

Paper- 6: COMMERCIAL & INDUSTRIAL LAWS AND AUDITING

Time Allowed: 3 Hours

Full Marks: 100

The figures in the margin on the right side indicate full marks.

- Please: (i) Answer all bits of a question at one place
(ii) Open a new page for answer to a new question
(iii) Attempt the required number of question only.

Answer Question No. 1 and Question No. 5 which are compulsory and attempt any two from the rest in Section-I and any two from the rest in Section-II.

Section-I (50 Marks)
(Commercial and Industrial Laws)

1. Comment on the following based on legal provisions (no mark for wrong reasons or justification) 2X7
- (a) A complaint can be filed under Consumer Protection Act within 30 days from the date on which the cause of action arose.
 - (b) Mr. Amit joining on 01/11/2013 as an accountant wanted to become member of PF from 01/11/2013 but personnel manager disagreed.
 - (c) Mr. Amit, who retired on 30/11/2013, did not vacate office quarter which was provided by his employer. Employer withheld the Gratuity to force him to vacate the quarter.
 - (d) Mr. Amit agrees to sale Mr. Rahim 20 bags of wheat out of 200 bags lying in his godown for ₹20,000. Wheat is completely destroyed by fire. Mr. Rahim cannot compel Mr. Amit to supply wheat as per contract.
 - (e) A lost his dog. He sent his servant to search the dog. When he did not hear about the lost dog, he advertised a reward of ₹ 500 to any person who found the lost dog and returned it to A. The servant found the lost dog and returned the dog to A. When the servant came to know about the reward, he claimed the reward from A. Can he claim the reward? Give reasons.
 - (f) Bonus is payable only if there is profit.
 - (g) A drew cheques in favour of B. A's clerk forged B's endorsement and negotiated the cheques to C who took them in good faith and for value. C received payment of the cheques. A claims to recover the amount from C. Will he succeeds?

Answer:

1. (a) Section 24A of the Consumer Protection Act provides that a consumer dispute can be filed within two years from the date on which the cause of action arises.
Since this provision was inserted in the Act in 1993, before that the Consumer Forums were following the Limitation Act, 1963, which says that a suit can be filed within three years after the cause of action arises.
- (b) As per P.F. Act an employee at the time of joining the employment and getting wages upto ₹ 6,500/- is eligible for membership of Provident fund.
Since inadequate of information in the question the answer can be as follows:

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- (i) In case Mr. Amit getting upto ₹ 6,500 per months, then he is eligible for membership under P.F Act from the first date of joining.
- (ii) In case Mr. Amit getting more than ₹ 6,500 per month, then he is not eligible for membership under P. F. Act.
- (c)** Gratuity cannot be withheld for non-vacation of service quarters by retired employees. (Ref: Air India Vs Authority under the Act 1998 CLA 34 Bon 66). Gratuity can only be forfeited to the extent of damage or loss where services have been terminated for any act or wilfull omission or negligence causing damage/loss/destruction of employer's property and not for non-vocation of service quarters.
- (d)** True: Mr. Rahim cannot compel Mr. Amit to supply wheat because where there is an agreement to sell specific goods and subsequently the goods without any fault on the part of the seller or buyer perish or become so damaged as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is therefore avoided.
- (e)** No, the servant cannot claim the money. He acted without any information as to the offer. A person cannot accept an offer unless he is aware of it. Therefore, the offer cannot be said to have been accepted thereby resulting in a contract. Similar decision was given in Lalman Shukla v. Gauri Dutt.
- (f)** False – Subject to the other provisions of the Payment of Bonus Act, every employer shall be bound to pay to every employee in respect of the accounting year commencing on any day in 1979 and in respect of any subsequent accounting year, a minimum bonus which shall be 8.33% of the salary or wage earned by the employee during the accounting year or ₹ 100 (₹ 60 in case of employees below 15 years of age), whichever is higher. The minimum bonus is payable whether or not the employer has any allocable surplus in the accounting year.
- (g)** A person who steals or finds a lost negotiable instrument does not acquire a title to the instrument as against the rightful owner. He cannot enforce payment on it against any party thereto. If he obtains payment on it, he is liable to the true owner. If the bill or note is payable to bearer, he can negotiate it to a bona fide transferee for value who acquires a good title to it. But if the bill or note is payable to order, and the thief or finder forges the endorsement of the rightful owner, even a bona fide transferee for value does not acquire a title to it.
- Hence in this case A will succeed if the cheque was an order cheque, but fail if the cheque was payable to bearer.
- 2. (a)** A's wife B paid ₹ 500 to C to be given as a bribe to a jailor for procuring release for her husband from jail. The Jailor failed to procure the release. Can B recover the amount? [2]
- (b)** B selects certain furniture in a shop. The price is settled. He arranges to take delivery of the furniture the next day and agrees to pay on the first of the next month. The furniture was destroyed by fire the same evening. Is B liable to pay the price? Give reasons. [2]
- (c)** A offers, by a letter, to sell a certain articles to B who receives the letter the next day. B immediately posts his letter of acceptance. The same evening A posts a letter revoking the offer. A's letter of revocation and B's letter of acceptance cross in the post. Is there a contract between A and B? [2]
- (d)** An employee committed an act in respect of which a fine was imposed. No prior notice specifying this particular act in respect of which fine could be imposed had been exhibited. The employer deducted the fine in 4 installments from the wages of the employee. What provisions of the Act does the employer violates? [2]
- (e)** A watchman whose duty was to guard the property of the premises of a rest house had his quarters within the premises of the rest house. His duty ended at 11 p.m. At 2.30 a.m. (i.e.

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- within 3.5 hours of the said 11 p.m.) he was found murdered near his quarters. Is the employer liable to pay compensation? [2]
- (f) A is the owner of a concern manufacturing cigars. 20 persons are employed in the concern. Of these 20 employees, one is a graduate for supervising the work and another apprentice learning work. The remaining 18 are employed not on the time wage system, but on the piece work system. Is the concern a factory within the meaning of that term under the Factories Act, 1948? [2]
- (g) The services of a woman worker who had completed 4 months' continuous service in a factory were terminated.
- i. To what leave she is entitled?
- ii. To what leave will she be entitled if she were below 15 years of age? [1+1]
- (h) A sells his grocery business, including goodwill, to B for a sum of ₹ 50,000. It is agreed that A is not to open another grocery store in the whole of India for the next ten years. A opens another store in the same city two months later. What are the rights of A? [2]
- (i) A, B and C jointly promise to pay D ₹ 5,000. A and B are untraceable. Can D compel C to pay him in full? [2]

Answer:

- (a) An agreement will not be enforceable if its object or the consideration is unlawful. According to Section 23 of the Act, the consideration and the object of an agreement are unlawful if the court regards it as immoral or opposed to public policy, an agreement whose object or consideration is immoral or is opposed to the public policy is void. In the given case, as the agreement is unlawful, being opposed to public policy is void. So, B cannot recover the amount.
- (b) Yes, B is liable to pay the price, the contract being an unconditional contract for the sale of specific goods in a deliverable state. In the case of specific goods, in a deliverable state, property in them passes at the time when the contract (unconditional) is made (Section 20). The fact that the time of payment or the delivery of the goods, or both, is postponed does not affect the passing the property.
- (c) The communication of a proposal (offer) is complete when it comes to the knowledge of the person to whom it is made (Sec. 4). The communication of an acceptance is complete – as against the proposer when it is put into a course of transmission to him, so as to be out of the power of the acceptor. In the given case, as B receives the letter sent by A the next day, the offer is complete. And as B posts his letter of acceptance immediately, the acceptance is complete as against A. So, there is contract between A and B.
- (d) An employer can deduct the fine imposed on any employee from the wages of the same. But as per Section 8(2) the notice specifying the acts and omissions for which fines may be imposed shall be exhibited in the prescribed manner on the premises (and in case of persons employed upon a railway, at the prescribed place or places) in which employment is carried on. Similarly section 8(6) provides that such a fine shall not be recovered from the employed person by installments or after expiry of 90 days from the day on which it was imposed.
- (e) Yes, as the accident arise out of and in the course of employment. When a person is employed on a duty of this kind his actual employment does not cease within the specified hours of duty but he is in a way constant employment since it can by no means be said that if a watchman detected a thief at a time he was not actually on duty, he

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would not be required to resist and obstruct the thief and that it would be no part of his duty to do so.

- (f) As per Section 2 (m) factory means any premises including the precincts thereof -
- i. Whereon 10 or more workers are working or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or
 - ii. Whereon 20 or more workers are working or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on.

For computing the number of workers, all the workers in different groups in a day shall be taken into account.

So, in the given case, as per section 2(m) the concern is a factory within the meaning of that term under the Factories Act, 1948.

- (g) As per section 79 every worker who has worked for a period of 240 days or more in a factory during a calendar year shall be allowed during the subsequent calendar year leave with wages for a certain number of days. These days of leave shall be calculated at the rate of -
- i. If an adult, one day for every 20 days of work performed by him during the previous calendar year.
 - ii. If a child, one day for every 15 days of work performed by him during the previous calendar year.

So, in the given case, she is entitled to

- i. 6 day's leave, and
- ii. 8 day's leave.

- (h) As per Section 27 of The Indian Contract Act, every agreement, by which anyone is retained from exercising a lawful profession, trade or business of any kind, is to that extent void. Exception to Section 27 provides that the seller of the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within local limits, so long as the buyer or any one deriving title to the goodwill from him carries on alike business, provided that such limits are reasonable.

In the given case, as the limits agreed regarding place as well as time is not reasonable, the agreement is void. So, B cannot take any legal action against A.

- (i) As per Section 43 of The Indian Contract Act when two or more persons make a joint promise and there is no express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise. This means the liability of joint promisors is joint and several.

So, in the given case, D can compel C to pay him in full.

3. (a) An individual dispute is not an industrial dispute. Comment. [2]
(b) Distinguish between Retrenchment and Lay Off. [2]
(c) Whether Ministry has adopted a "Consultative Approach" while bringing out the LLP Act?[3]
(d) At an auction sale, A makes the highest bid for a flower vase. Purporting to accept the bid, the auctioneer strikes the vase and breaks it. Who is to bear the loss? Would your decision differ if the auctioneer had struck the table on which the vase was kept with the hammer and the vase fell down and broke to pieces? [2]
(e) When gratuity payable to an employee can be forfeited? [2]

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- (f) Twelve employed persons acting in concert absent themselves for 2 days without due notice and without reasonable cause. What is the maximum amount that may be deducted on account of the absence from duty of these persons? [2]
- (g) A, a medical practitioner purchased an ultrasound scanner and the same stopped functioning within a short period of time. A claimed refund of the price from the supplier. The supplier pleaded that the complainant was not a consumer as the scanner was used for the professional purpose and A was making profit out of it. The complainant claimed that it was being run by his personal skill and to earn his livelihood. Decide. [3]
- (h) "Deficiency in service is a ground for preferring a complaint to the Consumer Protection Forum". Comment. [2]

Answer:

- (a) The statement can be said to be correct. However, under certain circumstances, as provided in section 2A of the Industrial Disputes Act, an individual dispute shall be deemed to be an industrial dispute, although no other workmen or any union of workmen is a party to the dispute.
- (b) Retrenchment and layoff are differently defined in the Industrial Dispute Act. While retrenchment means termination by the employer of the service of a worker for any reason other than a punishment as a disciplinary action, layoff has been defined as the failure, refusal or inability of an employer to give employment to a workman whose name appears on the master roll and who has not been retrenched due to shortage of coal, power, raw material, accumulation of stocks, breakdown of machinery, natural calamity etc.
- (c) True. The Ministry of Corporate Affairs, on 2nd November, 2005, placed a Concept Paper on LLP Law on its website so that all interested stakeholders may express their opinions on the concepts involved and suggest formulations for the consideration of the Ministry on various aspects of LLP Law. The Concept Paper was also circulated to various concerned Ministries/Departments and autonomous bodies like Comptroller and Auditor General of India (C&AG), Securities and Exchange Board of India (SEBI), Insurance Regulatory Development Authority (IRDA) etc. for their comments. Large number of comments and suggestions were received by the Ministry on the Concept Paper. These were examined in light of international practice/law on the subject. The Act has been prepared keeping in view the Indian requirements.
- (d) As per Section 64 of The Sale of Goods Act where goods are destroyed or damaged before the completion of sale, the loss will fall on the seller. The sale is complete when the auctioneer announces its completion by the fall of the hammer or in some other customary manner. Until such announcement any bidder may retract (withdraw, revoke) his bid. In the given case, as the auctioneer did not announce the completion of sale by the fall of the hammer or any other customary manner, the sale is not complete. So in both the cases the loss is to be borne by the owner of the vase.
- (e) The gratuity payable to an employee may be whole or partially forfeited if the services of such employee have been terminated for –
- His riotous disorderly conduct or any other act of violence on his part, or
 - Any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment [Sec. 4 (6) (b)]. Any decision to forfeit gratuity can however be taken only after affording opportunity of hearing to the employee.

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- (f) If, however, 10 or more employed persons, acting in concert, absent themselves without due notice and without reasonable cause, the deduction for absence from duty from any such person may include such amount not exceeding his wages for 8 days as may be due to the employer in lieu of notice [Proviso to Sec.9 (2)].
So, in the given case, wages for 10 days, i.e. two days' wages for absence plus 8 days' wages for not giving due notice may be deducted.
- (g) As per the definition of the 'Consumer', the goods purchased or services availed should not be meant for re-sale or for a commercial purpose. Commercial purpose does not include use by a consumer of goods bought and used by him and services availed by him exclusively for the purpose of earning his livelihood, by means of self-employment.
In the given case, the question of profit is not relevant. The question to be seen is whether the goods purchased by consumer were being used by himself. From the affidavit of the complainant, it is clear that the scanner was used by him by his skill for earning his livelihood. Hence, he is a consumer. The supplier is bound to refund the price.
- (h) Deficiency in service complained of could be in respect of the service hired or availed or agreed to be hired or availed of by the complainant who suffered from deficiency in any respect. Deficiency must pertain to performance. Whenever there is a deficiency arising out of negligence of a party, the consumer can approach the Forum for redressal. Negligence is sine qua non regarding deficiency of service.

4. (a) Write short notes on the following: (Any four).

[4 × 4]

- i. **Bailee's Lien**
- ii. **Essentials of a valid acceptance.**
- iii. **Personal liability of agent.**
- iv. **Permissible deduction under Payment of Wages Act.**
- v. **Sale and agreement to sell.**

- (b) **"A mere mental acceptance not evidenced by words or conduct is, in the eyes of the law, no acceptance." Comment.** **[2]**

Answer: (a)

- (i) Bailee's right of lien is particular in certain cases whereas general in other cases.
Particular Lien is conferred upon a bailee by virtue of the provision of Section 170. It reads: 'Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the service he has rendered in respect of them.'
General Lien: The provisions of Section 171 empower certain categories of bailees to exercise a general lien. These include: bankers, factors, attorneys of High Court and policy brokers. These bailees can retain all goods of the bailor so long as anything is due to them, unless there is a contract to the contrary.
- (ii) Essentials of a valid acceptance :
- (a) Acceptance must be absolute and unqualified.
 - (b) It must be communicated.
 - (c) It must be according to the mode prescribed.
 - (d) It must be given within the time prescribed or within reasonable time.
 - (e) It must be in response to offer.
 - (f) It must be made before the offer lapses.
 - (g) It must be given by the person to whom the offer is made.

(iii) The general rule is that only the principal can enforce, and can be held liable on a contract entered into by the agent except when there is a contract to the contrary. Sec. 230 of the Contract Act clearly lays down this rule: "In the absence of any contract to that effect, an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them."

An agent is, however, personally liable in the following cases:

- (a) When the contract expressly provides.
- (b) When the agent acts for a foreign principal
- (c) When he acts for an undisclosed principal
- (d) When he acts for a principal who cannot be sued
- (e) Where he signs a contract in his own name.
- (f) Where he acts for a principal not in existence.
- (g) Where he is liable for breach of warranty of authority.
- (h) Where he receives or pays money by mistake or fraud
- (i) Where his authority is coupled with interest.
- (j) Where the trade usage or custom makes him personally liable.

(iv) Deductions from Wages:

The wages of an employed person shall be paid to him without deductions of any kind except those authorized by or under the Payment of Wages Act, 1986. The deduction from wages of an employed person may be of the following kinds only subject to limit on deduction as prescribed.

1. Deductions for fines
2. Deductions for absence from duty
3. Deductions for Damages or Loss
4. Deductions for services
5. Deductions for recovery of Advances
6. Deductions for recovery of loans
7. Deductions for payments to co-operative societies and insurance schemes.
8. Other Deductions

Limit on Deductions:

The total amount of deductions which may be made under the above heads in a wage-period from the wages of any employed person shall not exceed 75 percent of such wages in case where such deductions are wholly or partly made for payments to co-operate societies. In any other case they shall not exceed 50 percent of such wages. Where the total deductions authorized exceed 75 percent, or as the case may be, 50 percent of the wages, the excess may be recovered in such manner as may be prescribed.

(v) Sale and Agreement to sell.

Where under the contract of sale, the property is transferred from the seller to the buyer for a price or consideration, the contract is called a sale. When the transfer of ownership is to take place at a future time or subject to some condition to be fulfilled later, it is an agreement to sell.

Sale is an executed contract as consideration moves simultaneously with the promise of the parties but the agreement to sell is an executory contract.

In an agreement to sell the property remains with the seller until the agreement to sales becomes a sale by expiry of agreed time or by fulfillment of agreed condition.

In an agreement to sell (a) risk is transferred only when sale is complete - buyer is not responsible for loss/damage of goods, (b) seller's remedy for a breach of contract by the buyer is a suit for damages. (c) but in case of sale, unpaid seller has certain relief i.e. lien, stoppage in transit, resale etc.

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- (b) One of the rules of valid acceptance is that it must be communicated to the offeror. The communication may, however, be express or implied. A mere, mental acceptance is no acceptance. A mere mental acceptance means that the offeree is assenting to an offer in his mind only and has not communicated it to the offeror.

Section -II (50 Marks) (Auditing)

5. **Comment on the following statements based on legal provisions: (No mark for wrong reasons or justification) [2X7]**
- (a) Year end stock ready for exports are proposed to be valued at realizable value.
 - (b) Shareholders, by a majority vote, have authorized the Board of Directors to keep the books of accounts of the company in its Administrative Office, as against the earlier practice of keeping them in the Registered Office. No Government authority has been informed about this.
 - (c) S Ltd. is the Subsidiary of H Ltd. Ram owes S Ltd. ₹ 10,000, Laxman has given guarantee for the same. Can Laxman be appointed as statutory auditor of H Ltd.? Give reason for your answer.
 - (d) Test checks refer to the out of routine checks that are carried out in the normal course of Audit.
 - (e) It is mandatory that provisions of Audit Committee are applicable to all the companies.
 - (f) When Chairman of a company is also Mg. Director, the Companies Act provides the constitution of Board of Directors?
 - (g) Auditor's primary responsibility is to detect errors and frauds.

Answer:

- 5 (a) As per AS-2, closing stock should be valued at cost or market value, whichever is lower, as it is a prudent business practice. It follows the principle of conservatism that means to account for all possible losses or expenses. This principle has been accepted in Chainrup Sampatram v. CIT (1953) 24 ITR 481 (SC) * ALA Firm v. CIT (1991) 189 ITR 285 = 55 Taxman 497 (SC).
- (b) False, as per section 209 of the Companies Act, 1956, the books of accounts can be kept in a place other than its registered office also, but the board of Directors should, within 7 days file a written notice to the Registrar of Companies, the full address of the new place. Here the company has not complied with this mandatory requirement.
- (c) Section 226 of the Companies Act, 1956 speaks of the qualifications and disqualifications of auditors.
As per Section 226(3), a person who has given any guarantee in connection with the indebtedness of any third person to the company for an amount exceeding ₹ 1,000 shall not be qualified to be appointed as auditor of the company. Hence Laxman cannot be appointed as auditor of S Ltd.
Sub Section (4) of section 226 states that where a person is not qualified to be appointed as auditor of a company, the disqualification shall extend to the holding company of the said company also.
Hence Laxman cannot be appointed as statutory auditor of H Ltd. also.
- (d) False. Test checking is a substitute for detailed checking. It involves only a partial checking. The auditor normally does not check completely all the records made into the books of

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accounts but, through a process of sampling, selects a few items and if they are found correct, he presumes that the remaining entries would also be correct likewise.

- (e) False. "Provisions relating to Audit Committee are not applicable to all the companies. According to Section 292A every public company having paid-up capital not less than ₹ 5 crore shall constitute Audit Committee, and as per Section 3 (iv) "Public Company" means a company which –
- (a) is not a private company;
 - (b) has a minimum paid-up capital of five lakh rupees or such higher paid-up capital, as may be prescribed;
 - (c) is a private company which is a subsidiary of a company which is not a private company.
- (f) According to the Birla Committee (and now in Clause 49 of the listing agreement as well as the Companies Act), at least 50 per cent of the board of a listed company should consist of non-executive directors. Furthermore, in the case of there being a non-executive Chairman, at least a third of the board should be independent directors; and if the Chairman is an executive, at least half the board should be independent.
- (g) False. The primary objective of auditing is reporting – whether the Financial Statements present a "true and fair view" of the financial position (Balance Sheet) and the financial performance (Profit and Loss Account) during the period
The incidental and secondary audit objective is to detect (not prevent) errors and frauds and to make recommendations to the appointing authority.

6. (a) **"An auditor must select his sample carefully because the results of a representative and unbiased sample can be mathematically interpreted."** – Comment. [2]
- (b) **State the difference between India's GAAP & US GAAP regarding:**
- i. **Related Party Transactions**
 - ii. **Pre-operative Expenses.** [1+1]
- (c) **Before accepting your appointment as auditor of a limited company, what steps will you take to ensure that your appointment is valid?** [2]
- (d) **A company has purchased Plant and Machinery from a foreign supplier on installment payment basis. The liability has been classified as "Secured Loan" by the Company. Give your opinion on the above.** [2]
- (e) **XYZ Ltd. has not deposited Provident Fund contributions of ₹ 15 lakhs to the authorities but accounted in the books. Comment on the above.** [2]
- (f) **List out the points of distinction between the Companies Auditor's Report Order (2003) (CARO) and section 227 of the Companies Act.** [4]
- (g) **State the behavioural problems involved in conducting Management Audit.** [4]

Answer:

- (a) Sampling is the selection of a part of the population representing the total affairs. At the time of actual start of audit the auditor has to decide whether all transactions are checked or only part of them is examined. If it is practicable to check each and every transaction then there is no need to think about statistical sampling. But in large scale organizations it would be almost difficult to check the huge volume of transactions due to the available limited time that is why some kind of selective checking becomes inevitable. Effective auditing depends upon the proper selection of transactions. Therefore, the

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auditor should be very careful at the time of selecting his audit samples and evaluating the results of audit procedure.

(b)

India	USA
(i) No specific disclosures required. Auditors have a duty to report certain transactions entered into by related parties as defined under the companies Act, 1956: AS-18 is issued w.e.f. 01.04.2001	Disclosures are stringent and require descriptions of nature of relations and control, transactions, amounts involved, and amounts due.
(ii) All direct and indirect expenses incurred prior to commencement of business are treated as pre-operative expenses and capitalized to the cost of fixed cost of assets. There are also allowed to be deferred and written off over a period of 3-5 years or 10 years.	Concept does not exist. They are expenses unless they are capital in nature.

(c) The Incoming Auditor should take the following steps before accepting his appointment -

1. **Ceiling Limit:** Ensure that a certificate has been issued u/s 224 so that total number of Company Audits held by him (including the new appointment) will not exceed the specified number.
2. **Resolution at AGM:** Inspect General Meeting Minutes Book to see that the appointment is duly recorded.
3. **Compliance with law:** Satisfy that the legal procedure contemplated in Sec.224 and 225 of the Act dealing with removal of existing Auditor, if required, has been followed. Also see whether Sec.224A (special resolution) and Sec.619B (C & AG Appointment) are attracted and complied with, if required.
4. **Code of Conduct:** Communicate with the previous Auditor, if any, to ascertain if there are any professional reasons for not accepting the appointment.

(d) **General Principles:** There are no specific disclosure requirements for Deferred Payment Liabilities under Schedule VI. The same should be disclosed on the basis of sound accounting principles and practices prevailing in the country, considering the general requirements of Sec. 211.

Nature: Deferred Payment Liability should be disclosed keeping in view the nature of the liability. It is not in the nature of Loan as per common commercial parlance.

Disclosure: The installments of Deferred Payment Liabilities payable within 12 months of the Balance Sheet date must be disclosed as "Current Liabilities" while the other installments i.e. long-term liabilities may be disclosed under "Provisions" in the Balance Sheet.

(e) **CARO Requirements:** Under CARO 2003, the Auditor is required to report -

- (a) Whether the Company is regular in depositing undisputed statutory dues, like, Provident Fund, Investor Education & Protection Fund, Employees State Insurance, Income Tax, Sales Tax, Wealth Tax, Service Tax, Customs Duty, Excise Duty, Cess and any other statutory dues with the appropriate authorities.

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(b) If not paid regularly, the extent of arrears of outstanding statutory dues as at the last day of the Financial Year concerned for a period of more than **6 months** from the date they became payable, shall be indicated in the Auditor's Report.

Conclusion: In the instant case, even though accrual principles have been followed, disclosure of non payment is necessary in view of CARO requirements. The Auditor should disclose the fact of nonpayment of ₹ 20 lakhs in his Report.

(f) The requirements laid down by the CARO, 2003 are in addition to those laid down in the existing provision of section 227 of the companies act regarding the auditor's report. Nevertheless, there are certain points of difference between the Order and the requirements of section 227, which are as under:-

- i. While CARO exempts certain classes of companies from its application, the provisions of sub-sections (1 A), (2), (3) and (4) of section 227 are applicable to all companies; and
- ii. The provisions of sub-section (1 A) cast an obligation on the auditor to make certain specific enquiries during the course of his audit. There is no requirement to report on any of the matters specified in the sub-section unless he has any special comments to offer in respect of the said matters. If he is content as a result of the enquiries conducted, there is no further obligation to report that he is so satisfied, CARO, 2003, on the other hand, casts an obligation to voice the opinion in respect of each of the matters specified therein even if he has no comments to make on any of the matter(s) contained in Order. In this regard, the provisions of CARO are similar to the provisions of sub-sections (2), (3) & and (4) of section 227.

(g) Management auditor is viewed as a fault finder or critic and this creates heartburns among the auditees.

Management auditors being staff experts came in conflict with line managers. While proposing recommendations, the view points of line manager involving their practical difficulties may be ignored by management auditors resulting in stiffness and conflicts. The management auditor is expected to evaluate the effectiveness of control systems. Consequently the report may have adverse effect on auditees, leading to hostile relationship on account of:-

1. Fear of criticism stemming from adverse audit findings.
2. Action by superiors on the basis of reported defects and deficiencies in audit practices namely:
 - In sensitive and highly critical reports
 - Reports that focus only on deficiencies
 - Hostile audit style such as when the management auditor is cold in his approach, lack of understanding of the practical problems of auditees and excessive concentration on insignificant errors.

7. (a) What are CAATs? Why CAATs are used? [3]
(b) Write short notes on – Teaming and Lading [4]
(c) Discuss the difference of nature and purpose of cost audit and management audit. [3]
(d) Enumerate five cases when auditing through the computer must be used. [2]
(e) Moon Ltd. had its Registered Office at Madras. During the current accounting year, it has shifted its Corporate Head Office to Kolkata though it has retained the Registered Office at Madras. The Managing Director of the Company wants to shift its books of account to Kolkata from Madras, as he feels that there is no legal bar in doing so. Comment. [2]

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- (f) What are the conditions or events peculiar to an EDP environment that increase the risk of fraud and error? [2]
- (g) State the circumstances in which a private limited company is exempt from the applicability of the Companies (Auditor's Report) Order 2003. [2]

Answer:

(a) Due to the special characteristics of an EDP environment, auditors often use the computer for performing several compliance procedures as well as substantive procedures. The techniques, which involve the use of the computer for audit purposes, are known as 'Computer assisted audit technique' (CAATs).

Statement on AAS-16 states that effectiveness and efficiency of audit procedures may be improved through use of CAATs. CAATs may be used in performing various auditing procedures, including the following:

- i. Tests of details of transactions and balances.
- ii. Analytical procedures
- iii. Tests of general controls
- iv. Sampling programmes to extract data for audit testing
- v. Tests of application controls
- vi. Re-performing calculations performed by the entity's accounting system.

(b) Teeming and Lading – It is an ingenious method of concealing a cash shortage. It involves misappropriation of receipts from one or more customers and covering the shortage with receipts from other customers. This shortage may be made up with receipts from other customers. Thus, while the shortage will continue to be there, it will never be in the same account. This can be understood with the help of following example. Suppose, a cheque of ₹ 6,000 received in full settlement of debt from Mr. A, is misappropriated. This means that Mr. A's debt will continue to remain outstanding. Now, suppose at a later date a cheque for same or similar amount is received from Mr. B. with a view not to let Mr. A's debt continue as outstanding for long, which might lead to discovery of misappropriation, the cheque from Mr. B may be shown as having been received from Mr. A, and posted to his account. As a result, now Mr. B's account will appear as outstanding and it will be cleared when another cheque for a similar amount is received from some other customer, and so it may go on. At time, the receipt from one customer may be split over the accounts of many customers, thus concealing several misappropriations at any time and rendering the detection of irregularity still more difficult.

(c) Comparison of Management and Cost Audit

Nature

Management Audit is an independent appraisal activity for the review of managerial functions so as to ensure compliance with organizational objective policies, procedures and purposes. Management audit covers all aspects or processes of management including planning, organization, control etc. of a business. Management audit is carried out to find out the efficacy of the control systems in operation and in business at any given time.

"Cost audit a systematic and detailed checking of costing systems, techniques and account to verify their correctness and to ensure adherence to the objective of cost accountancy".

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Cost audit is concerned with the review, examination and appraisal of cost accounting records so as to ensure true and correct cost of production.

Purpose

The purpose of management audit is to assess whether the integrated management systems which are required to fulfill the contractual and legal obligations of the company to its customers and community are being effectively implemented. It is to inform the management whether the control systems introduced are functioning properly or need to be strengthened.

The purpose of cost audit is to critically review the cost statements and other information and making recommendations for improvement.

(d) Auditing through the Computer must be used in the following cases:

1. The inherent risk associated with the application system is high.
2. The application system process large volumes of input and produces large volumes of output that makes extensive direct examination of the validity of the input and output difficult to undertake.
3. Significant parts of the internal system are inbuilt in the computer.
4. The processing logic embedded within the application system is complex.
5. Substantial gaps in the visible audit trail are common in the system.

(e) Section 209 Requirements: Sec. 209 provides as under -

(a) The books of account shall be kept at the Registered Office of the Company.

(b) All or any of the books of account may be kept at such other place in India as the Board of Directors may decide. The Company shall within 7 days of the decision of the Board, file with the ROC, a notice in writing giving the full address of that other place. The Notice to ROC shall be given in Form 23AA and shall specify the names of the books of account to be kept at other place.

Conclusion: From the above, it is clear that the Board of Directors of the Company may decide to keep the books of accounts of the Company in any other place other than the Registered Office of the Company by fulfilling the requirements specified in the above paragraph.

(f) Conditions or events that are peculiar to an EDP environment that increase the risk of fraud and error concerning the sphere of management, accounting records and routines as underlined by the Institute of Chartered Accountants of India in its statement of auditing practices (SAP4) are as follows :-

- i. Inability to extract information from computer files due to lack of, or non-current documentation of record contents or programmes.
- ii. Large number of programme change that are not documented, approved or tested.
- iii. In-adequate over-all balancing of computer transactions and data basis to the financial accounts.
- iv. Loss of audit trails.

(g) The conditions for exempting a private limited company from the operation of CARO, 2003 are as follows :

- i. The paid up capital and reserve should not exceed ₹ 50 lakhs.

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- ii. No loans should be outstanding from any Bank or Financial Institutions exceeding ₹ 25 lakhs.
 - iii. The turnover should not exceed ₹ 5 cr. at any point of time.
8. (a) How will the auditor overcome loss of or changes in audit trail in an EDP environment? [2]
- (b) A company running a Departmental Store and having total turnover of ₹ 150 Cr. during the financial year, need not get its branch audited whose turnover is ₹ 2.85 cr. during the same year. Decide. [2]
- (c) The cost auditor of a company can be its internal auditor, and is to be appointed by the shareholders of the company. Comment on the validity. [2]
- (d) A company has paid interest on share capital to the shareholders, as there was a long gestation period before the company would start making profits. As the Statutory Auditor of a Public Limited Company, comment on the situation. [4]
- (e) What are the internal control aspects in relation to Bank Reconciliation Statement? [2]
- (f) ABC Ltd. has ₹ 55 lakh Paid up Capital and ₹ 4.5 Crores average annual turnover of past three years preceding the financial year under Audit. The company does not have any Internal Audit System as the Management does not think it mandatory. Comment. [4]
- (g) How does an audit programme help to plan and perform the audit? [2]

Answer:

- (a) The Auditor may use special techniques to overcome the loss or changes in audit trail. Some measures to overcome the loss of audit trail include -
1. Arranging for special printouts containing additional information,
 2. Programmed interrogation facilities, e.g. records on magnetic or card files may be printed on a selective basis,
 3. Clerical re-creation like re-verification of computer generated totals with manually prepared vouchers,
 4. Testing on a total basis and ignoring individual items,
 5. Reliance on alternative tests, and
 6. Use of Special Audit Techniques, either manual or computer aided.
- (b) A branch office of a company shall be exempted from audit, if the company carrying on any manufacturing, processing or trading activity and the average quantum of activity of the branch does not exceed – i) ₹ 2 lakhs or ii) 2% of the average of the Total Turnover of the Company, whichever is higher.
- In the given case, the turnover of the branch Office of the Trading Company (Departmental Store) is 1.90%, i.e. less than 2% of the average of the total turnover of the company. Hence, the branch office is exempted from audit.
- Even if exemption is available, it is necessary that the fact must be mentioned in the Audit Report. The Company Auditor should expressly state in his Audit Report that the Branch Office is exempt from audit, by virtue of quantum of activity.
- (c) The cost auditor of a company cannot be its internal auditor or vice versa.
- The disqualifications attracting the (financial) auditor of a company are equally applicable to cost auditor of a company also. [Section 226(3) of the Companies Act, 1956].
- Section 226 is made applicable to appointment of cost auditor under section 224 (1B) of Companies Act. Therefore, a qualified person can be appointed as cost auditor of a

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company but he cannot be at the same time being its internal auditor or financial auditor. Even a qualified cost accountant who is acting as an internal auditor cannot be appointed as cost auditor of that company in view of the provisions of section 226(3) read with clause of that section.

The Cost Auditor having the requisite qualification will be appointed by the Board of Directors of the company with the previous approval of the Central Government and submit his report to the Central Government within the time prescribed by it.

The ceiling on the number of audits is also applicable to persons or firms appointed as Cost Auditors.

(d) Section 208 of the Companies Act, 1956 permits payment of interest to shareholders out of capital, where there is a long gestation period. Payment of interest on capital is, however, capitalized as part of cost of construction of the project. The auditor should ensure that following conditions have been complied whenever such interest has been paid:

- i. Payment is authorized by the Articles or by special resolution of shareholders in general meeting;
- ii. Payment is approved by the Central Government;
- iii. It is paid only for the period determined by the Central Government not exceeding six months after the half year in which the project has been completed.
- iv. The rate shall not exceed 12% p.a. or such other rate as may be prescribed by the Government;
- v. The payment of interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid.

(e) Internal control aspects in relation to bank Reconciliation Statement are as follows:

- i. Receipt of Bank Statement: Decision regarding handing over/ receipt of Bank Statements.
- ii. Frequency of reconciliation: How frequently reconciliation should be performed.
- iii. Authorisation: By whom and the detailed procedure to be followed for reconciliation. The person responsible for carrying out the bank reconciliation should not normally be concerned with handling cash and cheques received or with arrangements for disbursements.
- iv. Attention points: Special attention to be given for long standing un presented cheques, stop payment notices, examination of the sequence of cheque numbers and comparison of cheque details with details recorded in the Cash Book.

(f) As per clause 4(vii) of CARO, having regard to their size and nature of business, the Auditor should report whether or not the following Companies have an Internal Audit System –

- i. Listed companies,
- ii. Companies having paid-up capital and reserves exceeding ₹ 50 lakhs as at the commencement of the financial year concerned,
- iii. Companies having an Average Annual Turnover exceeding ₹ 5 crores for a period of three consecutive financial years immediately preceding the financial year concerned.

In the given case the paid-up capital is ₹ 55 lakhs (exceeding the limit of ₹ 50 lakhs) and the Average Annual Turnover is ₹ 4.5 crores (within the limit of ₹ 5 crores) and hence, the above reporting clause is attracted.

CARO does not mandate the above clauses of Companies to compulsorily have an Internal Audit System. Hence, the Management's view that the Internal Audit is not mandatory is correct. However, the Auditor is required to report the fact that the Company does not have any internal audit system, in view of CARO Reporting requirements.

(g) An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions. The auditor should prepare a written audit programme setting forth the procedures that are needed to be implemented while carrying out the audit plan. The audit programme serves as a ready check list of audit procedures to be performed. So, the audit programme is of immense help to plan and perform the audit.