internal check and internal audit

It primarily relates to auditing financial accounts and operational processes, ensuring compliance, and identifying areas for improvement	It encompasses the entire organisational system, including financial and non-financial controls
---	---

Scope of the internal audit

- a. Evaluation of the application and efficacy of risk management procedures and risk assessment practices.
- b. Appraisal of the management and financial information systems and electronic information system.
- c. Evaluation of the accuracy and dependability of the accounting records and financial reports.
- d. Evaluation of the economy and efficiency of the operations. Check-up and assessment of the adequacy and efficacy of the internal control systems.
- e. Evaluation of the systems established to safeguard compliance with legal and regulatory requirements.
- f. Testing of the reliability and suitability of the supervisory reporting.
- g. Evaluation of the means of safeguarding assets.
- h. Testing of transactions and the working of specific internal control procedures.

Table 4.2.3

Differences between Internal Check and Internal Audit

Internal Check	Internal Audit
The work one person is automatically checked by another person	The work is checked after it is completed
The object is prevention of errors and frauds	The object is detection of errors and frauds
It is done by the staff of the organisation	It is done by separate staff called internal auditors
It is an automatic review of operations	It is an independent review
The scope is limited	The scope is wide

4.2.4 Internal Audit-Industry Specific

Developments in advanced technology, globalization, and complex controlling atmosphere have led to an increased attention on company governance, risk management, and prevention of fraud. As a result, internal audit has gained significant attention as a critical tool for addressing weaknesses that may challenge business operations or lead to non-compliance with regulatory requirements. At present, it is more important for internal audit to be seen as a sincere business partner, able to recognize and control weaknesses. Internal audit function should solve these encounters of higher prospects by sharp and acting strategically, developing partnership of belief with all stakeholders.

The Institute of Chartered Accountants of India through Internal Audit Standards Board has been working persistently, to strengthen the primacy of the institute as a promoter, source and transmitter of knowledge relating to internal audit and other features related to it. It enables its members to provide more effective and efficient value added services to the clients. The Board has been bringing out standards on internal audit, technical guides of both generic and industry specific nature for the guidance of the members to conduct internal audit. The Internal Audit Standard Board of Institute of Chartered Accounts of India has issued technical guides for the benefit of members of the institute to conduct internal audit with high degree of perfection.

Internal Audit of Banks

Now a days, in India, the volume of bank frauds is increasing. Hence the Reserve Bank of India is bringing in more stringent controls to reduce the risk involved in the banking sector. The RBI gives more importance to risk-based bank audit by the implementation of Basel III requirements. RBI frequently issues more guidance and circulars to banks for regulating and controlling the banking sector in the country. Therefore, the management of bank's focused to bring about a strong framework to identify, evaluate and manage the financial risks by conducting internal audit. Good internal audit process assist the management in the active discharge of its responsibilities, monitor the bank's system of internal control and procedures. It reduces the risk and increases operational performance of the bank.

Scope of Internal Audit in Bank

- a. Examine the effectiveness of the internal control systems and monitor its application.
- b. Evaluate the trustworthiness and accuracy of the financial records and reports
- c. Conduct investigation for detecting fraud.
- d. Observing the Non-Performing Assets (NPA) of the bank and informing the management when required
- e. Ensuring proper steps for protecting and safeguarding the bank's properties
- f. Examine the efficiency of the electronic banking services
- g. Review the capability of the risk management measures and practices
- h. Assess the management information system.
- i. Execution of policies and procedures, ensure its efficacy and comply with the legal and regulatory necessities
- j. Checking the efficiency of day-to-day operations of the bank

Advantages of Internal Audit in Bank

Following are the advantages of internal audit system in banks:

- a. Systematic internal audit assures the head office that all the banking procedures and rules are followed by the branch

- b. Internal audit system enables early detection of errors and fraud
- c. Good control over the bank's non-performing assets
- d. Surprise visit and cash verification by the internal auditors will ensure all the cash transactions are recorded correctly
- e. Regular internal audit at banks helps the statutory auditors work and give better comfort and assurance
- f. Identifies terminated procedures and recommends improvement which increases the operational efficiency
- g. Overall operational and control atmosphere of the bank is enhanced
- h. It increases accountability of the employees due to regular internal audit system
- i. Constant observation of the policies and procedures helps in reducing financial risks
- j. Ensures acquiescence with statutory law and regulations

Independent Functions of Internal Audit in Bank

- a. Internal audit team must be given freedom to carry out their functions with objectivity and report its findings and communicate directly to the board of directors, external auditors etc.
- b. Internal audit bank must function independent of the other audit activities
- c. Internal audit remuneration must be consistent with the objectives of the audit
- d. Internal audit function has to be impartial

General Functions of Internal Audit in Bank

Audit Plan

The audit team in consultation with the management prepares an audit plan. The audit plan includes the timing and frequency of the internal audit work based on control risk assessment. Risk assessment means examination of all the bank's activities and internal control system which exhibits the probable degree of risk present in these activities.

Audit procedures

The audit procedures, including which types of transactions should be examined closely and whether random sampling can be applied, are determined based on risk assessment. According to the risks identified in every process across the bank's operations, based on the value and volume of the banking transactions, samples are selected in each of the core areas to be audited. Some of the important areas to be covered in bank's internal audit are:

- **Cash Transactions** – The deposits and withdrawals made, need to be traced. In addition, surprise verification of the cash balance should be done.
- **Documentation** – Checking of the supporting documents to comply with the

KYC norms and ensuring the sufficiency of security.

- **Charges** – Analysing if all charges required as per the head office circulars are collected from the customers and if there are any revenue leakages, it should be reported
- **Loan** – Checking of loan with supporting documents is necessary. Make sure that it is properly sanctioned. Schedules of repayment and examining the reported statement of non-performing assets are also required.
- **Tax** – All tax deductions have to be executed promptly.
- **Other Services** – Other banking commercial services such as swift money transfers etc. have to be done with required approvals, documentation, etc.

Cost reduction through process improvements and reducing the non-value added activities should be worked on.

All the audit procedures carried out by the internal audit staff must be properly documented in working papers.

1.2.5 Statutory Auditors and Internal Auditors

A. Statutory Auditors

Statutory audit means an audit which is compulsory as per law. One who is conducting statutory audit is called statutory auditor. Statutory auditors are also called external auditors or the external public accountants who are certified. A statutory auditor is an external auditor to certify the financial statements in accordance to specific professional auditing standards such as those issued by the ACA, ACCA, INSTOSAI. Statutory auditors are independent and are responsible for providing an objective assessment of the financial statements. They also assess the compliance of the company with legal and regulatory requirements. Audit of Joint Stock Company is compulsory. Therefore Section 226 (1) and (2) of the companies Act of 2013 makes it clear that a company auditor must be a qualified practicing Chartered Accountant within the meaning of Chartered Accountant Act 1949. Sometimes, a firm may be appointed as auditors of a company. In such cases all the partners of the firm must be practicing chartered accountants.

B. Internal Auditors

The Institute of Internal Auditors (IIA) defines a Certified Internal Auditor as “An internal auditor is a company employee who independently and objectively evaluates the organization’s operations”. The role of an internal auditor is to gather relevant and objective information about the organization. An internal auditor essentially serves as the eyes and ears of the company’s senior leadership and board of directors. Their assigned work may cover any area of an organization; however, their work should be directed by the audit committee. Historically, internal audits have been closely aligned with accounting and financial reporting audits. However, internal auditing encompasses much more, including operational and performance audits.

Internal auditing is defined as “an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process”.

Differences between internal auditor and statutory auditor

- Appointment of statutory auditor is compulsory whereas appointment of internal auditor is optional.
- Internal auditors are generally employees of the company but statutory auditor is always a third-party.
- Internal auditors generally do not perform a single comprehensive annual audit, but a number of smaller focused internal audits throughout the year but statutory auditor is confirmed with a single annual audit.
- Internal auditors generate reports for the use of management, while statutory auditor reports are prepared for use by outsiders such as investors, clients, lenders, and other stakeholders.
- Internal auditors can also serve as internal consultants but statutory auditors are barred from providing attestation and consultative services to the same organisation.

Recap

- ◊ Internal control is a system adopted by the management to conduct the business efficiently and effectively.
- ◊ In internal check the work of one person is automatically checked by another.
- ◊ Internal audit involves inspecting and reporting the operations and records of a concern.
- ◊ Audit plan is prepared by audit team in consultation with the management.
- ◊ Statutory audit is the audit which is compulsory as per law.
- ◊ Statutory auditors are external auditors conducting statutory audit.
- ◊ Internal auditor is a company employee who evaluates the organisation’s operations.

Objective Questions

1. Which type of internal control system is designed to identify errors or irregularities after they have occurred?
2. When the auditor is an employee of the organisation being audited, what type of audit is this classified as?
3. What is the term for a system of control measures introduced by management to run a business?
4. What term is used to denote the errors that occur when a transaction has not been recorded in the books of accounts either wholly or partially?
5. To whom is the report of statutory audit of a government company submitted?
6. What type of control is used to rectify errors or irregularities after they have been identified?
7. Internal audit is usually conducted in which type of organisations?
8. What is the role of an internal auditor in relation to the management of a company?
9. What is the official term for an audit required by law?
10. What is the term for the arrangement where the work of one employee is checked by another?

Answers

1. Detective control
2. Internal audit
3. Internal control
4. Error of omission
5. CAG
6. Corrective control
7. In big organisations where volume of transactions is large.
8. To report on the efficiency of internal controls and suggest improvements to management
9. Statutory
10. Internal check

Self-Assessment Questions

1. What is internal audit?
2. Differentiate between statutory auditors and internal auditors.
3. Explain internal control?
4. How does internal control differ from internal check?
5. Why is internal auditing being important in banks in India?
6. Compare and contrast internal control, internal check, and internal audit?
7. Who is a statutory auditor?
8. Explain the components of internal check?
9. Who is an internal auditor?
10. Briefly explain the scope of internal audit?

Assignments

1. Compare and contrast the internal check system and internal audit with respect to their scope, objectives, and methodologies. How do each of these systems contribute to the overall internal control environment of a company?
2. You are requested to visit a textile shop of your city and watch how they implemented internal check system for cash sales.
3. Identify and describe the three types of internal control systems: preventive, detective, and corrective. Provide real-world examples for each type of control system in the context of a manufacturing company.
4. Discuss the significance of the internal check system in reducing the risk of errors and fraud within an organization. Provide an example of how an internal check system works in practice, focusing on a specific area such as cash receipts or inventory management.
5. Analyze the impact of Basel III requirements on internal audit practices in banks. How should internal auditors adapt their approaches to align with these regulatory changes and enhance the bank's risk management framework?

Suggested Reading

1. Jagadeesh, P. (1968). Auditing: Principles and practices. Chaithanya Publishing House.
2. Bhatia, R. C. (2005). Auditing. Vikas Publishing House.
3. Gupta, K. (1987). Contemporary auditing. Tata McGraw Hill Publishing Co.
4. Saxena, & Saravanavel. (2016). Practical auditing. Himalaya Publishing Co.
5. Sharma, R. (2006). Auditing. Lakshmi Narain Agarwal.

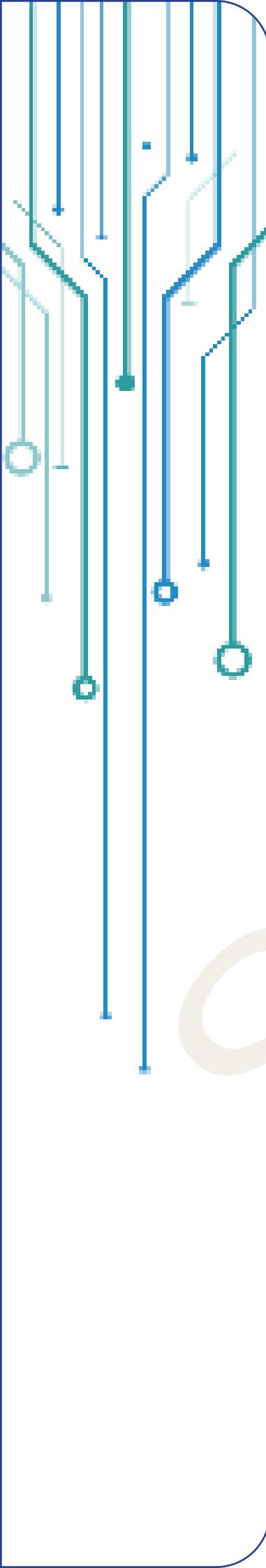
Reference

1. Arens, A.A, Elder,R.J, Beasley, M.S (2020) Auditing and Assurance Services (17th ed). Pearson.
2. Gupta, R.N Gupta, R.K(2020) Auditing: Princiles and Practice (22nded). Sultan Chand Sons.
3. Moroney,R, Campbell,F, Hamilton,J.(2020).Auditing: A Practical approach (7thed). John Wiley \$ Sons.

5

BLOCK

AUDIT REPORT



Unit 1

Audit Report and Audit Certificate

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ get an awareness on the reporting requirements under Indian companies Act
- ◊ learn different types of audits.
- ◊ distinguish between audit report and audit certificate

Prerequisites

Imagine Mr. Rajesh, an experienced businessman who owned a mid-sized manufacturing company. For years, he had confidence in his financial team and trusted them with overseeing all the company's accounts, finances, and transactions. His business was growing, and he believed everything was in order. However, one day, he noticed unexpected financial discrepancies, which caused concern. Upon further investigation, it was discovered that several financial entries in his accounts were inaccurately recorded. This led to a significant loss, and he realized that funds were misused over time by employees he trusted. If he had conducted frequent audits and kept correct audit reports and certificates, he may have identified these errors sooner and avoided such a huge disaster.

An audit report is a detailed document issued by a professional auditor after conducting a comprehensive examination of the company's financial statements. It provides insights into the financial health of the business, ensuring the accounts accurately represent the company's financial status. On the other hand, an audit certificate is more specific and certifies particular financial data or aspects of the business rather than a complete analysis of the company's

entire financial position. By understanding and regularly using both audit reports and audit certificates, business owners can significantly reduce the risk of financial discrepancies, build trust among stakeholders, and make more informed decisions. Teaching the importance of these tools helps ensure future business professionals prioritize financial transparency and accountability in their own ventures.

Keywords

Auditing, audit report, audit certificate

Discussion

5.1.1 Auditing

5.1.1.1 Nature of Auditing

Auditing is basically related to the inspection of books of accounts prepared by the accountant. It is done by an outsider usually at the end of the accounting year or periodically. It is an intelligent and critical test of the accuracy, adequacy, and credibility of accounting data and accounting statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view of financial position and profit or loss of the business.

5.1.1.2. Meaning

Auditing was derived from the Latin word “audire”. In ancient days, the person responsible for maintaining accounts has gotten it certified as correct by an independent person. For this purpose, he has to explain the details of accounts before an expert and the expert heard it carefully and certifies the correctness of the accounts. The person hearing the details of accounts is called Auditor. That is why the term auditing originated from the term audire which means to hear.

Auditing is a critical examination of books of accounts and other documents of a business so as to assure the accuracy and authenticity of books of accounts and profit/loss account and the balance sheet shows a true and correct picture of profit or loss and financial position of the business

5.1.1.3. Definition

Without examining the definition of Spicer and Pegler, the meaning of the term Auditing is meaningless. According to him, ”Auditing is the examination of books, accounts and vouchers of a business as will enable the auditor to satisfy himself that the balance sheet is properly drawn up, so as to give a true and fair view of the state of

affairs of the business and whether the profit and loss account gives a true and fair view of the profit or loss of the financial period, according to the best of the information and explanation given to him and as shown by the books, and if not, in what respect he is not satisfied.”

5.1.1.4. Scope of Audit

Auditing is basically connected to the examination of books of accounts to test their authenticity and accuracy. The depth and width of auditing depend on the need. For example, if fraud is suspected, all cash transactions should be examined. Due to the immensity of transactions, the auditor cannot check all transactions, but he can adopt test checking if there is an effective internal check system in force. In recent years, the scope of audits has increased. It is related to the examination of books of account, evidence, bills, stock, and its physical verification, etc. An auditor does not only check the books of account on the basis of evidence but also has to check the authenticity of documents. In short, the scope of audit covers the checking of books of accounts, valuation and physical verification of assets and liabilities, and checking of available evidence. Moreover, the legal requirements also decide the scope of the audit.

5.1.2. Auditor's report

This is the document through which the auditor expresses his opinion. It is the medium through which an Auditor communicates his opinion on financial statements or other relevant data under Audit. At the end of each financial year the Company Auditor prepares a report. On the basis of findings and definite information, the Auditor prepares a report making suggestions for improvement in the working of the Management. His report should give a correct assessment of the working of organisation. His report should be constructive and not merely condemning in nature .The importance of auditors' report is governed by the major provisions in the Companies Act.

- A. At every Annual General Body Meeting (A G M) of a company, the Board of Directors of the company shall lay before the company
 - 1. A Balance sheet as at the end of the period and
 - 2. Profit and loss Account for that period
- B. That Every Balance sheet of a company shall give a true and Fair view of the state of affairs of a company as at the end of the financial year and every profit and Loss Account shall give a true and fair view of the profit or loss of the company for that particular financial year.
- C. That the profit and loss account shall be annexed to the Balance Sheet and the Auditors report shall be attached thereto.

The shareholders of a company extend their trust, faith and confidence to the Audit report submitted by the Auditor. In fact ,the report offers an opportunity to the Auditors to explain to the stakeholders what they consider significant and relevant information relating to the financial position of the company for the period under reporting.

5.1.2.1. Reporting requirements under Companies Act

A new format for the issue of audit reports in case of statutory reports of companies under companies Act 2013 was introduced as Companies (Auditor's report) order (C A R O 2020) on 25th February 2020, replacing the earlier order Companies (Auditors Report) Order 2016. The aim of CARO 2020 is to enhance the overall quality of reporting by the company Auditors. This is applicable to all the companies in India including foreign company. CARO 2020 has included additional reporting requirements after consultations with the National Financial Reporting Authority (N F R A), which is an independent regulatory authority for regulating the audit and accounting profession in India.

However, it does not apply to the following companies;

- i. One person company
- ii. Small Companies (Companies with paid up capital less than/equal to RS 4 Crores and with a last reported turn over which is less than/equal to Rs 40 crores)
- iii. Banking companies
- iv. Companies registered for charitable purpose
- v. Insurance Companies

In addition some private companies are also exempted.

The Auditors report (CARO 2020) shall include a statement on the following matters

1. Details of Tangible and intangible assets.
2. Details of Inventory and working Capital.
3. Details of Investments, any guarantee or security or advances or loans given.
4. Compliance in respect of a loan to directors.
5. Compliance in respect of deposits accepted.
6. Maintenance of Costing records.
7. Deposit of statutory liabilities.
8. Unrecorded income.
9. Default in repayment of borrowings.
10. Funds raised and its utilisation.
11. Funds and Whistle –blower complaints
12. Compliance by a Nidhi.
13. Compliance on transactions with related parties.
14. Internal Audit system.

15. Non cash dealings with Directors.
16. Cash losses.
17. Resignation of statutory Auditors.
18. Material uncertainty on meeting liabilities.
19. Transfer of fund specified under schedule (vii) of the companies Act 2013.
20. Registration under Section 45-IA of R B I Act 1934
21. Qualification or Adverse Auditor remarks in other group companies.

In any case where the auditor ‘s answer to any of the requirements mentioned above is unfavourable or negative, then the auditor’s report shall also state the basis for such unfavourable or qualified answer. Also, in a case where the auditor is unable to express any opinion on any specific matter, the report shall indicate such fact along with the reasons as to why it is not possible for the auditor to give an opinion on the same.

5.1.3. Annual Financial Statements (Section 129)

Under the Companies Act, 2013, every company must prepare its financial statements. Which include the balance sheet, profit and loss account, cash flow statement, statement of changes in equity (for specific types of companies), and explanatory notes. These financial statements should present a “true and fair” view of the company’s financial status. Additionally, they must be prepared in compliance with accounting standards notified under Section 133 of the Act. Adherence to prescribed accounting standards and principles (like Generally Accepted Accounting Principles or GAAP) ensures comparability and reliability in financial reporting. Once prepared, financial statements must be approved by the board, signed by at least two directors, and presented at the Annual General Meeting (AGM).

5.1.4. Directors' Report (Section 134)

The Directors' Report is a key disclosure document that provides an overview of the company’s operations and financial performance. Required annually, it must include information on:

- The company’s state of affairs and financial highlights.
- Dividend declarations and transfers to reserves.
- Material changes and commitments affecting the financial position of the company.
- Conservation of energy, technology absorption, foreign exchange earnings and outgo (for certain classes of companies).
- Risk management initiatives and the identification of principal risks.
- Corporate social responsibility (CSR) initiatives and spending, where applicable (as per Section 135).
- A statement confirming compliance with applicable laws.
- Policies for financial control and any deviations or material weaknesses

identified.

This report, signed by the company's directors, provides shareholders with key information about the company's activities, growth strategies, and compliance with statutory requirements.

5.1.5. Corporate Social Responsibility (CSR) Reporting (Section 135)

Section 135 mandates CSR for companies meeting specific financial thresholds (net worth of ₹500 crore or more, turnover of ₹1,000 crore or more, or net profit of ₹5 crore or more). Companies must spend at least 2% of their average net profits (over the past three financial years) on CSR activities. These companies are required to create a CSR policy and disclose the following in their annual report:

- CSR policy and initiatives.
- Detailed information on CSR projects, expenditure, and outcomes.
- Reasons for failing to meet the CSR obligation, if applicable.

CSR reporting promotes accountability and allows the public to assess the company's commitment to social and environmental responsibilities.

5.1.6. Maintenance of Statutory Registers (Section 88)

The Act mandates that every company shall keep and maintain the following registers in such form and in such manner as may be prescribed. Namely;

1. Register of Members: indicating separately for each class of equity and preference shares held by each member residing in or out side India. This includes names, addresses, and shareholdings of all shareholders.
2. Every register maintained under sub-section (I) shall include an index of names included therein.
3. The register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act, 1996 shall be deemed to be corresponding register and index for the purpose of this Act.
4. If a company does not maintain a register of members or debenture –holders or other security holders or fails to maintain them in accordance with the provisions of Sub-section (1) or (2) the company shall be liable to a penalty of three lakh rupees and every officer of the company who is in default shall be liable for a penalty of fifty thousand rupees.
5. Register of Charges: Details of all secured loans, collateral offered, and charges on company assets.
6. Register of Directors and Key Managerial Personnel: Contains information on directors, managerial personnel, and their shareholdings.

These registers, open to inspection by members and shareholders, offer transparency regarding the company's governance and ownership structure. The accuracy of these records is essential as they may impact decisions made by investors, creditors, and

regulatory bodies.

5.1.7. Board Meetings and Resolutions (Section 118)

As per the Companies Act, companies must conduct periodic board meetings and record minutes for every meeting. Resolutions passed at these meetings must be recorded accurately, particularly when they involve significant business decisions, financial undertakings, or changes in the company's structure. The minutes are to be maintained for inspection and must be signed by the chairman of the meeting. This provides a documented trail of corporate decisions, ensuring transparency in governance.

5.1.8. Disclosure of Related Party Transactions (Section 188)

Section 188 mandates that companies disclose all related party transactions in their financial statements. This includes transactions with directors, senior management, relatives, and any entity in which the company has substantial interest. Such disclosures prevent conflicts of interest and ensure that the transactions are carried out fairly and transparently. If related party transactions exceed a specified limit, they require board and shareholder approval.

5.1.9. Internal Financial Controls (Section 134(5)(e) and Section 177)

The Act requires directors to take responsibility for laying down adequate internal financial controls to prevent financial irregularities. This is especially relevant for listed companies, where audit committees must review the adequacy of these controls. Section 134 mandates a statement in the Directors' Report about the adequacy of internal financial controls, which demonstrates the company's commitment to managing and mitigating financial risks. Auditors must also express an opinion on these controls as part of the audit report.

5.1.10. Annual Return (Section 92)

The Annual Return, filed annually with the Registrar of Companies (RoC), provides a comprehensive snapshot of the company's financial and operational status, including information on the following:

- Registered office and principal place of business.
- Principal business activities.
- Shareholding pattern and changes in shareholding.
- Details of directors, managerial personnel, and key managerial changes.
- Debenture holders and member class composition.

This form serves as a vital public document, providing transparency into the company's ownership structure, governance, and financial strength.

5.1.11. Financial and Compliance Filings with the Registrar of Companies (RoC)

Beyond the Annual Return, the Companies Act requires companies to file numerous compliance forms with the RoC. These filings cover the following events:

- Change in Directors or Key Personnel: Appointment or resignation of directors must be promptly reported to the RoC.
- Change in Registered Office Address: Any change in the company's registered office address must be reported within a specified period.
- Allotment and Transfer of Shares: Companies are required to submit details of any change in share capital or transfer of shares.

Such filings serve as an official record of the company's corporate activities, ensuring compliance with the regulatory framework.

5.1.12. Secretarial Audit for bigger companies (Section 204)

Every listed company and a company belonging to other class of companies as may be prescribed shall annex with its Board's report made in terms of sub-section (3) of section 134, a secretarial audit report, given by a company secretary in practice, in such form as may be prescribed. This ensures compliance with company laws, securities regulations, and other statutory requirements. A qualified company secretary conducts this audit, and the report is annexed to the Board Report, highlighting any potential non-compliance issues. This audit offers an independent assessment of the company's regulatory adherence.

5.1.13. Disclosure of Director's Interests and Restrictions on Loans (Section 184 and 185)

Directors must disclose their direct or indirect interests in any contract or arrangement involving the company. Section 184 requires directors to provide a written disclosure of such interests and mandates that they abstain from voting on relevant resolutions. Additionally, Section 185 restricts companies from providing loans, guarantees, or securities to directors or entities where directors have an interest, with some exceptions for specific situations or group companies. These requirements protect against conflicts of interest and ensure that company assets are not misused.

5.1.14. Whistle blower Policy and monitoring Mechanism (Section 177)

For certain classes of companies, particularly listed ones, the Act mandates a monitoring mechanism for directors and employees to report genuine concerns related to unethical practices or financial misconduct. The monitoring mechanism is typically an independent whistleblower policy that provides an anonymous channel for reporting concerns. This requirement strengthens internal governance and fosters a culture of ethical behavior within the organization.

5.1.15. Risk Management Policy (Section 134)

Section 134 requires companies to disclose information on their risk management policy and measures taken to mitigate foreseeable risks in their Director's Report. This requirement helps investors and other stakeholders understand how the company plans to address market fluctuations, regulatory changes, and other risks that may affect financial performance.

5.1.16. Cost Audit (Section 148)

Cost audit requirements apply to companies involved in sectors with high regulatory oversight, like manufacturing, infrastructure, and public utilities. These companies must maintain cost records and appoint a cost auditor to assess production, distribution, and operational costs. The cost audit report is filed with the RoC and provides insights into cost efficiency and the company's competitiveness.

The reporting requirements under the Indian Companies Act, 2013, embody an exhaustive framework that ensures transparency, accountability, and integrity in corporate governance. They cover a wide range of disclosures, from financial reporting and audits to CSR initiatives and director interests. These requirements aim to protect shareholders, maintain market integrity, and build public confidence in corporate governance. For companies, adherence to these requirements not only fosters a reputation for reliability but also reduces the risk of legal penalties, financial misstatements, and regulatory scrutiny. By enforcing strict reporting standards, the Companies Act, 2013, plays a pivotal role in enhancing corporate governance and fostering sustainable growth within India's dynamic business environment.

5.1.17 Audit Certificate

An audit certificate is an official document issued by an auditor after reviewing and validating an organization's financial records, accounts, or specific transactions. It attests to the accuracy, fairness, and compliance of financial statements and other specified information according to prescribed standards. Unlike a comprehensive audit report, which provides a detailed examination of financial statements, an audit certificate is more concise and specific, often limited to verifying particular figures, compliance, or sections of the financial records.

The primary purpose of an audit certificate is to certify specific financial data for compliance, assurance, or regulatory needs. Organizations may require an audit certificate for various reasons, such as meeting regulatory obligations, applying for loans or grants, or participating in tenders. For example, non-profit organizations often need an audit certificate to show donors or grantors that funds are used according to agreed-upon purposes. Companies might also seek an audit certificate to assure investors or regulatory authorities that financial disclosures are accurate and complete. Audit certificates are often mandatory in sectors where precise financial disclosure is crucial, like government-funded projects, non-profit organizations, and specific regulated industries. They play a significant role in increasing credibility, particularly

when an external body requires confirmation of financial data accuracy or compliance with statutory regulations.

5.1.17.1 Contents of an Audit Certificate

An audit certificate usually includes the following components:

1. Title and Introduction: Identifies the document as an audit certificate and outlines the purpose of the certification.
2. Scope of Work: Specifies the area or information the auditor has reviewed, like revenue figures, inventory valuation, grant usage, or fund allocations.
3. Auditor's Opinion: Unlike an audit report that may offer a qualified or adverse opinion, an audit certificate typically confirms that the examined information meets the specified standards. The certificate states whether the figures or information presented are accurate and free from material misstatements.
4. Compliance Statement: Certifies whether the company's records are compliant with specific regulations, accounting standards, or requirements set by a regulatory body.
5. Date and Signature: The certificate must include the date of issuance and the auditor's signature and seal, confirming the auditor's authority and responsibility for the certification.

5.1.17.2 Audit report v/s Audit certificate

An audit report and an audit certificate are essential documents in the auditing process, but they differ significantly in scope, purpose, and level of detail. An audit report provides a comprehensive assessment of a company's financial statements, examining whether they present a true and fair view in accordance with accepted accounting standards, such as GAAP or IFRS. This report is a broader evaluation covering all aspects of the company's financial position, including assets, liabilities, income, and expenses, often issued annually after a rigorous audit process. Stakeholders like shareholders, creditors, and regulators rely on the audit report to understand the organization's financial health, compliance with regulatory requirements, and adequacy of internal controls, helping them make informed decisions.

An audit certificate is more focused and concise. It certifies specific financial information or compliance with certain regulations rather than the entire set of financial statements. Commonly used in scenarios where organizations need to verify particular financial data, such as revenue figures, fund utilization, or inventory valuations, the audit certificate confirms the accuracy of specified items rather than providing an overall opinion. Often required for regulatory compliance, loans, grants, or project funding, the audit certificate serves as a quick, specific verification and typically does not involve the extensive testing and analysis seen in a full financial audit.

The content and structure of these documents reflect their differing purposes. An

audit report follows a standardized format, including sections like the auditor's opinion, basis for the opinion, and additional explanatory notes to provide clarity on any uncertainties or special observations. It may be qualified, unqualified, or adverse based on the auditor's findings. An audit certificate, however, is shorter and straightforward. It includes only the purpose, the specific financial data reviewed, and the auditor's confirmation that the data is accurate, with no further breakdown or analysis. This simplicity allows it to meet specific verification needs quickly, without the comprehensive disclosures found in an audit report.

Both the audit report and the audit certificate play essential roles in fostering transparency and accountability, albeit in different ways. The audit report offers stakeholders a well-rounded view of the company's financial stability, promoting confidence and helping stakeholders assess risks. The audit certificate, on the other hand, caters to organizations needing assurance on specific financial aspects, providing a reliable, targeted verification without requiring a full audit. Together, these documents enhance the credibility of an organization's financial information, allowing it to maintain regulatory compliance, strengthen investor trust, and secure funding when needed.

Recap

- ◊ Auditing - related to the inspection of books of accounts prepared by the accountant
- ◊ Continuous audit - audit work is done along with the accounting work throughout the accounting year
- ◊ An annual audit -a complete audit or final audit
- ◊ An interim audit- between two annual audits
- ◊ A statutory audit -audit made compulsory as per statute or law
- ◊ The balance sheet audit - the audit of items of the balance sheet
- ◊ Cost audit- is the examination of the cost accounting records of a company
- ◊ An audit certificate- document issued by an auditor after validating an organization's financial records
- ◊ Purpose of an audit certificate- certify specific financial data

Objective Questions

1. What is the primary purpose of auditing?
2. What is the main objective of continuous audit?

3. Which is the regulatory body for regulating audit and accounting profession?
4. What is CARO 2020?
5. Which audit type is conducted in between financial years to assess interim results?
6. Which audit type focuses on examining costs incurred by the business?
7. An audit that is conducted annually at the end of a financial year is known as:
8. The primary objective of a Government Audit is to ensure:
9. A continuous audit is best suited for which type of organization?

Answers

1. Certify the authenticity of financial statements
2. Detect irregularities periodically
3. N F R A
4. New format of Audit report.
5. Interim Audit
6. Cost Audit
7. Annual Audit
8. Accuracy in government expenditures and compliance with laws
9. Large organizations with frequent transactions

Self-Assessment Questions

- ◊ What is the primary purpose of auditing, and how does it help maintain financial integrity within an organization?
- ◊ Describe the scope of an audit. How does the scope vary depending on the type and objective of the audit being conducted?
- ◊ What is N F R A?
- ◊ List and explain the main objectives of auditing. How do these objectives contribute to accurate financial reporting and stakeholder confidence?
- ◊ Identify and briefly describe the different types of audits, including statutory, cost, and government audits. How does each type serve a unique

purpose?

- ◊ How does a government audit differ from other types of audits, and what impact does it have on public accountability and the management of government resources?
- ◊ Differentiate between an audit report and an audit certificate. In what situations might a business require each, and what specific information does each document provide?

Assignments

1. Explain the role of auditing in today's business environment. Discuss its importance in maintaining transparency and trust among stakeholders.
2. Examine the scope of auditing in various contexts, such as financial audits, compliance audits, and operational audits. Discuss how the scope may vary based on an organization's needs.
3. Identify and analyze the key features of auditing, such as independence, professional skepticism, and accuracy, and discuss how these features contribute to financial accountability.
4. Describe the objectives of auditing and evaluate how achieving these objectives can lead to improved financial health and operational effectiveness.
5. Compare and contrast different types of audits, focusing on statutory audits, cost audits, and government audits. Explain their unique characteristics and relevance in different sectors.
6. Discuss the concept of continuous auditing compared to annual auditing. Analyze their advantages, challenges, and which businesses might benefit from each type.
7. Explain the purpose of an interim audit, the steps involved in conducting one, and its role in helping organizations maintain financial accuracy throughout the year.
8. Explore the purpose and process of government audits. Discuss how they enhance accountability and ensure compliance in government-funded projects and public organizations.
9. Collect the annual reports of five public-sector companies and categorise them according to the types of audits.

Suggested Reading

1. Asish K Bhattacharjee, Tata McGraw Hill, Indian Accounting Standards
2. Dr. B D Agarwal - Advanced Financial Accounting
3. Israr Shaikh and Rajesh Makkar, Lexis Nexis. Accounting Standards
4. Jain S.P and Narang K.L .Corporate Accounting, Kalyani Publishers, New Delhi
5. Maheswari S.N. and Maheswari S.K. Corporate Accounting, Vikas Publishing House, New Delhi
6. Mukherjee A. and Hanif M. Corporate Accounting, Tata McGraw-Hill Publishing Co.Ltd. New Delhi
7. Nirmal Gupta and Chhavi Sharma. Corporate Accounting Theory and Practice, Ane Books India, Delhi.

Reference

- ◊ P C Thulsian - Advanced Corporate Accounting
- ◊ Paul. K.R. Accountancy, New Central Book Agency Pvt. Ltd. Kolkata
- ◊ Pillai R.S N,Bhagavathi and Uma S. Fundamentals of Advanced Accounting, S Chand & Co. Ltd., New Delhi
- ◊ Rawat D S—Taxman Accounting Standards
- ◊ RL Gupta and Radhaswamy- Advanced Accounting
- ◊ Shukla M C, GrewalT.S.and Gupta S.C. Advanced Accounts S.Chand& Co. Ltd., New Delhi

Types of Audit Report

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ get an awareness on the audit report
- ◊ familiarize the contents of audit report
- ◊ explain the qualifications in audit reports
- ◊ gain an insight on the types of audit report

Prerequisites

Sara, a young tech entrepreneur, has recently launched her own business. She is excellent at software development and understands the fundamentals of business, but managing the company's funds is a new experience for her. Sara employs an accountant to keep her financial records in order as her business grows and investor interest increases. She soon discovers that potential investors want an audit report to ensure her finances are accurate and trustworthy. She seeks guidance from her friend Raj, an experienced accountant, as she is unfamiliar with audit reports. Raj continues, "Consider an audit report as a financial check-up for your company. It's like a report card prepared by an independent auditor who checks your financial records and determines whether they are accurate. This report demonstrates to investors that your financial information can be trusted." He continues, "There are various audit reports, each showing a particular aspect of your company's finances.

He adds, "Getting audit reports regularly can help you detect financial concerns early on and reassure investors that your finances are in order. It's like having an outside expert confirm that your company is financially sound. Sara begins to see how important these audit reports are for keeping trans-

parency. "Thanks, Raj," she responds. "I understand now!" Knowing what these reports cover helps me understand what investors are searching for.

Keywords

Audit report, clean report, qualified opinion

Discussion

An audit report is a formal document issued by an auditor after reviewing a company's financial statements, processes, and internal controls. Its primary goal is to give stakeholders a clear picture of the company's financial health, any issues identified, and the auditor's opinion on the accuracy of the financial records.

5.2.1. Introduction to an Audit Report

An audit report provides stakeholders with a professional opinion on whether the company's financial statements are accurate and in compliance with accounting standards. It's used by various groups such as investors, management, government authorities, and banks. This opinion helps them to decide if they can trust the information provided in the company's financial reports.

Audit reports are generally issued by external auditors, who are independent of the organization. This independence allows auditors to provide an unbiased view. Sometimes, however, companies also have internal audit reports prepared by their own staff to check their processes more frequently and stay on track.

5.2.1.1 Contents of audit report

1. Title

The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor.

2. Addressee

The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed. The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited. In case of a company, the report is addressed to the shareholders of the company.

3. Introduction

This section identifies the company, the period covered by the audit, and the financial statements that were audited.

4. Scope of the Audit

This section outlines the nature of the audit procedures performed and the scope of the auditor's examination.

5. Auditor's Opinion

This is the most critical part of the report. It expresses the auditor's opinion on the fairness of the financial statements in all material respects, in accordance with applicable accounting standards.

6. Basis for Opinion

The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

1. States that the audit was conducted in accordance with Standards on Auditing.
2. Refers to the section of the auditor's report that describes the auditor's responsibilities.
3. Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
4. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

7. Key Audit Matters

For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report. When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so. Law or regulation may require communication of key audit matters for audits of entities other than listed entities.

8. Responsibilities of Management and Those with Governance

Management is responsible for preparing the financial statements and ensuring they are presented fairly. They must select appropriate accounting policies and apply them consistently. Management should also maintain adequate internal controls to prevent and detect fraud and errors. Those with governance, such as the board of directors, have the responsibility of overseeing the financial reporting process. They should ensure that management is competent and trustworthy, and that the company's financial statements are accurate and complete. They may also appoint an audit committee to oversee the audit process.

9. Auditor's Responsibilities for the Audit of the Financial Statements

The auditor's report shall include a section with the heading "Auditor's

Responsibilities for the Audit of the Financial Statements.”

This section of the auditor’s report shall state

- Objectives of the auditor
- That reasonable level of assurance is high level of assurance and not guarantee
- That misstatements can arise from fraud and error

10. Signature of the Auditor

The auditor’s report shall be signed. The report is signed by the auditor in his personal name. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm.

11. Date

The date on which the report is issued.

5.2.2. Qualifications in Audit Reports

A qualification in an audit report is a statement by the auditor that indicates a significant limitation or exception to their opinion on the financial statements. This can arise due to various reasons, such as:

- **Material Misstatements**

When the auditor identifies material misstatements in the financial statements that are not pervasive, they may issue a qualified opinion. This means that the financial statements are presented fairly in all material respects, except for the specific areas where the misstatements exist.

- **Uncertainty**

If there is a significant uncertainty that could affect the financial statements, the auditor may also issue a qualified opinion. For example, if there is a pending lawsuit with a significant potential outcome, the auditor may qualify their opinion until the outcome is resolved.

5.2.2.1 Types of Qualifications:

Scope Limitation : If the auditor is unable to obtain sufficient appropriate evidence to form an opinion on a material portion of the financial statements, they may issue a qualified or a disclaimer opinion. This could happen due to factors such as management restrictions or limitations imposed by the company's circumstances.

Departure from Generally Accepted Accounting Principles (GAAP): This arises when the company has not followed GAAP in a material way.

Uncertainty : This occurs when there is a significant uncertainty that could affect the financial statements.

5.2.2.2. Impact of Qualifications

A qualified opinion can have a significant impact on the credibility of the financial statements. Investors, creditors, and other stakeholders may be less likely to rely on the financial statements if they are qualified. It is important for users to understand the nature of the qualification and its potential impact on the company's financial performance and position.

A qualification in an audit report is a serious matter that should be carefully considered by users of the financial statements. It indicates a significant limitation or exception to the auditor's opinion and can have a significant impact on the credibility of the financial information.

5.2.3. Types of Audit report

An audit report is a formal statement issued by an independent auditor after examining a company's financial statements, records, and internal controls. This report is essential for stakeholders, including investors, regulatory bodies, and management, as it gives them a professional assessment of the company's financial health and adherence to accounting standards. The report typically ends with an opinion on whether the financial statements accurately represent the company's financial status. There are four main types of audit reports, each indicating a different level of assurance and accuracy: unqualified, qualified, adverse, and disclaimer of opinion.

5.2.3.1. Unqualified Opinion (Clean Report)

An unqualified opinion, commonly referred to as a "clean report," is the most favourable type of audit report a company can receive. In this report, the auditor states that the financial statements are presented fairly in all material respects and comply with the applicable accounting standards, such as Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS). A clean report signifies that the auditor did not find any major discrepancies or issues in the financial statements and that they believe the company's records accurately reflect its financial position.

An unqualified opinion provides a high level of confidence for investors and other stakeholders, as it indicates that the company's financial reporting is reliable and transparent. This type of report also benefits the company's reputation and can make it easier to secure loans or attract new investors. For management, a clean report suggests that their internal controls and financial practices are effective, contributing to business stability and growth.

5.2.3.2. Qualified Opinion

A qualified opinion is issued when the auditor finds that the financial statements are generally accurate but include a specific area where they do not conform to accounting standards. This opinion highlights that, although the company's financial records are largely reliable, there is a minor issue that needs to be addressed. The qualified opinion is generally accompanied by a paragraph explaining the exact nature of the issue.

Common reasons for a qualified opinion include scope limitations, where the auditor is unable to access specific information, or deviations from standard accounting practices in isolated areas.

For example, if a company's inventory records are incomplete, or a specific revenue recognition policy is not in line with GAAP, the auditor might issue a qualified opinion. While this does not reflect an overall distrust of the company's financial position, it cautions stakeholders about a particular concern that should be monitored or corrected.

Although a qualified opinion may raise some concerns, it still allows stakeholders to rely on most aspects of the company's financial statements. This type of report is generally seen as a moderate level of assurance, where the company has a specific, correctable issue but remains mostly compliant with accounting standards.

5.2.3.3. Adverse Opinion

An adverse opinion is the most serious type of audit report and is issued when the auditor determines that the company's financial statements are not accurate or reliable. In this case, the financial records are found to contain significant misstatements or departures from accounting standards, which may mislead stakeholders about the company's financial health. An adverse opinion suggests that the financial statements do not fairly represent the company's true financial condition and could indicate deeper problems, such as fraud, poor management, or severe internal control weaknesses.

Receiving an adverse opinion has serious consequences for a company. It often leads to a loss of investor trust, difficulties in obtaining financing, and potential regulatory scrutiny. Management must address the issues highlighted in the report urgently to regain confidence and credibility with stakeholders. If the adverse opinion is due to intentional misrepresentation or fraud, it could also result in legal actions against the company and its executives.

An adverse opinion is highly concerning for external stakeholders as it questions the reliability of the company's financial information. For investors and creditors, this report serves as a red flag, signaling a significant risk if they decide to invest in or lend to the company. Consequently, companies that receive an adverse opinion must take swift corrective action to prevent further negative impacts on their business.

5.2.3.4. Disclaimer of Opinion

A disclaimer of opinion is issued when the auditor cannot express an opinion on the company's financial statements. This situation arises if the auditor is unable to complete the audit due to lack of access to critical information, insufficient documentation, or significant uncertainties affecting the financial data. A disclaimer indicates that the auditor was unable to obtain sufficient evidence to form an opinion, leaving stakeholders without a clear understanding of the company's financial position.

For instance, if management restricts the auditor's access to important financial records or fails to provide necessary documentation, the auditor may issue a disclaimer.

Other situations that might lead to a disclaimer include major legal uncertainties or unresolved contingencies that make it impossible for the auditor to assess the company's financial statements accurately.

A disclaimer of opinion can be highly problematic for the company, as it implies significant weaknesses in record-keeping, transparency, or cooperation with the auditor. For stakeholders, a disclaimer raises substantial concerns about the credibility of the company's financial statements, potentially leading to a loss of confidence, investment hesitancy, or increased scrutiny by regulators. Companies that receive a disclaimer should take immediate steps to resolve the issues preventing a full audit, ensuring more transparent and accurate reporting in the future.

Recap

- ◊ Auditor's Opinion- most critical part of the report
- ◊ A qualification - is a statement that indicates a significant limitation
- ◊ An unqualified opinion, -“clean report”
- ◊ A qualified opinion - financial statements are generally accurate but include a specific area where they do not conform to accounting standards
- ◊ An adverse opinion is the -the company's financial statements are not accurate or reliable
- ◊ A disclaimer of opinion -the auditor cannot express an opinion on the company's financial statements

Objective Questions

1. What does an audit report assess?
2. What is an Unqualified Opinion also known as?
3. What does a Disclaimer of Opinion mean?
4. Which audit opinion indicates severe financial misstatements?
5. What type of opinion suggests minor issues but overall reliability in financial statements?
6. Which type of opinion would indicate the highest level of investor confidence?
7. In which type of opinion does the auditor provide a "clean bill of health"?
8. Which section of an audit report gives the final opinion on the financial statements?

Answers

1. The accuracy and reliability of a company's financial statements
2. Clean Report
3. The auditor cannot form an opinion due to lack of information
4. Adverse Opinion
5. Qualified Opinion
6. Unqualified Opinion
7. Unqualified Opinion
8. Opinion

Self-Assessment Questions

- ◊ What is the primary purpose of an audit report, and why is it important for investors?
- ◊ Explain what an Unqualified Opinion (Clean Report) signifies in an audit report. Why is it considered the most favorable opinion?
- ◊ What is a Qualified Opinion, and how does it differ from an Adverse Opinion? Provide an example of when a company might receive a qualified opinion.
- ◊ Describe a Disclaimer of Opinion and identify a scenario in which an auditor might issue this type of report.
- ◊ How can an Adverse Opinion impact a company's relationship with its stakeholders and investors?
- ◊ List the main sections found in a typical audit report. What is the purpose of each section?
- ◊ What information is generally included in the Scope of the Audit section, and why is this important for the users of the report?
- ◊ Why might an auditor issue a qualified opinion rather than an unqualified opinion, and what impact does it have on the perceived accuracy of the financial statements?
- ◊ How does the Basis for Opinion section support the auditor's conclusions in an audit report? Why is it important for transparency?

Assignments

1. Select a company that received an Adverse Opinion in its audit report in recent years. Summarize the reasons for the opinion, how the company responded, and the impact it had on its stock price and investor trust. Analyze how this audit opinion affected the company's financial standing and reputation.
2. Prepare a detailed report explaining the contents of an audit report. Describe the purpose of each section (Title, Opinion, Scope, Basis for Opinion, and any other relevant sections), and explain how each part contributes to the overall transparency and reliability of the report.
3. Compare and contrast an Unqualified Opinion with a Qualified Opinion. Explain the key differences in the circumstances that lead to each opinion, how each opinion is presented in the audit report, and how they might influence a potential investor's decision.
4. Imagine you are an auditor for a mid-sized business. The business has some financial discrepancies that are not severe but require disclosure. Write a mock audit report summarizing your findings and presenting a Qualified Opinion. Include the main sections of an audit report and provide a clear explanation in each.
5. Write an in-depth report on the various Types of Qualifications in audit reports. Describe situations where a company might receive a qualified opinion, and explain how the qualification impacts the interpretation of the financial statements.
6. Create a fictional company scenario where the company's records are missing some financial data. Based on this scenario, decide which type of audit opinion (Disclaimer of Opinion or Qualified Opinion) would be issued, and explain your reasoning.

Suggested Reading

1. Asish K Bhattacharjee, Tata McGraw Hill, Indian Accounting Standards
2. Dr. B D Agarwal - Advanced Financial Accounting
3. Israr Shaikh and Rajesh Makkar, Lexis Nexis. Accounting Standards
4. Jain S.P and Narang K.L .Corporate Accounting, Kalyani Publishers, New Delhi

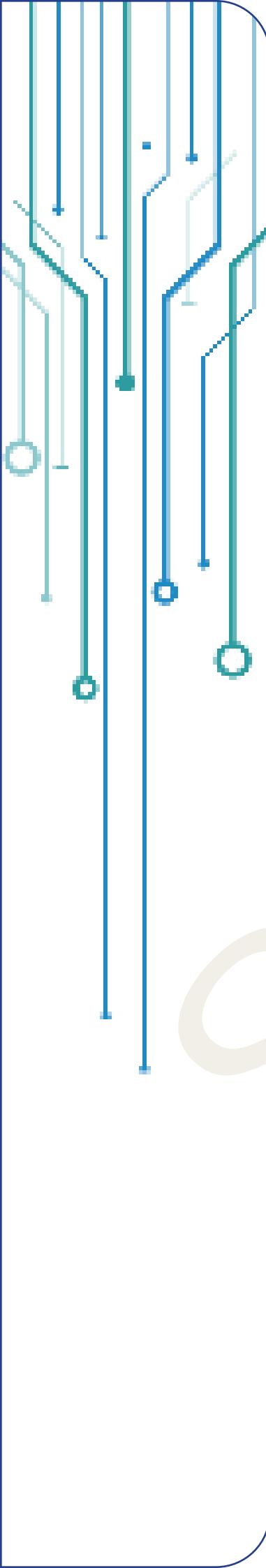
5. Maheswari S.N. and Maheswari S.K. Corporate Accounting, Vikas Publishing House, New Delhi
6. Mukherjee A. and Hanif M. Corporate Accounting, Tata McGraw-Hill Publishing Co.Ltd. New Delhi
7. Nirmal Gupta and Chhavi Sharma. Corporate Accounting Theory and Practice, Ane Books India, Delhi.

Reference

- ◊ P C Thulsian - Advanced Corporate Accounting
- ◊ Paul. K.R. Accountancy, New Central Book Agency Pvt. Ltd. Kolkata
- ◊ Pillai R.S N,Bhagavathi and Uma S. Fundamentals of Advanced Accounting, S Chand & Co. Ltd., New Delhi
- ◊ Rawat D S—Taxman Accounting Standards
- ◊ RL Gupta and Radhaswamy- Advanced Accounting
- ◊ Shukla M C, GrewalT.S.and Gupta S.C. Advanced Accounts S.Chand& Co. Ltd., New Delhi

6
BLOCK

COMPANY AUDIT



Unit 1

Introduction to company audit

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ get an insight to the company audit
- ◊ understand the qualifications required for a Company Auditor
- ◊ disqualifications of an Auditor
- ◊ familiarise with the appointment and removal of auditors
- ◊ get an awareness on the powers and duties of an auditor

Prerequisites

In the previous units we have discussed that Auditing is an intelligent and critical test of accuracy, adequacy, and dependability of accounting data and accounting statements. It is an examination of accounts to ascertain whether the financial statements give a true and fair view of financial position and profit and loss of the business.

Arun, a recent graduate, had just started working in the finance department at Finances Inc. He was still learning when his manager, Lakshmi, invited him for a coffee chat to explain an important part of the company's finances—Company Audits. Lakshmi explained that a company audit is like a regular “check -up” for the business's finances, just like a doctor checks your health. An independent auditor looks at the company's financial statements to make sure everything is correct and that no money is missing. This process helps find mistakes, prevent fraud, and ensure that Finances Inc. is following the law. She continued that picking an auditor is a big decision made at the company's annual general meeting, where shareholders or the board vote on the choice. They look

for someone who is independent and qualified, like a CPA or Chartered Accountant, to avoid bias. Lakshmi compared this to choosing a fair referee for a sports game, ensuring the auditor has no personal connections that could affect their work. By including shareholders in this choice, the company makes sure that the auditor's review is fair and trustworthy.

Keywords

Company audit, contractual duties, auditor's lien

Discussion

6.1 Company Audit

A company audit is a systematic examination of a company's financial records, operations, and controls to verify their accuracy, compliance with regulations, and adherence to accounting standards. Conducted either internally by an in-house audit team or externally by independent auditors, a company audit aims to assess the truthfulness and reliability of the financial statements. Company is a big form of business organisation. It is owned by thousands of shareholders having small holdings, scattered all over the country or world. Therefore, it is not possible to manage the company by all shareholders. Hence, they elected a group of persons called Board of Directors to look after the affairs of the company. Hence, shareholders like to know what is happening in the financial activities of the company and whether their investment is safe or not. Therefore, Companies Act of 2013 has made it compulsory that accounts of a joint stock company must be audited by a qualified chartered accountant to disclose, to reveal and to put report to the shareholders regarding what is happening in the financial resources and activities of the company.

Company audits are independent examinations of a company's financial records and practices. They ensure accuracy, completeness, and reliability of financial statements. Auditors assess compliance with laws, identify potential fraud, and evaluate internal controls. Audits provide investors with confidence and help companies improve efficiency and risk management.

6.1.1 Appointment of Companies' Auditors

The provisions regarding appointment of auditor are contained in Chapter X Section 139 of Companies Act 2013. Every company shall at the first Annual General Meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth Annual General Meeting, and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed:

6.1.2 Tenure of appointment

As per Section 139(2) of the Companies Act

1. An individual can be appointed for a term not more than five years.
2. An audit firm can be appointed for a consecutive term not more than two terms of five years.
3. An individual or a firm which has completed its term shall not be eligible for re-appointment as auditor in the same company for five years from the completion of the term.

6.1.3 Appointment of auditor of government companies

According to Section 139(5), the Comptroller and Auditor General shall in respect of financial year appoint an Auditor duly Qualified within 180 days from the commencement of financial year who shall hold office till conclusion of Annual General Meeting, in the case of a government company or any other company owned or controlled directly or indirectly by the Central Government, or by any State Government or Governments.

6.1.4 Appointment of first Auditor by Board of Directors

As per Section 139 (6), the first auditor of a company other than Government company shall be appointed by the Board of Directors within 30 days of incorporation of company. If the board fails to appoint first Auditor it shall inform the Members of Company who shall appoint auditor within 90 days at an extra ordinary general meeting who shall hold office till conclusion of first annual general meeting.

6.1.5 Casual vacancy of an Auditor

- a. According to section 139(8), the casual vacancy of an Auditor, except in case of Government Company, shall be filled by the board of directors within 30 days but if it arises as a result of resignation of the Auditor it shall be approved by the company at general meeting convened within 3 months of recommendation of board. Such Auditor shall hold office till conclusion of next annual general meeting.
- b. 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 the C&AG, within 30 days.

6.1.6 Re-appointment of a retiring Auditor

As per section 139(9), a retiring auditor may be re-appointed at an annual general meeting if-

- a. he is not disqualified for re-appointment
- b. he has not given the company a notice in writing of his unwillingness to be re-appointed

- c. a special resolution has not been passed at that meeting appointing some other auditor or providing expressly he shall not be appointed.

6.1.7 Qualification required for an auditor

Audit of Joint Stock Company is compulsory. Therefore Section 141 (1) and (2) of the Companies Act of 2013 makes it clear that a company;

1. Auditor must be a qualified practicing Chartered Accountant within the meaning of Chartered Accountant Act 1949 (act number 38 of 1949), who holds a valid certificate of practice under sub section (1) of section 6 of that act.
2. Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.
3. Sometimes, a firm may be appointed as auditors of a company. In such cases all the partners of the firm must be practicing chartered accountants.

6.1.8 Disqualification of Company Auditors

Certain persons are disqualified from the appointment of a company auditor. According to Section 226(3) of the Companies Act of 2013, the following persons are disqualified from the appointment of company auditor;

1. A body corporate other than a Limited Liability Partnership registered under Limited Liability Partnership Act,2008 (6 of 2009), It means that a company cannot be appointed as auditor of another company.
2. An employee or an officer of the company.
3. A person who is a partner or who is in the employment, of an officer or employee of the company.
4. A person who, or his relative or partner
 - a) is holding any security of or interest in the company or its subsidiary.
 - b) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed.
5. A person having voting right holding the security of the company.
6. A person whose relative is a key managerial person or director of the company.
7. A person who has been convicted by a court of an offence involving fraud and not completed a period of 10 years has not elapsed from the date of such conviction.
8. A person who directly or indirectly, renders any service referred to in Section 144 to the company or its holding company or its subsidiary company.
9. A person who is in full employment elsewhere or a person or a partner of a firm holding an appointment as its auditor, if such person or partner is at the date of such an appointment or re-appointment holding an appointment as auditor of more than 20 companies.

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacancy shall be deemed to be a casual vacancy in the office of the auditor.

6.1.9 Remuneration of Company Auditors (Section 142)

- 1) Generally, the remuneration of the auditor of a company is fixed in its general body meeting or in such manner as may be determined therein:

Provided that the Board may fix remuneration of the first auditor appointed by it.

- 2) The remuneration under sub-section (1) shall, in addition to the fee payable to an auditor, include the expenses, if any incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

If the auditor is appointed by the Government, the Government will fix the remuneration and if they are appointed by the shareholders in the Annual General Meeting, the company will fix the remuneration. In case, an existing auditor is re-appointed, the amount fixed for the previous year will be his remuneration unless otherwise a resolution is passed in the annual general meeting to increase his remuneration. In case an auditor is performing any extra work in addition to the audit work; such as preparation of accounts, appearing before Income Tax and GST office for tax matters etc, he should be given extra remuneration. The total amount of remuneration paid to the auditor should be shown in the Profit and Loss Account.

6.1.10 Removal of Company Auditors

An auditor is appointed by the shareholders or board of directors or Government for a period of one accounting year unless he is re-appointed. Normally, he can hold office till the conclusion of next Annual General Meeting. However, he may be terminated before the expiry of his term under the following circumstances

- The first auditor appointed by the board of directors of the company may be terminated by the shareholders before the first Annual General Meeting by passing an ordinary resolution by shareholders.
- The succeeding auditors appointed by the shareholders can be removed by the shareholders before the conclusion of the next Annual General Meeting by passing an ordinary resolution and with the prior sanction of the Central Government.
- In all other cases, an auditor can be removed before the expiry of his term after obtaining the previous approval of the Central Government and by fulfilling the following conditions.
- A special notice of 14 days comprising the proposed resolution to remove an auditor before his term of office and to appoint a new auditor in his place must

be given to the company.

- After receiving the notice of such resolution, the company must send a copy of resolution to the auditor who is required to be removed.
- After receiving a copy of the proposed resolution, the auditor concerned can make his representation to the company in writing and he should also be given a chance to speak on his case at the meeting.
- After hearing the auditors' opinion, if the members' desires to remove the auditor before his term of office and another person should be appointed in his place, shareholders should be passed an ordinary resolution in the general meeting.

6.1.11 Right and Powers of Company Auditors

A company auditor has been given elaborate powers under the Companies Act. He is an agent of shareholders. Hence, he should exercise all his powers to discharge his duties for the benefit of shareholders. The following are the Rights and Powers of company auditor:

1. Right to access to Books of Accounts and Vouchers:

Under section 143 (1) every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as an auditor.

2. Right to obtain information: The auditor has the right to obtain necessary information and explanations from the officers of the company, if he found it is necessary to discharge his functions.

3. Right to receive notice: All notices of the company and other communications relating to any general meeting of the company shall be forwarded to the auditor of the company.

4. Right to attend meetings: He has the right to attend the meetings and make clarity on any statement or explanation with regard to the accounts audited by him.

5. Right to visit branch offices & access to branch account: If the accounts of a branch office of the company are audited by a person other than the company's auditor, he is entitled to visit the branches, if he deemed it necessary to do so for the performance of his duties as an auditor.

6. Right to make representation: A retiring auditor has a right to make his representation in writing and request that the same is circulated among members, if the company issues a special notice intending to remove him or proposing to appoint any other person as auditor.

7. He has the Right to Sign audit report: Only the person appointed as auditor of the Company, or where a firm so appointed only a qualified partner in the firm practicing in India, may sign the auditors' report or authenticate any other document of the company.

8. Right to seek legal and technical advice: The auditor of a company is entitled to seek the legal and technical advice which may be needed in the performance of his duties.
9. Right to remuneration: When the audit work is completed, the auditor has the right to receive remuneration.
10. Right to correct any wrong statement presented by the directors: If there is any wrong statement presented by the directors, is noticed, the auditor has the right to correct it.
11. Right to be indemnified: If the auditor acted honestly in the opinion of court of law, he has the right to be indemnified against any liability suffered by him in defending against any criminal or civil proceedings by the company

6.1.12. Auditor's Lien

An auditor's lien is a legal right that allows an auditor to retain possession of a client's financial records, documents, or other property until the client has paid any outstanding fees for services rendered. Generally, lien means right to retain the property belonging to another until any charges due to him is paid. There are a lot of case decisions relating to auditor's lien. Here, the question arises whether an auditor can exercise lien on the books of account in which he has audited. The books of accounts are the property of the company. It is kept in the head office for inspection by the shareholders and public. Therefore, the auditor cannot exercise lien on the books of accounts. However, the audit working papers are the property of auditor and therefore, he can exercise lien on it.

6.1.13. Duties of Company Auditor

The scope of duties of an auditor depends upon the nature of the business carried on by the concern. He has to verify the statements of account drawn up on the basis of books of the business. However, he is not liable for facts which are concealed intentionally and kept out of books which he cannot verify in the ordinary course of the exercise of reasonable care and diligence.

6.1.13.1 Duties under Section 143 (1)

Duty as to enquiry

- a. The auditor has a duty to enquire whether loans and advances made by the company have been properly secured, whether the terms and conditions thereof are prejudicial to the interest of the company or its members.
- b. Duty to enquire whether assets of the company being shares or debentures and other securities have been sold at a price less than the price at which these were purchased.
- c. whether any shares have been allotted for cash, whether cash actually received and whether the position in the account books and balance sheet is correct, regular and not misleading.

6.1.13.2 Statutory Duties

Statutory duties are the duties imposed as per Companies Act of 2013. These duties cannot be restricted by the Articles of Association or passing any resolution by the shareholders or board of directors. The various statutory duties of a company auditor under the Companies Act are

6.1.13.3 Duty to make Report to members [Section 143(2)]

It is the primary duty of an auditor to make and present a detailed report on the Profit and Loss Account and Balance Sheet of the company before the shareholders in the annual general meeting and state whether or not the directors maintain accounts properly. So, in the report, each and every matter should be reported. The following matters should be included in the report.

- Whether in his opinion, the Profit and Loss Account exhibit a true and fair view of profit or loss of the financial year.
- Whether in his opinion, the Balance Sheet exhibits a true and fair view of state of affairs of the company
- Whether or not he has collected all the information and explanations essential for performance of his audit
- Whether or not proper books of accounts required as per law have been maintained by the company
- Whether or not the Profit and Loss Account and Balance Sheet related to the period mentioned in the report as correct as per books of accounts and returns
- In case of audit of branch done by some other auditors, whether he received a report from the branch auditor under Section 228
- Whether the Balance Sheet and Profit and Loss Accounts are drawn up by the company as per provisions of Companies Act.
- If any of the above facts are not in satisfaction of the auditor, the reason for the same should be reported in his report
- Whether personal expense of any officer or employee have been charged to revenue account.

6.1.13.4 Duty to assist Investigation

When an investigation is conducted, it is the duty of the auditor

1. To preserve and produce all books & papers relating to the company to the inspector.
2. give the investigating authority all assistance in connection with Investigation.

6.1.13.5 Duty to certify Profit and Loss Account in the Prospectus (Section 56)

Whenever a company issue a prospectus, it should contain Profit and Loss Account of last five years, rate of dividends for the last five years and assets and liabilities of the company. The auditor should provide a report on these statements.

6.1.13.6 Duty to certify Statutory Report

It is the duty of the auditor to certify the correctness of statutory report. The statutory report contains a summary of all cash receipts and payments, number of shares issued for cash and total amount received in respect of shares allotted etc. All these statements should be certified by the auditor as correct.

6.1.13.7 Duty to sign the report

In case audit is conducted by a single auditor, not an audit firm, the auditor himself has to sign in the auditor's report. In case, the audit is conducted by a chartered accountant firm, any partner of the firm, who is a qualified certified chartered accountant only can sign in the auditor's report.

6.1.13.8 Duty to make a statement on public deposit

In case of a non-banking company, if any public deposit is accepted, the auditor must make sure that the company has disclosed necessary statements as per the provisions of Companies Act and directions of issued by RBI.

6.1.13.9 Duty to assist the Central Government

It is the duty of the auditor to assist the Central Government for prosecution activities instituted against managerial persons. In case the Central Government has taken any steps for prosecutions against the directors, managing director or any officers of the company, the auditor is bound to give all reasonable assistance.

6.1.13.10 Duty to certify the solvency of the Company

When a company go into voluntary liquidation, the directors of the company must issue a solvency certificate to the liquidator and the same must be certified by the auditor as correct.

6.1.13.11 Contractual Duties

A contractual duty is an obligation that one party is legally required to fulfill as part of a binding contract with another party. Auditors have essential contractual duties that ensure the integrity and reliability of a company's financial statements. Firstly, their primary responsibility is to conduct an independent examination of the company's financial records, including balance sheets, income statements, and cash flow statements. This process involves assessing the accuracy and completeness of the

information presented, verifying that it adheres to relevant accounting standards and legal requirements. Auditors must remain impartial, free from any influence that might compromise their objectivity, ensuring that their findings are credible and trustworthy for stakeholders, including shareholders, management, and regulatory authorities.

In addition to examining financial statements, auditors are responsible for communicating their findings through an audit report. This report outlines the scope of the audit, methodologies used, and any discrepancies or issues identified during the examination. Auditors must also provide recommendations for improving internal controls and financial practices. Furthermore, they have a duty to maintain confidentiality regarding sensitive information obtained during the audit process, only disclosing necessary details to authorized parties. By fulfilling these contractual duties, auditors play a critical role in enhancing transparency and accountability, fostering trust between the company and its stakeholders, and ensuring compliance with applicable laws and regulations.

6.1.14 Liabilities of a company Auditor

A company auditor is appointed under the companies Act. Therefore, his appointment, remuneration rights, duties and responsibilities, etc., are defined and laid down by the Companies Act. Liabilities of an auditor can be summed under the following heads:

6.1.14.1 Civil liabilities

a) Liability for Negligence

An auditor appointed by a company is expected to safeguard the interests of the shareholders as such and he performs his duties as an agent of shareholders. He must exercise his reasonable care and diligence in the performance of his duties as laid down under the statute. If he fails to do so and as a consequence thereof, the principal suffers a loss, the auditor is held liable to make good the loss under the law of Agency. Thus, he can be compelled to indemnify the loss caused to the company resulting from his negligence. An auditor is not liable for

1. loss without negligence
2. negligence without loss

b) Liability for Misfeasance

According to Section (340) of Companies Act 2013, the court may assess damages against delinquent director and other officers of the company including an auditor for misfeasance or breach of trust. If an auditor or other officers of the company is found to be guilty of neglect of duty or misfeasance, so as to cause loss to the company in any way, proceedings may be taken under this section against him either independently or other officers or jointly with them. Company can recover the damages. The time limit is five years.

6.1.14.2 Criminal Liabilities

An auditor is an officer of the company and in that capacity, he is liable for his acts of omission/commission which can be construed as an offence under the provisions of the Companies Act, Penalties for such offences may be imprisonment and/or fine. It includes;

1. Misstatement in prospectus (Section 34)

Where an auditor makes false statement knowingly in reports, returns, prospectus or other statements, he shall be punishable with imprisonment for a minimum term of 6 months extendable up to 10 years.

2. Non-compliance by auditor (Section 143 and 145)

Punishable with imprisonment upto 1 year and fine not less than Rupees twenty thousand extendable to five lakhs.

3. Failure to assist in the investigation (Section 217(6))

If the auditor fails to preserve and produce to the inspector, all books and papers relating to the company and fails to assist the inspector in investigation, he shall be punishable with imprisonment up to 1 year and with fine not less than twenty -five thousand extendable to Rupees one lakh.

4. Penalty for falsification of books (Section 336)

He is punishable with imprisonment for a term not less than 3 years extendable to 5 years and with a fine not less than Rs1 lakh extendable to Rupees 3 lakhs.

5. Penalty for deliberate act of commission or omission (Section 448)

In such case he shall be punishable with imprisonment for a term not less than 6 months extendable to 10 years and fine not less than amount involved in fraud extendable to 3 times of such amount.

6.1.14.3 Contractual liability

An auditor is appointed by the shareholders under a contract. Hence, he has some contractual liabilities. They are

- To see his appointment is in order and in proper form.
- He has to discharge his duties as per provisions of Contract Act of 1872.
- If as per contract, any other work is committed to perform in addition to his audit work, he is liable to perform it
- He is expected to exercise reasonable care and diligence to perform his work otherwise he will be liable for breach of contract.

Recap

- ◊ A contractual duty -an obligation that one party is legally required to fulfill as part of a binding contract with another party.
- ◊ The primary duty of an auditor - make and present a detailed audit report
- ◊ Statutory duties - the duties imposed as per Companies Act of 2013
- ◊ An auditor's lien - a legal right that allows an auditor to retain possession of a client's financial records
- ◊ The remuneration of the auditor -fixed by the authority who appoint the auditor
- ◊ Company auditor - qualified practicing Chartered Accountant within the meaning of Chartered Accountant Act 1949.
- ◊ A company audit - systematic examination of a company's financial records

Objective Questions

1. Who is qualified to be appointed as a company auditor?
2. Under which act are the qualifications and disqualifications of auditors governed?
3. Who appoints the first auditor of a company?
4. How is the statutory auditor appointed in an annual general meeting (AGM)?
5. What is the term for the appointment of an auditor in a public company?
6. Who must approve the appointment of an auditor in a government-owned company?
7. In case of auditor removal, who appoints the new auditor?

Answers

1. A chartered accountant with a valid certification.
2. The Companies Act, 2013

3. The Board of Directors.
4. The shareholders appoint the statutory auditor in the AGM.
5. An auditor is typically appointed for a 5-year term.
6. The Comptroller and Auditor General (CAG) must approve the appointment.
7. The shareholders, with board or tribunal approval if necessary.

Self-Assessment Questions

1. What are the basic qualifications required for an individual to be appointed as an auditor?
2. Why are partners or employees of a company disqualified from becoming its auditor?
3. Explain why individuals indebted to a company are disqualified from acting as its auditor.
4. How is the statutory auditor appointed in an annual general meeting?
5. Describe the process of auditor appointment in government-owned companies.
6. What formal approvals are needed to remove an auditor from office?
7. What are the requirements for appointing a new auditor if the current auditor is removed mid-term?
8. What rights does an auditor have regarding access to a company's books and records?
9. What is an auditor's duty if they detect fraud during their audit?

Assignments

1. Provide an in-depth study on the procedures and legal framework for appointing auditors in different types of companies. Compare the appointment process, legal requirements, and regulatory authority involvement in each type of organization.
2. Analyze the process for removing an auditor, required approvals, and the legal consequences of removal. Use real-life cases where auditors were

removed, examine the reasons, procedures, and outcomes, and discuss the impact on the company's transparency and reputation.

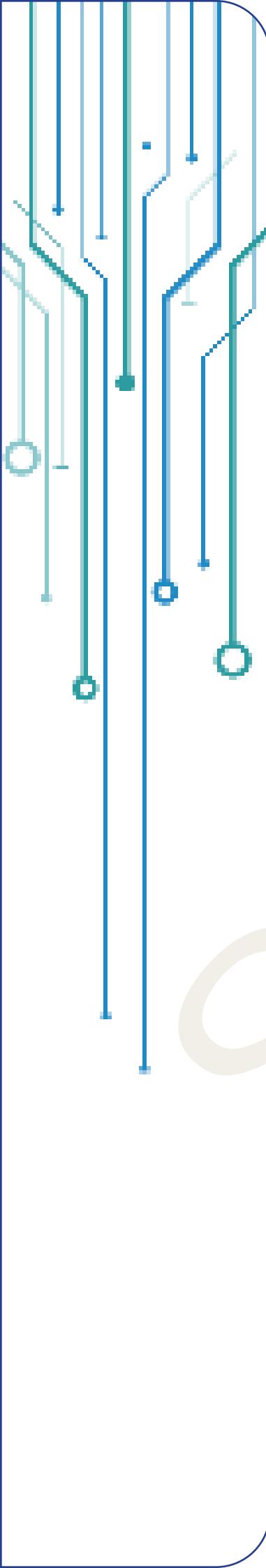
3. Discuss the role of regulatory bodies like the Public Company Accounting Oversight Board (PCAOB), the Institute of Chartered Accountants, or similar organizations in auditor qualifications and appointments.

Suggested Reading

1. Asish K Bhattacharjee, Tata McGraw Hill, Indian Accounting Standards
2. Dr. B D Agarwal - Advanced Financial Accounting
3. Israr Shaikh and Rajesh Makkar, Lexis Nexis. Accounting Standards
4. Jain S.P and Narang K.L .Corporate Accounting, Kalyani Publishers, New Delhi
5. Maheswari S.N. and Maheswari S.K. Corporate Accounting, Vikas Publishing House, New Delhi
6. Mukherjee A. and Hanif M. Corporate Accounting, Tata McGraw-Hill Publishing Co.Ltd. New Delhi
7. Nirmal Gupta and Chhavi Sharma. Corporate Accounting Theory and Practice, Ane Books India, Delhi.

Reference

- ◊ Tulsian, P.C, & Tulsian, B. (2020). Auditing: Theory and Practice(24th ed). Taxmann Publications.
- ◊ Agarwal, S.K.,& Agarwal, R.K.(2020). Auditing and assurance(14thed). Kalyani Publishers
- ◊ Gupta,R.N, & Gupta, R.K (2020). Auditing principles and Practice(22nded) Sultan Chand & Sons.
- ◊ Paul. K.R. Accountancy, New Central Book Agency Pvt. Ltd. Kolkata
- ◊ Pillai R.S N,Bhagavathi and Uma S. Fundamentals of Advanced Accounting, S Chand & Co. Ltd., New Delhi
- ◊ Rawat D S—Taxman Accounting Standards
- ◊ RL Gupta and Radhaswamy- Advanced Accounting
- ◊ Shukla M C, GrewalT.S.and Gupta S.C. Advanced Accounts S.Chand& Co. Ltd., New Delhi



Unit 2

Audit of Companies

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ get awareness on the audit of shares.
- ◊ familiarise with key areas in the audit of shares and Debentures.
- ◊ get an insight into the audit of divisible profit & dividend.
- ◊ study the importance of transparent dividend audit

Prerequisites

Share capital audit is the process of verifying the compliance of the company's share capital transactions with the requirements and provisions of the Companies Act. Priya recently invested in X Ltd., drawn to its promising green energy projects. But she wonders, "How can I be sure they're actually using my investment properly?" Her friend Raj explains that auditing is like a financial health check, ensuring the company's finances are managed responsibly. "Think of it as a physical check-up," Raj says. "Just like a doctor measures different aspects of your health, auditors review key aspects of the company's finances." With shares, auditors verify that X Ltd followed all regulations in issuing them, keeping accurate records of shareholders, and confirming that shares were issued fairly. For debentures, which Raj explains are essentially loans the company must repay with interest, auditors check that X Ltd is using the funds as promised. They look for signs that the money is going toward the green project and not being misused, such as on excessive executive perks. Auditors also verify X Ltd's ability to repay these loans by reviewing repayment schedules and overall financial stability.

Raj emphasizes that auditing is thorough, designed to catch any mismanagement or risky financial practices. He adds, "When audits check out, it shows investors that the company is transparent and accountable, giving us confidence that X Ltd is honouring its commitments and managing our investments responsibly." Reassured, Priya realizes that auditing serves as an essential safeguard, protecting her investment and building trust in X Ltd's integrity.

Keywords

Audit of shares, transparent dividend audits, Debenture Audit

Discussion

6.2.1 Audit of Shares

Audit of shares, also known as a "share capital audit," involves the review and verification of a company's share-related records, ensuring compliance with various regulatory frameworks in India. A share audit in India helps detect discrepancies, verify ownership details, and confirm that the company's records align with regulatory requirements.

6.2.2. Importance of Share Audits

The audit of shares holds significant importance due to the complex regulatory environment. Ensuring the accuracy and legality of share transactions is essential because any discrepancies or unauthorized transactions could lead to financial losses, legal complications, and a loss of reputation for the company. For public companies, share audits are vital as they ensure transparency and compliance with SEBI regulations, helping to build investor confidence. Share audits are also important for private companies, especially if they aim to attract external investment or go public.

6.2.3 Regulatory Framework Governing Share Audits

Several regulatory authorities oversee the processes related to shares. The primary legislation governing corporate shares is the Companies Act, 2013, which sets forth guidelines on share issuance, transfer, and compliance. SEBI has stringent regulations for publicly listed companies, mandating that they maintain accurate records of shareholding and comply with transparency requirements. For instance, SEBI's Listing Obligations and Disclosure Requirements (LODR) ensure that companies report changes in shareholding, maintain shareholder registers, and comply with stock exchange requirements.

For listed companies, share audits are also influenced by guidelines issued by the Ministry of Corporate Affairs (MCA). The MCA provides specific rules on auditing

and compliance, ensuring that companies follow a standardized process for managing and recording share transactions. For unlisted companies, especially startups, it is equally important to maintain clear and accurate shareholding records, given that future investors, such as venture capitalists, often require verified shareholding details before investing.

6.2.4 Objectives of a Share Audit

The primary objectives of a share audit include verifying the authenticity and accuracy of share records, ensuring compliance with regulatory frameworks, and checking for unauthorized share transactions. An audit also aims to verify that share capital has been issued according to the authorized capital limit defined in the company's Memorandum of Association. In addition, it verifies that the company's share transactions comply with the applicable provisions of the Companies Act, 2013, and SEBI regulations.

A share audit also seeks to verify the payment of dividends to eligible shareholders, ensuring that these distributions are made accurately and that the dividend policy is fair. In cases of public companies, it confirms adherence to SEBI guidelines, ensuring that the company is not involved in any manipulation of share prices or insider trading. This level of assurance helps maintain the integrity of the company's financial standing.

6.2.5 Key Areas in the Audit of Shares

1. Share Capital Verification: Auditors begin by verifying the share capital recorded in the company's financial statements. This includes confirming that the number of shares issued does not exceed the authorized capital stated in the company's Articles of Association. Any discrepancy could indicate a legal violation, especially if the shares exceed the authorized capital.
2. Share Allotment Process: Auditors examine the process by which shares are issued and allotted. They ensure that each share issuance has been authorized by the Board of Directors, and that all required documentation, including share application forms and board resolutions, is in place. Auditors verify compliance with legal procedures for share allotment, ensuring that shares are allocated to eligible parties.
3. Share Transfer and Transmission: The share transfer process is reviewed to confirm that shares have only been transferred with proper authorization. Auditors examine share transfer deeds and check for compliance with statutory requirements, such as the payment of stamp duties on transferred shares. Additionally, auditors verify that the company follows legal processes for the transmission of shares in cases like the death of a shareholder.
4. Shareholder Register: The shareholder register, also known as the register of members, records the names, addresses, and holdings of each shareholder. Auditors verify that this register is accurate and updated with all changes in shareholding. This is particularly important for companies with a large shareholder base, as maintaining accuracy in these records is crucial for compliance with SEBI's disclosure requirements.

5. Dividend Distribution Verification: Auditors examine the company's dividend distribution records to ensure that dividends have been paid correctly according to each shareholder's entitlement. They check for board approvals, confirm that the distribution aligns with the company's policies, and verify that dividend payments have been made to eligible shareholders.
6. Compliance with SEBI and MCA Regulations: For listed companies, compliance with SEBI's regulations is essential. Auditors verify that the company submits timely reports to SEBI on changes in shareholding patterns, insider trading compliance, and adherence to corporate governance standards. They also ensure that companies comply with MCA regulations, such as annual returns and filing requirements related to share capital.

6.2.6 Audit Procedures for Share capital

In the audit of share capital, we usually test various audit assertions, such as existence completeness and valuation. Hence in audit of share capital auditor tries to detect the material misstatement that could occur at various assertion levels. Audit assertions for share capital are listed below.

- Review of Corporate Documents: Auditors begin by reviewing essential documents such as the Memorandum of Association, Articles of Association, and the company's bylaws. These documents define the company's share capital structure and outline any specific provisions regarding share issuance or transfer.
- Examination of Share Certificates and Allotment Letters: Each shareholder receives a share certificate as proof of their ownership. Auditors verify that these certificates match the records in the company's share register and are issued in accordance with board approvals and SEBI guidelines.
- Verification of Share Transfers: Auditors closely examine the documentation for each share transfer, ensuring that it meets regulatory requirements and involves authorized parties. They check for compliance with the Companies Act, 2013, and verify the payment of necessary stamp duties.
- Review of Board Resolutions and Approvals: The Board of Directors must approve all share allotments and transfers. Auditors review board resolutions to ensure that the directors approved each transaction and that the transaction was conducted legally.
- Cross-checking with Financial Records: Auditors compare share capital entries in the company's financial statements with the information in the shareholder register and transfer documents. This helps to ensure consistency and detect discrepancies.

6.2.7 Types of Issues detected in Share Audits

Auditors may encounter various issues during share audits, such as discrepancies in share certificates, unauthorized share transfers, or incorrect dividend payments. In cases of non-compliance with SEBI or MCA guidelines, companies may face fines or other

penalties. Auditors may also identify issues such as over-issuance of shares beyond authorized capital or failure to update shareholder registers. These findings often lead to recommendations for corrective action, which may include revising internal controls, updating records, or implementing more robust compliance procedures.

6.2.8 Audit of Debentures

The audit of debentures is a critical process for companies that issue these financial instruments. Debentures are a form of long-term debt instruments issued by companies to raise capital from the public or institutions. Holders of debentures are creditors of the company and are entitled to receive regular interest payments and, upon maturity, repayment of the principal. Since debentures are debt instruments, they are governed by various regulations under the Companies Act, 2013, as well as the Securities and Exchange Board of India (SEBI) for listed companies. The audit of debentures ensures that these financial obligations are accurately recorded, managed, and compliant with applicable laws.

6.2.9 Purpose and Importance of Debenture Audit

The main purpose of a debenture audit is to verify the accuracy, legality, and compliance of debenture issuance and management. For stakeholders, the audit provides reassurance that the company is properly handling its debt obligations and fulfilling all legal requirements related to debenture issuance and servicing. This is essential for maintaining investor trust, especially in companies that rely heavily on debt financing. A debenture audit also helps identify discrepancies or potential fraud, ensuring that the company's financial statements accurately reflect its debt obligations.

6.2.10 Key Aspects of Debenture Audit

1. Authorization and Compliance: Auditors verify that the issuance of debentures was authorized by the Board of Directors and shareholders, in line with the company's Memorandum and Articles of Association. For listed companies, auditors check compliance with SEBI regulations, ensuring that the debentures meet the regulatory requirements set forth by the securities exchange.
2. Debenture Terms and Conditions: The terms of each debenture series are carefully reviewed, including interest rates, repayment schedules, and any covenants. Auditors ensure these terms align with those agreed upon with debenture holders and as outlined in debenture trust deeds.
3. Debenture Trust Deed: A debenture trust deed is often required, especially when debentures are secured. This document defines the rights of debenture holders and the role of a debenture trustee, who is responsible for protecting the interests of debenture holders. Auditors examine the trust deed to verify that it complies with Section 71 of the Companies Act, 2013, and any SEBI requirements.
4. Interest and Redemption: Auditors verify that interest payments on debentures are made accurately and on time, as per the agreed terms. For debentures approaching maturity, they ensure that the company has a proper plan for

redemption. Any redemption reserve, if created, should also be verified.

5. **Verification of Records:** Auditors scrutinize financial records, checking that debenture proceeds have been accurately recorded in the company's books. They also verify if the funds raised through debentures have been utilized for the stated purpose.
6. **Compliance with Debenture Redemption Reserve (DRR):** Certain companies are required to create a Debenture Redemption Reserve (DRR) for non-convertible debentures. Auditors verify the adequacy of this reserve and confirm that it has been created and maintained in compliance with applicable regulations.

6.2.11 Audit of Divisible Profit and Dividend

Companies are legally bound to follow strict guidelines regarding the calculation and distribution of dividends to ensure that shareholders are rewarded fairly while also safeguarding the company's financial health. An audit of divisible profits and dividends helps confirm that companies adhere to these regulations, ensuring accurate distribution of profits and preventing misuse of funds.

Understanding Divisible Profit and Dividend

1. **Divisible Profit :** Divisible profit refers to the portion of a company's profit that can be legally distributed as dividends to shareholders. It excludes funds that are earmarked for future expenses, taxes, and statutory reserves, ensuring that the company maintains sufficient resources for growth and contingencies. Determining the amount of divisible profit is crucial as it balances rewarding shareholders and retaining funds for the company's financial stability.
2. **Dividend :** A dividend is a portion of the profit paid to shareholders based on their ownership. Dividends can be interim (paid during the year) or final (declared at the end of the financial year). For shareholders, dividends provide an immediate return on investment, while for companies, distributing dividends can enhance investor trust and attract potential shareholders.

6.2.12 Regulatory Framework for Divisible Profit and Dividend

The Companies Act, 2013, provides the legal foundation for calculating divisible profits and distributing dividends in India. The Act specifies various requirements related to the source of dividends, their distribution, and compliance. For instance, Section 123 of the Companies Act, 2013, outlines conditions for dividend declaration, ensuring that dividends are only paid from profits or reserves and that due consideration is given to the company's financial health.

The SEBI guidelines also regulate dividend distribution for listed companies, focusing on transparency, timely disclosure, and protecting shareholders' interests. Companies must also adhere to their Articles of Association (AoA), which may have specific rules governing dividend distribution.

6.2.13 Objectives of the Audit of Divisible Profit and Dividend

The primary objectives of auditing divisible profits and dividends include:

1. **Ensuring Compliance:** The audit ensures the company adheres to the legal requirements of the Companies Act, SEBI regulations, and internal policies specified in the Articles of Association. This compliance guarantees that dividends are declared from legitimate profits and distributed fairly.
2. **Accuracy in Calculation:** Auditors verify the accuracy of profit calculations to ensure that only the correct amount is treated as divisible. Any overstatement of profits can lead to unauthorized dividends, risking the company's long-term sustainability.
3. **Transparency and Fairness:** The audit enhances transparency, providing confidence to shareholders that dividend decisions are based on fair calculations and reliable data. This improves investor trust in the company's financial practices.
4. **Protection of Minority Interests:** Audits also focus on protecting minority shareholders, ensuring dividends are distributed equitably and that no shareholder receives preferential treatment.

6.2.14 Key Aspects in the Audit of Divisible Profit and Dividend

1. **Verification of Profit and Loss Account:** Auditors begin by examining the Profit and Loss Account to verify that the profits reported are accurate and calculated following accounting standards. This includes ensuring that all revenues, expenses, and extraordinary items are accounted for and that any provisions for doubtful debts, depreciation, and other contingencies are deducted before calculating divisible profits.
2. **Review of Reserves and Provisions:** Auditors assess the company's reserves to ensure they meet statutory requirements. For instance, companies are often required to set aside a portion of profits as reserves before distributing dividends, particularly for contingencies, capital expansion, or debt servicing.
3. **Dividend Declaration Process:** The dividend declaration process is closely reviewed to confirm that the board of directors followed all legal requirements. The board's recommendation for dividend distribution should be backed by a valid board resolution and approved by shareholders during the company's annual general meeting (AGM).
4. **Compliance with Articles of Association (AoA):** Companies are expected to comply with their AoA in dividend matters. The AoA may have specific provisions on dividend distribution that override the general rules. Auditors ensure that these provisions are followed and that any special dividends or preferential pay-outs comply with company policies.
5. **Adequacy of Funds for Dividend Payment:** Auditors confirm that sufficient funds are available for dividend payment, ensuring the company can meet this obligation without compromising its liquidity. If dividends are paid from

reserves, auditors check that such reserves are legally allowed for dividend distribution.

6. **Verification of Dividend Records:** Accurate records of dividends, including shareholder details, dividend amounts, and dates of payment, are verified. Auditors check that these records align with the dividend declared and that they accurately reflect the company's transactions.
7. **Adherence to SEBI Regulations for Listed Companies:** For listed companies, SEBI has additional requirements, including prompt disclosure of dividend decisions, ensuring timely payment to shareholders, and filing relevant reports. Auditors verify that these regulations are adhered to in the dividend distribution process.

6.2.15 Audit Procedures for Divisible Profit and Dividend

The audit procedures for divisible profit and dividend consists of

1. **Review of Financial Statements:** The auditor starts by reviewing financial statements, focusing on the Profit and Loss Account and Balance Sheet. This helps to verify that the profit declared is consistent with accounting principles and that appropriate deductions have been made for liabilities, provisions, and reserves.
2. **Examination of Resolutions and Meeting Minutes:** Auditors examine the board resolutions and meeting minutes, particularly the AGM where dividends are approved. They ensure that all decisions comply with the legal requirements and shareholder approvals, confirming that dividends were declared following due process.
3. **Verification of Dividend Bank Accounts:** Companies in India must maintain a dedicated bank account for dividend payments. Auditors check this account to ensure it holds adequate funds and that dividends are disbursed to shareholders on time.
4. **Examination of Tax Compliance on Dividends:** Dividends distributed by Indian companies are subject to tax under the Dividend Distribution Tax (DDT) framework. (now no dividend distribution tax) Auditors ensure compliance with DDT and other applicable taxes and confirm that taxes are deducted as per regulations before paying dividends to shareholders.
5. **Checking for Interim and Final Dividends:** Companies may declare interim and final dividends. Auditors verify both, ensuring that interim dividends are appropriately funded from profits and that final dividends are declared after a comprehensive financial review.

6.2.16 Common Issues Identified During Audit

1. **Overstatement of Profits:** Some companies might overstate profits to declare higher dividends. Auditors review revenue and expense recognition practices to ensure that only legitimate profits are included in dividend calculations.
2. **Non-Compliance with Dividend Declaration Rules:** In some cases, companies

may declare dividends without proper authorization from shareholders or the board, which violates legal and regulatory norms. Auditors identify and report these irregularities.

3. Delayed or Missed Dividend Payments: Companies are required to pay dividends within a specified period. Auditors check for compliance with these timelines and report delays or missed payments, which can lead to penalties.
4. Misuse of Reserves for Dividend Payments: Auditors ensure that only permissible reserves are used for dividends, as using unauthorized reserves can harm the company's financial stability.

6.2.17 Importance of Transparent Dividend Audits

A transparent audit of divisible profit and dividend distribution enhances corporate governance by holding companies accountable for their financial decisions. This transparency ensures that shareholders receive accurate information, enabling them to make informed decisions about their investments. Additionally, accurate dividend audits help maintain the company's financial health, as auditors identify potential red flags that could indicate unsustainable dividend practices. For companies, a transparent dividend policy fosters trust among investors, leading to improved investor relations and potentially higher valuations.

Recap

- ◊ Audit of shares- "share capital audit"
- ◊ The primary legislation governing corporate shares - The Companies Act, 2013,
- ◊ The primary objectives of a share audit - verifying the authenticity and accuracy of share records
- ◊ Share Capital Verification- Auditors begin by verifying the share capital recorded in the company's financial statements
- ◊ Debenture audit - verify the accuracy, legality, and compliance of debenture issuance
- ◊ Debenture Trust Deed- defines the rights of debenture holders and the role of a debenture trustee,
- ◊ Divisible profit - to the portion of a company's profit that can be legally distributed as dividends to shareholders
- ◊ Audits - focus on protecting minority shareholders, ensuring dividends are distributed equitably

Objective Questions

1. Which of the following documents is primarily verified during the audit of shares?
2. During the audit of shares, which of the following is verified to check the authorization for share allotment?
3. What is the primary purpose of a statutory audit of shares?
4. Which of these terms is associated with the audit of shares issued at a value higher than the face value?
5. The main purpose of the audit of debentures is
6. Which document is most important for verifying the authorization of debenture issuance?
7. Which document should an auditor refer to for confirming dividend payment to shareholders?

Answers

1. Share certificate
2. Board meeting minutes
3. To ensure compliance with share issue regulations
4. Share Premium
5. To verify debenture interest payments and compliance with terms
6. Debenture Trust Deed
7. Dividend Register

Self-Assessment Questions

1. What are the key documents an auditor should review during the audit of shares?
2. What are the common compliance issues that auditors might encounter during the audit of debentures?
3. How should an auditor verify that dividends declared by a company comply with legal requirements?

4. What documentation is essential for an auditor to confirm the payment of dividends to shareholders?
5. What criteria must be met for profits to be classified as divisible?
6. How can an auditor ensure that divisible profits are properly allocated among shareholders?

Assignments

1. Discuss the regulatory requirements for share capital audits, including checking share certificates, shareholder ledgers, and compliance with corporate laws.
2. Explore the common risks and challenges faced by auditors in verifying share premium and debenture discount accounts. Discuss the need to ensure accurate recording and reporting as per accounting standards.
3. Conduct a case study on a real or hypothetical scenario where misstatements occurred in equity capital. Analyze the auditor's role in identifying the misstatements, applying correct procedures, and reporting to stakeholders.
4. Discuss the accounting and reporting standards related to dividend payments and the auditor's responsibility to verify compliance. Include a discussion on IFRS and GAAP requirements for dividend disclosures in financial statements.

Suggested Reading

1. Asish K Bhattacharjee, Tata McGraw Hill, Indian Accounting Standards
2. Dr. B D Agarwal - Advanced Financial Accounting
3. Israr Shaikh and Rajesh Makkar, Lexis Nexis. Accounting Standards
4. Jain S.P and Narang K.L .Corporate Accounting, Kalyani Publishers, New Delhi
5. Maheswari S.N. and Maheswari S.K. Corporate Accounting, Vikas Publishing House, New Delhi
6. Mukherjee A. and Hanif M. Corporate Accounting, Tata McGraw-Hill Publishing Co.Ltd. New Delhi
7. Nirmal Gupta and Chhavi Sharma. Corporate Accounting Theory and Practice, Ane Books India, Delhi.

Reference

1. Tulsian, P.C., & Tulsian, B(2020). Auditing : Theory and Practice(24thed). Taxmann Publications.
2. Agarwal, S.K., and Agarwal, R.K.(2020). Auditing and assurance (14th ed). Kalyani Publishers.
3. P C Thulsian - Advanced Corporate Accounting
4. Paul. K.R. Accountancy, New Central Book Agency Pvt. Ltd. Kolkata
5. Pillai R.S N, Bhagavathi and Uma S. Fundamentals of Advanced Accounting, S Chand & Co. Ltd., New Delhi
6. Rawat D S—Taxman Accounting Standards
7. RL Gupta and Radhaswamy- Advanced Accounting
8. Shukla M C, Grewal T.S. and Gupta S.C. Advanced Accounts S.Chand & Co. Ltd., New Delhi

SGOU



QP CODE:

Reg. No :

Name :

SECOND SEMESTER, BACHELOR OF COMMERCE (B. COM) EXAMINATION

DISCIPLINE CORE - 4- B21CM05DC - Corporate Accounting and Auditing

2023-24 - Admission Onwards-Set-1

Time: 3 Hours

Max Marks: 70

Section A

Answer any ten of the following questions in one word or sentence. (10×1= 10)

1. What is ESOP?
2. What is the minimum subscription requirement for shares as per company law?
3. What is the fixed interest rate paid by the company on the face value of debenture known as?
4. Irredeemable debentures are otherwise known as?
5. What is the minimum number of members required to form a public company?
6. Who will appoint an auditor of a Govt. Company?
7. Name of the audit conducted by the large concerns.
8. What is the term for the arrangement where the work of one employee is checked by another?
9. Which audit type is conducted in between financial years to assess interim results?
10. Which audit type focuses on examining costs incurred by the business?
11. What is an Unqualified Opinion also known as?
12. What is the term for shares offered to existing shareholders at a discount?
13. What is the process of offering shares privately to selected investors?
14. What is the phase of capital that represents the total amount a company can raise?
15. Which type of preference shares accumulate unpaid dividends?

Section B

Answer any five of the following questions in one or two sentences. (5×2=10)

16. Who can be appointed as a company auditor?
17. List any two disqualifications of a company auditor.
18. How does a qualified audit report impact stakeholders' decision-making?
19. Why is an audit certificate not considered a substitute for an audit report?
20. If the opening stock is ₹50,000, purchases are ₹2,00,000, and the closing stock is ₹70,000, calculate the cost of goods sold (COGS).
21. A firm's Profit and Loss Account shows Gross Profit of ₹8,00,000 and Operating Expenses of ₹3,50,000. If the company also earns ₹50,000 as other income,

calculate the Net Profit.

22. A company has a total authorized capital of ₹50,00,000, out of which ₹30,00,000 is issued and ₹25,00,000 is subscribed. Calculate the unissued and unsubscribed capital.
23. List any 2 qualifications of company auditor.
24. What is the difference between Reserve Capital and Capital Reserve?
25. What is meant by pro-rata allotment of shares?

Section C

Answer any four of the following questions in one paragraph.

(4×5=20)

26. XYZ Ltd. issued 1,000, 10% Debentures of ₹100 each at par for cash. The amount was payable as follows:
 - ◊ ₹50 on application
 - ◊ ₹50 on allotment
- Pass the necessary journal entries in the books of XYZ Ltd.
27. What are the journal entries involved in the issue and redemption of debentures? Explain with examples.
28. What are the various types of shares? Explain Equity Shares and Preference Shares in detail.
29. Swaliha Company Limited issued 1000 shares of Rs. 10 each at a premium of Rs. 2 per share. Rs.2 on applications. Rs.5 on allotment (including Rs.2 premium) Pass journal entries in the books of Swaliha Ltd. till allotment.
30. Explain the nature and objectives of auditing. Why is auditing important for businesses?
31. Differentiate between audit and investigation. When is each required?
32. Explain the disqualifications of an auditor as per the Companies Act.
33. Discuss the process of appointment and removal of a company auditor.

Section D

Answer any two of the following questions in 300 words.

(2×15 = 30)

34. Dhruvi Company Ltd. invited the public to subscribe to 1,00,000 Equity Shares of ₹10 each at a premium of ₹1 per share (payable on allotment). The payment schedule was as follows:
 - ◊ On Application: ₹3
 - ◊ On Allotment: ₹3 (including ₹1 premium)
 - ◊ On First Call: ₹3
 - ◊ On Final Call: ₹2
- Applications were received for 1,30,000 shares. Applications for 20,000 shares were rejected, and the remaining 1,10,000 shares were allotted proportionately.

All calls were made, and all money was received except the final call on 3,000 shares, which were forfeited after due notice. These forfeited shares were later reissued as fully paid at ₹8.50 per share.

35. From the following Trial Balance, prepare the Trading Account, Profit & Loss Account, and Balance Sheet of Madhav for the year ending 31st March 2023, after considering the given adjustments.

Trial Balance

Particulars	Debit (₹)	Credit (₹)
Opening Stock	80,000	-
Purchases	2,50,000	-
Sales	-	4,00,000
Wages	30,000	-
Salaries	40,000	-
Sundry Debtors	1,50,000	-
Sundry Creditors	-	80,000
Vehicles	1,00,000	-
Capital	-	2,50,000
Bank Loan	-	60,000
Bank Overdraft	-	20,000
Cash in Hand	15,000	-

Adjustments to be made:

- Outstanding Liabilities:
 - Salaries: ₹10,000
 - Wages: ₹20,000
 - Interest on Bank Overdraft: ₹3,000
 - Interest on Bank Loan: ₹6,000
- Interest on Capital: Provide interest on capital at 10% p.a.
- Bad Debts:
 - Actual Bad Debts: ₹10,000
 - Provision for Bad Debts: 10% on Sundry Debtors after deducting bad debts.
- Closing Stock: ₹1,20,000
- Depreciation on Vehicles: 10% p.a.
- Auditing is an essential tool for financial transparency and corporate governance. Critically analyze the meaning, objectives, and significance of auditing in modern businesses.
- Critically analyze the concept of share capital, its phases, the distinction between Reserve Capital and Capital Reserve, and the various types of shares (Equity Shares, Redeemable Preference Shares, Convertible Cumulative Preference Shares, and Sweat Equity Shares), explaining their impact on investor decisions and corporate financing.

SREENARAYANAGURU OPEN UNIVERSITY

QP CODE:

Reg. No :

Name :

SECOND SEMESTER, BACHELOR OF COMMERCE (B. COM) EXAMINATION

DISCIPLINE CORE - 4- B21CM05DC - Corporate Accounting and Auditing

2023-24 - Admission Onwards-Set-2

Time: 3 Hours

Max Marks: 70

Section A

Answer any ten of the following questions in one word or sentence. (10×1= 10)

1. Which type of share gives voting rights to shareholders?
2. Which preference shares can be converted into equity shares?
3. What type of shares are issued to employees as a reward for their contribution?
4. Which document defines the rights and obligations of debenture holders?
5. Which type of debenture is backed by the company's assets as security?
6. What is the journal entry recorded when debentures are redeemed?
7. What is the financial statement that shows a company's financial position at a specific date?
8. Which statement summarizes a company's revenues and expenses for a financial period?
9. Which auditor is responsible for reporting to shareholders as per legal requirements?
10. Which type of audit is conducted by a company's employees to evaluate internal processes?
11. What is meant by "closing stock" in final accounts?
12. Which document defines the internal rules and regulations of a company?
13. What is the main purpose of final accounts?
14. If a company wants to ensure that its financial statements comply with legal requirements, which type of audit should it conduct?
15. A company suspects fraud in its financial records. Which audit process would be most suitable to investigate this?

Section B

Answer any five of the following questions in one or two sentences. (5×2=10)

16. How does an Internal Audit differ from a Statutory Audit?
17. State any two key objectives of Internal Control in an organization.
18. Explain the difference between Calls in Arrears and Calls in Advance.
19. What is Under-Subscription, and how does it affect the share issue process?

20. A company makes a Right Issue in the ratio of 1:5 (one new share for every five shares held). If an investor holds 500 shares, how many additional shares can they subscribe to?
21. ABC Ltd. received applications for 1,20,000 shares, but only 1,00,000 shares were available. If shares are allotted pro-rata, how many shares will an applicant who applied for 6,000 shares receive?
22. A company forfeited 2,000 shares of ₹10 each on which ₹6 per share was paid. Later, these shares were reissued at ₹8 per share. Calculate the amount transferred to the Capital Reserve after reissue.
23. A company issued debentures at ₹95 (₹100 face value) and will redeem them at ₹105 after five years. What is the loss on the issue of debentures, and how should it be treated in the accounts?
24. What are the statutory records that a company must maintain as per company law?
25. Differentiate between a public company and a private company with one key point.

Section C

Answer any four of the following questions in one paragraph. (4×5=20)

26. A company has appointed an individual as an auditor who is also a shareholder of the company. Is this appointment valid? Justify your answer concerning auditor disqualifications.
27. A company plans to distribute dividends to its shareholders but is unsure whether sufficient divisible profits are available. As an auditor, how would you verify the legality of the dividend distribution?
28. Define and explain the difference between a Clean Report and a Qualified Report with examples.
29. What are the essential elements of an audit report?
30. A company issued 50,000 equity shares of ₹10 each at a premium of ₹2 per share. The payment schedule was: ₹3 on application, ₹5 on allotment (including premium), and ₹4 on first & final call. All shares were applied for and money was received except from a shareholder holding 2,000 shares who failed to pay the final call. Pass necessary journal entries.
31. A shareholder who was allotted 3,000 shares of ₹10 each failed to pay the first and final call of ₹4 per share. After due notice, the company forfeited these shares and later reissued them at ₹8 per share as fully paid. b for forfeiture and reissue.
32. A company purchased machinery worth ₹5,00,000 and issued 50,000 shares of ₹10 each as payment. Pass the journal entry for this transaction.
33. Differentiate between shares and debentures based on ownership, risk, return, and voting rights. How does investing in debentures differ from investing in shares?

Section D

Answer any two of the following questions in 300 words. (2×15 = 30)

34. From the following Trial Balance, prepare the Trading Account, Profit & Loss Account, and Balance Sheet of Madhav for the year ending 31st March 2023, after considering the given adjustments.

Trial Balance

Particulars	Debit (₹)	Credit (₹)
Opening Stock	70,000	-
Purchases	2,60,000	-
Sales	-	5,00,000
Wages	20,000	-
Salaries	50,000	-
Sundry Debtors	1,50,000	-
Sundry Creditors	-	80,000
Vehicles	1,00,000	-
Capital	-	2,50,000
Bank Loan	-	60,000
Bank Overdraft	-	20,000
Cash in Hand	15,000	-

Adjustments to be made:

1. Outstanding Liabilities:
 - Salaries: ₹50,000
 - Wages: ₹10,000
 - Interest on Bank Overdraft: ₹3,000
 - Interest on Bank Loan: ₹6,000
2. Interest on Capital: Provide interest on capital at 10% p.a.
3. Bad Debts:
 - Actual Bad Debts: ₹10,000
 - Provision for Bad Debts: 10% on Sundry Debtors after deducting bad debts.
4. Closing Stock: ₹1,20,000
5. Depreciation on Vehicles: 10% p.a.

35. XYZ Ltd. issued 10,000 equity shares of ₹10 each at a premium of ₹2 per share. The amount was payable as follows:

- On Application: ₹5 (including ₹2 premium)
- On Allotment: ₹3
- Balance On First and Final Calls

Applications were received for 12,000 shares. The company made a pro-rata allotment to applicants of 10,000 shares, refunding the excess application money. Mr A, who had applied for 500 shares, failed to pay the allotment and call money. His shares were forfeited and reissued to Mr. B at ₹8 per share.

You are required to:

1. Prepare necessary journal entries to record the above transactions, including application, allotment, call, forfeiture, and reissue.
2. Show the calculation of the amount transferred to the Share Forfeiture Account.
3. Compute the amount received by the company from the reissue of forfeited shares and the loss on the reissue.

36. Auditing plays a crucial role in ensuring the accuracy and reliability of financial statements. Different types of audits are conducted based on the nature and scope of an organization.

(A) Define Auditing and explain its objectives.

(B) Explain any five types of audits with suitable examples.

Types of audits may include:

1. Statutory Audit
2. Internal Audit
3. Tax Audit
4. Forensic Audit
5. Management Audit
6. Cost Audit
7. Government Audit

37. An auditor's report is a crucial document that provides an opinion on the financial statements of a company. However, depending on the findings, an auditor may issue different types of reports, including a Clean Report and a Qualified Report.

(A) Explain the essential contents of an Auditor's Report as per auditing standards.

(B) Differentiate between a Clean Report and a Qualified Report with suitable examples

(C) Suppose you are an auditor of ABC Ltd. During the audit, you find that the company has not provided adequate information regarding contingent liabilities in its financial statements.

1. What type of audit report would you issue in this situation? Justify your answer
2. Suggest any two possible modifications that can be made in the report based on your findings.

SREENARAYANAGURU OPEN UNIVERSITY

QP CODE:

Reg. No :

Name :

THIRD SEMESTER, BACHELOR OF COMMERCE (B. COM) EXAMINATION DISCIPLINE CORE - 10- B21CM06DC - Cost Accounting

2023-24 - Admission Onwards-Set-1

Time: 3 Hours

Max Marks: 70

Section A

Answer any eight of the following questions in one or two sentences.

(8×1= 8)

1. What is a cost unit?
2. Define Economic Order Quantity (EOQ).
3. What is a bin card used for in inventory management?
4. What is meant by indirect labour cost?
5. Name one method of cost absorption.
6. What is the formula to determine the cost per unit?
7. Define fixed overheads.
8. What is the purpose of a cost sheet?
9. What is the Just-in-Time (JIT) inventory system?
10. What is the difference between a fixed budget and a flexible budget?

Section B

Answer any six of the following questions in two or three sentences.

(6×2=12)

11. Differentiate between financial accounting and cost accounting.
12. Explain the concept of marginal costing.
13. What are the advantages of ABC analysis in material management?
14. How does the piece-rate wage system differ from the time-based wage system?
15. Explain the concept of cost apportionment with an example.
16. What is a reconciliation statement in cost accounting?
17. Explain the significance of process costing.
18. What are the key elements of a labour cost sheet?

Section C

Answer any six of the following questions in one paragraph. (6×5=30)

19. Calculate the Economic Order Quantity (EOQ) for a company with an annual demand of 10,000 units, ordering cost per order of ₹50, and holding cost per unit per year of ₹2.
20. Prepare a cost sheet for a company with the following details: Direct Material Cost = ₹50,000, Direct Labor Cost = ₹30,000, Factory Overhead = 40% of Prime Cost, Administrative Overheads = ₹10,000, Selling & Distribution Expenses = ₹5,000.
21. Explain the importance of cost classification in managerial decision-making.
22. Calculate the total wage payment using Halsey's premium plan where the standard time is 50 hours, actual time taken is 40 hours, and hourly wage rate is ₹20.
23. Differentiate between job costing and batch costing with relevant examples.
24. Calculate the re-order level, minimum stock level, and maximum stock level for a company given: Normal usage = 500 units/week, Minimum usage = 300 units/week, Maximum usage = 700 units/week, Re-order period = 4 to 6 weeks.
25. Explain the different methods of absorption of overheads with examples.
26. Discuss the impact of cost accounting on pricing decisions.

Section D

Answer any two of the following questions in 300 words. (2×10 = 20)

27. Prepare a detailed cash budget for a company with the following estimated data: Opening Cash Balance = ₹20,000, Receipts = ₹50,000 (Month 1), 40,000 (Month 2), ₹45,000 (Month 3); Payments = ₹30,000 (Month 1), ₹35,000 (Month 2), ₹25,000 (Month 3).
28. Prepare a stores ledger using FIFO and LIFO methods for the following transactions: Opening stock = 100 units @ ₹10, Purchases: 50 units @ ₹12, 200 units @ ₹11, Issues: 120 units, 80 units, 50 units.
29. Compare and contrast different methods of cost control and cost reduction.
30. Develop a master budget for a manufacturing firm including sales, production, and capital expenditure budgets.

SREENARAYANAGURU OPEN UNIVERSITY

QP CODE:

Reg. No :

Name :

THIRD SEMESTER, BACHELOR OF COMMERCE (B. COM) EXAMINATION DISCIPLINE CORE - B21CM01SE - E-BUSINESS(CBCS-UG)

2022-23 - Admission Onwards-Set-2

Time: 3 Hours

Max Marks: 70

Section A

Answer any ten of the following questions in one word or sentence. (10×1= 10)

1. What facilitates most Consumer-to-Consumer (C2C) transactions?
2. What is the key feature of C2C e-commerce?
3. What is the main focus of the B2B model?
4. What is the primary focus of the B2C model?
5. Which feature of e-commerce allows global accessibility?
6. What technology helps create personalized travel experiences for customers ?
7. What is a key challenge in digital publishing?
8. How does data analytics in E-CRM assist businesses?
9. What does digital marketing primarily involve?
10. What does SEO stand for?
11. What is the primary purpose of SEO?
12. When do advertisers pay in a Pay-Per-Click (PPC) campaign?
13. What type of advertising model does Google Ads represent?
14. What metric measures the cost-effectiveness of a PPC campaign?
15. What is the primary focus of content marketing?

Section B

Answer any five of the following questions in one or two sentences. (5×2=10)

16. What is the Consumer-to-Consumer (C2C) model?
17. How does the Consumer-to-Business (C2B) model function?
18. What is the Business-to-Government (B2G) model, and what are its primary characteristics and benefits?
19. What is e-tourism, and how does it enhance the travel and hospitality industry?
20. What are the different types of e-publishing?

21. What is Electronic Customer Relationship Management (E-CRM)?
22. What are the advantages of E-CRM?
23. What is digital marketing?
24. What is Search Engine Optimisation (SEO)?
25. What is Pay-Per-Click (PPC) advertising?

Section C

Answer any four of the following questions in one paragraph.

(4×5=20)

26. What is the difference between E-Business and E-Commerce?
27. What is Business-to-Consumer (B2C)?
28. What is Business-to-Business (B2B)?
29. How does E-Business impact employment and the job market?
30. What is e-supply chain management?
31. Describe the best practices for ERP implementation in e-business?
32. What are the key components of e-supply chain management?
33. What is the role of emerging technologies in E-CRM?

Section D

Answer any two of the following questions in 300 words.

(2×15 = 30)

34. What are the features of E-Business?
35. What are the advantages of E-Commerce?
36. What is customer relationship management, what are its key components, and what benefits does it offer?
37. What is e-learning, and what are its advantages and disadvantages?

സർവ്വകലാശാലാഗീതം

വിദ്യയാൽ സ്വത്രതരാകണം
വിശ്വപ്രതിരായി മാറണം
ഗ്രഹപ്രസാദമായ് വിളങ്ങണം
സുരൂപ്രകാശമേ നയിക്കണേ

കൂർത്തുട്ടിൽ നിന്നു തെങ്ങങ്ങളെ
സുരൂവായിയിൽ തെളിക്കണും
സ്നേഹദീപ്തിയായ് വിളങ്ങണും
നീതിവെജയയന്തി പാറണും

ശാസ്ത്രവ്യാപ്തിയെന്നുമേകണും
ജാതിഫേദമാകു മാറണും
ബോധരശ്മിയിൽ തിളങ്ങുവാൻ
ജനാനക്കേടുമേ ജുലിക്കണേ

കുരീപ്പും ശ്രീകുമാർ

SREENARAYANAGURU OPEN UNIVERSITY

Regional Centres

Kozhikode

Govt. Arts and Science College
Meenchantha, Kozhikode,
Kerala, Pin: 673002
Ph: 04952920228
email: rckdirector@sgou.ac.in

Thalassery

Govt. Brennen College
Dharmadam, Thalassery,
Kannur, Pin: 670106
Ph: 04902990494
email: rctdirector@sgou.ac.in

Tripunithura

Govt. College
Tripunithura, Ernakulam,
Kerala, Pin: 682301
Ph: 04842927436
email: rcedirector@sgou.ac.in

Pattambi

Sree Neelakanta Govt. Sanskrit College
Pattambi, Palakkad,
Kerala, Pin: 679303
Ph: 04662912009
email: rcpdirector@sgou.ac.in

Corporate Accounting and Auditing

COURSE CODE: B21CM05DC



YouTube



Sreenarayananaguru Open University

Kollam, Kerala Pin- 691601, email: info@sgou.ac.in, www.sgou.ac.in Ph: +91 474 2966841



ISBN 978-81-982853-0-0



9 788198 285300