

Paper-6: COMMERCIAL AND INDUSTRIAL LAWS AND AUDITING

Full Marks: 100

Time Allowed: 3 Hours

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)**

Question 1: Answer all questions

2 X 7 = 14

Comment on the following:

- (i) A offered to purchase shares of XYZ Ltd on 1st May 2014. The company made allotment of shares on 30th November 2014. A refused to accept the shares. Can it do so?
- (ii) Ascertain the date of maturity of a bill payable hundred days after sight and which is presented for sight on 4th September, 2014.
- (iii) X is engaged in two types of job in a factory, that of a mechanic and watchman. The wage rates are different for two different jobs. The employer calculates his minimum wage at an average rate. State whether this is correct as per the Minimum Wages Act, 1948?
- (iv) The payment of contribution to provident fund of an employee, to be made by his employer, who has become insolvent. A preferential payment as per the provisions of the Employees Provident fund and Miscellaneous Provisions Act, 1952 is possible?
- (v) A contracts to sell B, by showing sample, certain quantity of lotion described as "Imported". The lotion when delivered matches with the sample, but is not "imported" but "Made in India" but of the same company. Referring to the provisions of Sale of Goods Act, 1930 advise the remedy, if any, available to B.
- (vi) When is a LLP not bound by act of its members?
- (vii) Who is a 'Holder for value'?

Answer:

- (i) According to Sec 6(2) of the Indian Contract Act, 1872 an offer is revoked by lapse of time prescribed in the proposal or by lapse of reasonable time without communication of acceptance. What is reasonable time is question of fact in each case. In the given case the offer lapsed as it was not accepted within reasonable time [Ramsgate Victoria Hotel Co. vs Montefiore.]

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(ii) In this case the day of presentment for sight is to be excluded i.e. 4th September, 2014. The period of 100 days ends on 13th December, 2014 (September 27 days + October 31 days + November 30 days + December 13 days). Three days of grace are to be added. It falls due on 16th December, 2014.

(iii) Where an employee does two or more classes of work to each of which a different minimum rate of wages is applicable, the employer shall pay to such employee in respect of the time respectively occupied in each such class of work, wages at not less than the minimum rate in force in respect of each such class. Thus employer just cannot pay him at simple average rate of both wages of both classes of job.

(iv) According to Section 11 of the Employees Provident Fund and Miscellaneous Provisions Act 1952, if the employer is adjudged as insolvent or if the employer is a company and an order winding thereof has been made, the amount due from the employer whether in respect of the employee's contribution or employer's contribution must be included among the debts which are to be paid in priority to all other debts in the distribution of the property of the insolvent or the assets of the company.

In other words, this payment will be a preferential payment provided the liability thereof has accrued before this order of adjudication or winding up is made.

(v) B has a remedy to repudiate the contract. According to section 15 of the Sale of Goods Act, 1930, when the goods are sold by sample as well as by description, there shall be an implied condition that the goods shall correspond to the sample as well as description. In this case, A supplied lotion which did correspond with the sample but was not correspond to the description of "Imported".

Hence the B has the right to repudiate the contract.

(vi) A limited liability partnership is not bound by any act of a member in dealing with a person if:

- a) The member in fact has no authority to act for the limited liability partnership by doing that thing;
- b) The person knows that the member has no authority or does not know or believe him to be a member of limited partnership.

(vii) 'Holder for value' means, as regards all parties prior to himself, a holder of an instrument for which value has at any time been given.

Question 2

(i) X sent a consignment of mobile phones worth ₹60,000 to Y and obtained a railway receipt thereof. Later, he borrowed a loan of ₹40,000 from Star Bank and endorsed the railway receipt in favour of the Bank as security. In transit the consignment of mobile phones was lost. The Bank files a suit against the railway for a claim of ₹60,000, the value of the consignment. The railway contended that the Bank is entitled to recover the amount of loan i.e. ₹40,000 only. Examining the provisions of the Indian Contract Act, 1872, decide, whether the contention of the railway is valid.

(ii) TV is the holder of a bill of exchange made payable to the order of 'P'. The bill of exchange contains the following endorsements in blank:

First endorsement

'P'

Second endorsement

'Q'

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Third endorsement

'R'

Fourth endorsement

'S'

'N' strikes out, without S's consent, the endorsements by 'Q' and 'R'. Decide with reasons whether 'N' is entitled to recover anything from 'S' under the provisions of Negotiable Instruments Act, 1881.

(iii) S retired from the services of PQR Limited, on 31st March, 2013. He had a sum of ₹5 lakh in his Provident Fund Account. It has become due for payment to S on 30th April, 2013 but the company made the payment of the said amount after one year. S claimed for the payment of interest on due amount at the rate of 15 percent per-annum for one year. Decide, whether the claim of S is tenable under the provisions of the Employee's Provident Funds and Miscellaneous Provisions Act, 1952.

(iv) Mr. D started "Self Service" system in his shop. Mr. A entered the shop, took a basket and after taking article of his choice into the basket reached the cashier for payments. The cashier refused to accept the price. Can Mr. D be compelled by Mr. A to sell the said article? Decide.

(v) Mr. A agreed to purchase 100 bales of cotton from 'B' from his large stock. 'A' sent his men to take delivery of cotton. On completion of packing of only 70 bales there was accidental fire and entire stock including packed 70 bales were destroyed. There was no insurance cover. Who will bear the loss?

[4+4+4+4+2= 18]

Answer:

(i) The given problem is based on the case of Morvi Mercantile Ltd. v Union of India. As stated by the Court, the deposit of title deed with the Bank as security against an advance constitutes a Pledge, as per Sections 178 and 178A of the Indian Contract Act, 1872.

As a Pledgee, a banker's rights are not limited to his interest in the goods pledged. In the case of injury to the goods or their deprivation by a third party, the Pledgee would have all such remedies that the owner of the goods would have against them.

In this case the Supreme Court also held that the Bank (Pledgee) was entitled to recover not only the amount of the advance due to it, but also the full value of the consignment. However, the amount over and above his interest is to be held by him in trust for the Pledger.

Thus, the Star Bank will succeed in recovering the claim of ₹60,000 against the railway.

(ii) According to Section 40 of the Negotiable Instruments Act, 1881, where the holder of a Negotiable Instrument without the consent of the endorser destroys or impairs the endorser's remedy against a prior party the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity. Therefore if the endorsements of 'R' and 'Q' are struck out without the consent of 'S', 'N' will not be entitled to recover anything from 'S', the reason being that as between 'R' and 'S' 'R' is the principal debtor and 'S' is the surety. If 'R' is released by the holder under Section 39 of the Act, 'S' being surety will be discharged. In this given problem, the rule may be stated thus that when the holder without the consent of the endorser impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder.

(iii) According to section 7Q of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 the employer shall be liable to pay simple interest @ of 12% per annum or at such

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higher rate as may be specified in the Scheme on any amount due from him under this Act from the date on which the amount has become so due till the date of its actual payment:

Provided that higher rate of interest specified in the Scheme shall not exceed the lending rate of interest charged by any scheduled bank.

As per above provision, S can claim for the payment of interest on due amount @ 12 percent per annum or at the rate specified in the Scheme, whichever is higher, for one year. Here in the absence of specified rate he(S) can claim only 12 percent per annum interest on the due amount.

Hence claim of S for interest rate of 15% is not tenable.

(iv) An invitation to offer is an act precedent to making an offer. It is done with intent to generally to induce and negotiate. An invitation to offer gives rise to an offer after due negotiation and it cannot be per se accepted. In an invitation to offer there is no expression of willingness by the offeror to be bound by his offer. It is only a proposal of certain terms on which he is willing to negotiate. It is not capable of being accepted as it is.

In *Harvey v Facey* [1893] AC 552 Privy Council succinctly explained the distinction between an offer and an invitation to offer.

In the instant case Mr. A entered the shop, took a basket and after taking article of his choice into the basket reached the cashier for payments. The cashier refused to accept the price. The display of articles with a price in a self-service shop is merely an invitation to offer. It is not an offer for sale. Therefore, Mr. A cannot compel the cashier Mr. D to sell the-said article. [*Fisher v Be*/(1961)]

(v) Since 70 bales were ascertained and appropriated, property in those 70 bales was transferred to A, hence A is liable for 70 bales only and B is liable for remaining stock.

Question 3

(i) 'A' draws a bill of exchange payable to himself on X', who accepts the bill without consideration just to accommodate 'A'. A transfers the bill to 'P' for good consideration. State the rights of A' and 'P'. Would your answer be different if 'A' transferred the bill to 'P' after maturity?

(ii) Ramesh, aged 16 years, was studying in an engineering college. On 1st March, 2012 he took a loan of ₹1 lakh from Suresh for the payment of his college fee and agreed to pay by 30th May, 2014. Ramesh possesses assets worth ₹10 lakhs. On due date Ramesh fails to pay back the loan to Suresh. Suresh now wants to recover the loan from Ramesh out of his assets. Whether Suresh would succeed? Decide, referring to the Provisions of the Indian Contract Act, 1872.

(iii) Mr. X was serving in Popular Company Limited. After serving for four years X met with an accident and became permanently disabled. X applied to the company for the payment of gratuity. The company refused to pay the gratuity on the ground that X has served only for four years. Decide, whether the contention of the company is valid?

(iv) State the rights and liabilities of 'A' in the following cases;

- A. 'A' is owner of the factory building and also product. 'A' authorizes 'B' to take an insurance policy on factory building for ₹2 lacs.'B' procures a policy for ₹2 lacs on factory and another policy for ₹2,000 on products. 'A' refused to reimburse to 'B'

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- B. 'A' authorizes 'B' to buy 500 pieces of sunlight soap for him but 'B' buys 500 pieces Henko at a price of ₹5,000. 'A' refused to pay to 'B'
- C. An Auctioneer advertised in a newspaper that sale of office furniture will be held at Kolkata on 29.10.2014. 'A' came from New Delhi to buy the furniture but the auction was cancelled. Whether 'A' can file a suit against the auctioneer for his loss of time and cost.

[4+4+4+6=18]

Answer:

(i) The problem is based on the provisions of sections 43 and 59 of the Negotiable Instruments Act, 1881. 'A' cannot recover from 'X' because it is an accommodation bill drawn by 'A' and accepted by 'X' without consideration. According to section 43, an instrument without consideration creates no obligation between the parties to the transaction i.e. 'A' and 'X' in this case.

Section 43 also provides that if such a bill is transferred to a holder for consideration, such holder may recover the amount due on such instrument from the transferor for consideration or any prior party thereto. Hence 'P' in this case can recover the amount from 'X' and 'A'.

According to Section 59, in the case of accommodation bills, a defect in the title of the transferor does not affect the title of holder acquiring after maturity. Hence the answer will be the same even if 'P' has acquired the bill for consideration after maturity.

(ii) According to Section 11 of the Indian Contract Act, 1872, a person who is of the age of majority is competent to enter into any contract. The Majority Act of 1875 states that every person domiciled in India shall attain the age of majority on completion of 18 years and not before. Therefore, a person who has completed the age of 18 years is a major and otherwise he will be treated as minor.

In the instant case, Ramesh who is a minor is not competent to enter into a contract and any agreement with him is void [Mohiri Bibi v Dharmodas Ghose 1903, 30 Cal, 539 (PC)]. Section 68 of the Indian Contract Act, 1872 however, prescribes the liability of a minor for the supply of the things which are the necessaries of life to him. It says that though minor is not personally liable to pay the price of necessaries supplied to him or money lent for the purpose, the supplier or lender will be entitled to claim the money/price of goods or services which are necessaries suited to his condition of life provided that the minor has a property. The liability of minor is only to the extent of the minor's property. This type of contract is called a Quasi-contract and the right of the supplier/lender is based on the principle of equity.

Therefore, in view of the position explained above, Suresh will be entitled to recover the amount of loan given to Ramesh for payment of the college fees from the property of the minor.

(iii) In accordance with the provisions of the Payment of Gratuity Act, 1972, as contained in Section 4(1), Gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than 5 years, on his superannuation, or on his retirement or resignation, or on his death or disablement due to accident or disease. The condition of the completion of 5 years continuous service is not essential in case of the termination of employment of any employee due to death or disablement. Disablement means such disablement as incapacitates an employee for the work which he was capable of performing before the accident or disease resulting in such disablement.

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In the light of the above, the condition of the completion of 5 years continuous service is not essential and therefore, the contention of company is not valid. X, is therefore, entitled to claim gratuity in the given case.

(iv)

- A. In this case "B" was authorized to pay premium for a policy for the factory building at ₹2 lacs. "B" was not authorized to take a policy for the products. Hence 'A' is bound to pay for the insurance of the factory building.
- B. In this case, the agent i.e. "B" does more than he is authorized to do and the amount of ₹5,000 cannot be separated between sunlight and Henko. "A" may repudiate the whole transaction. As per contract principal is not bound when excess of Agent's Authority is not separable.
- C. 'A' cannot file a suit against the Auctioneer for his loss of time and cost because the Advertisement was merely a declaration of intention to hold Auction.

Question 4

(i) State with reasons whether the following persons are entitled to receive bonus under the Payment of Bonus Act, 1965:

- A. An apprentice under the Apprentice Act.
- B. A probationer
- C. An employee employed through contractors on building operations
- D. A retrenched employee
- E. A dismissed employee reinstated with back wages

(ii) When an employee becomes disabled due to any accident or disease and is unable to do the same work and re-employed on the reduced wages, how the gratuity of such employee shall be computed under the provisions of the payment of Gratuity Act, 1972?

(iii) X agreed to become an assistant for 5 years to Y who was a doctor practicing at Chennai. It was also agreed that during the term of agreement X will not practice on his own account in Chennai. At the end of one year, X left the assistantship of Y and began to practice on his own account. Referring to the provisions of the Indian Contract Act, 1872, decide whether X could be restrained from doing so?

(iv) Comment on the following :

- A. Daily working hours in a factory cannot be more than 8 hours on any day considering ceiling of 48 working hours in a week as per the Factories Act 1948.
- B. An individual dispute is not an industrial dispute under the Industrial Disputes Act, 1947.
- C. W, a heart patient worked for four hours in a factory premises. He profusely sweated during the recess and died of heart failure which resulted on account of severe stress and strain inside the factory premises. Is the employer liable to pay compensation under the Employees Compensation Act, 1923?

[5+4+3+6=18]

Answer:

(i) Entitlement to Bonus:

- A. **Apprentice:** An Apprentice who is an apprentice under the Apprentice Act is not entitled to bonus, as apprentice is specifically excluded from 'Employee' under section 2(13).

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- B. Probationer:** A probationer is an employee and as such is entitled to bonus provided he has worked in the establishment for not less than 30 working days in the accounting year (section 8) Confirmation of the employee is not a necessary requirement.
- C. An employee employed through contractors on building operations** is entitled to bonus as section 32(vi) has been deleted by Payment of Bonus (Amendment) Ordinance, 2007.
- D. Retrenched Employee:** He is eligible to get bonus provided he has worked for minimum qualifying period. {East Asiatic Co. (P) Ltd. v Industrial Tribunal}
- E.** Employee includes a person who is no longer in service (Explanation under Section 21). A **dismissed employee reinstated with back wages** is entitled to bonus. (Commom India Ltd v Neeranjan Das)

(ii) Computation of Gratuity of a disabled employee: According to Section 4(4) of the Payment of Gratuity Act, 1972, when an employee becomes disabled due to any accident or disease and is not in a position to do the same work and re-employed on reduced wages on some other job, the gratuity will be calculated in two parts:-

- (1) For the period preceding the disablement: on the basis of wages last drawn by the employee at the time of his disablement.
- (2) For the period subsequent to the disablement: on the basis of the reduced wages as drawn by him at the time of the termination of services.

In the case of Bharat Commerce and Industries Vs. Ram Prasad, it was decided that if for the purposes of computation of quantum of the amount of gratuity the terms of agreement or settlement are better than the Act, the employee is entitled for that benefit but the maximum statutory ceiling limit as provided under Sub-section (3) of Section 4 of the Act cannot be reduced by mutual settlement or agreement.

(iii) According to Section 27 of the Indian Contract Act, 1872, in any agreement through which a person is restrained from exercising a lawful profession or trade/business is void.

However, an agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else directly or indirectly to promote any business in direct competition with that of his employer is not in restraint of trade. In such a situation the agreement is valid.

In the instant case, X has agreed not to practice on his own account during the term (5 years) of agreement. After one year, X left Y and began to practice on his own account. Therefore, as per the above provisions, X can be restrained by an injunction from practicing on his own account in Chennai.

(iv)

A. As per Sec . 51 of the Factories Act, 1948 no adult employee is required to work more than 48 hours in any week. Subject to this rule, no adult employee shall be required to work for more than 9 hours in any day. But in order to facilitate the change of shift, this limit may exceed. This can, however, be done with the previous approval of the Chief Inspector of Factories.

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B. Where any employer discharges, dismisses, retrenches or otherwise terminates the services of an individual workman, any dispute or difference between that workman and his employer connected with, or arising out of, such discharge, dismissal, retrenchment or termination shall be deemed to be an industrial dispute notwithstanding that no other workman nor any union of workmen is a party to the dispute. [Sec 2-1]

C. According to Section 3 of the Employees Compensation Act, 1923, employer is liable to pay compensation if personal injury is caused in course of employment. The course of employment is not interrupted by intervals of rest. So the employer is liable to pay compensation in the given case.

Section-II (50 Marks) (Auditing)

Question 5: Answer all questions

2 X 7 = 14

Comment on the following:

- (i) Ratio analysis only highlights symptoms.-Comment.**
- (ii) Automated data Processing Audit and Information Technology Audit are same.**
- (iii) Vouching can be avoided.**
- (iv) Year end stock ready for exports are proposed to be valued at realisable value.**
- (v) Practicing Cost Accountant cannot be Internal Auditor as Internal Audit is related to financial accounting.**
- (vi) Test checks may be applied to all transactions.**
- (vii) Dividend has been declared out of profit on re-issue of forfeited shares.**

Answer:

(i) Ratio analysis only highlights symptoms. It is for the auditor to study the symptoms properly, calculate them, review and arrive at a definite conclusion or identify for further enquiries. Thus the statement is true.

(ii) Yes. Automated data processing audit (ADP) is also known as Information Technology Audit. It is an examination of the control within information technology infrastructure.

(iii) Vouching cannot be avoided. Vouching is foundation stone on which whole of the Accounting structure stands. Vouching helps in detecting errors & frauds, reduce liability of auditor, moral check on employees, compliances with law etc. Thus the statement is false.

(iv) As per AS 2 closing stock is to be valued at cost or market price whichever is lower, the stock shall not be valued at realizable value.

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(v) The statement is false. Practising Cost Accountant can also be the internal auditor provided; he is not the Cost Auditor of the same company.

(vi) The statement is false. Only some transactions are subject to Test Check. Cash/Bank Book and Pass Book should be thoroughly checked.

(vii) Profits on re-issue of forfeited shares are not freely available for distribution as dividend because Profit on reissue of forfeited shares is transferred to capital reserve. Hence Auditor shall advise the management for rectification otherwise to report to the shareholders through his Audit Report.

Question 6

(i) What are the main sources of GAAP in India?

(ii) How will you verify 'Development of Property'?

(iii) What do you understand by Computer Information System (CIS) environment?

(iv) "An auditor must select his sample carefully because the results of a representative and unbiased sample can be mathematically interpreted." – Explain this statement.

(v) Briefly state the basis and types of liability of auditors.

[3+4+2+4+5 = 18]

Answer:

(i) The main sources of GAAP in India are :

1. Accounting Standards and Statements issued by the Institute of Chartered Accountants of India.
2. Derived from the Companies Act, 1956.
3. Standards issued under Income Tax Act, 1961.
4. Statement and Regulations issued under SEBI Act and Guidelines issued by SEBI.
5. Industry specific Legislations (Insurance, Banking, Financial Institutions, etc.)

(ii) When expense incurred for the development of any property, they cannot be conveniently added to the value of such property. Such expenses should be capitalized under the head "Development of Property" e.g. expenses incurred in grading and preparing the soil for plantations. Such amount shall be written off over the period during which the benefit from such development will accrue to the business. To verify this the auditor should :

1. Verify the amount of budget allocation for such expenditure and note the sanction of the appropriate authority.
2. Examine whether the amount of expenditure is reasonable based on Technical Reports, if applicable.
3. Vouch the payment made and expenditure incurred on the basis of bills enclosed and payments made through the cash/bank book.
4. Verify whether an appropriate amount has been written off, keeping in view the period of benefit or the exploitation, as the case may be.

(iii) A CIS environment exists when one or more computers of any type or size are involved in the processing of financial information, including quantitative data. Those computers may be operated by the entity or by a third party

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(iv) 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, which is why some kind of selective checking becomes inevitable. Effective auditing depends upon the proper selection of transactions. Therefore, the auditor should be very careful at the time of selecting his audit samples and evaluating the results of audit procedure.

(v) The liability of professional negligence may arise under the statute or agreement with the client. The liability may be civil or criminal liability; further, the auditor may expose himself to disciplinary action by ICAI under the Chartered Accountants Act, 1949 for professional negligence and for failure to conduct the audit with reasonable care and caution required of him, under the facts and circumstances of the case.

The liability of an auditor may also arise under misfeasance provisions of the Companies Act, for failure to report properly and adequately the mis-statements in the financial statements, in order to hide more than they reveal.

The auditor will also be held criminally liable for negligent performance of his task and for collusion with the company management in the commission of frauds etc

Question 7

(i) Write short notes on – Teaming and Lading.

(ii) How will you verify 'Goods in Bond'?

(iii) State with reasons whether you, as an auditor, would approve the payment of dividend out of capital?

(iv) How will you verify imported plant & machinery?

(v) 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 reasons for your answer.

[4+4+5+3+2 = 18]

Answer:

(i) Teaming 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 still 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,

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thus concealing several misappropriations at any time and rendering the detection of irregularity still more difficult.

(ii) For goods in bond, the auditor should –

- A. Ascertain –
 - i. the reason for goods remaining in bonded warehouse
 - ii. Period for which it remains there and
 - iii. The date of subsequent removal/ clearance.
- B. Ensure that there are separate stock sheets for goods in bond
- C. Examine the bond warrants as acknowledgement of goods lying in the bonded warehouse, and trace the same into bond stock sheet.
- D. Obtain bankers' certificate when such goods are pledged with banks.
- E. Ensure that the bonded goods are valued at the lower of cost or market value.
- F. Test checks the valuation of goods in bond, based on relevant invoices from foreign suppliers. See whether the principles of translation of foreign currency as per AS-11 are properly followed.

(iii) According to the Companies Act, 1956, no dividend can be paid out of capital as expressly provides in Section 205 that the dividend is payable only out of current profit or past undistributed profits, arrived at after providing for depreciation. Therefore, if the memorandum or the articles of association even empower the company to declare dividend out of capital, such power becomes automatically invalid. [Verner vs General and Commercial Investment Trust Ltd. (1894)]

In the following circumstances, payment of dividend may amount to payment of dividend out of capital:

1. If dividend is paid out of the sale proceeds of fixed assets
2. If profits are inflated by the following :
 - Charging revenue expenditure to capital
 - Making lower provisions for depreciation or liabilities
 - Overvaluing closing stock or investments
 - Excluding revenue expenditure from accounts
 - Increasing profit by any other way
3. If a deficiency of capital exists and dividend is paid without making good such deficiency.

(iv)

1. The Auditor should examine the director's minute Book for the resolution passed authorizing the purchases.
2. The Auditor should check the RBI's permission and the import License.
3. The Auditor should examine the agreement with the foreign supplier, particularly check the terms of payment, interest rates and the basis of deferred Payment.
4. The Auditor should vouch the bills & receipts relating to purchases, customs duty payment, clearing & shipping charge, insurance premium etc.,
5. The Auditor should check the entries made in the books of accounts.

(v) 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.

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Hence Laxman cannot be appointed as statutory auditor of H Ltd. also.

Question 8

- (i) What are the major phases in the audit of computerized accounts?**
- (ii) Distinguish between – Negative Opinion and Disclaimer of Opinion.**
- (iii) How would the remuneration of an auditor fixed as per Companies Act, 1956.**
- (iv) As per Companies Act, 2013, how should application forms for securities be issued.**
- (v) An auditor requires more reliable evidence to reach the conclusion regarding materiality.
Comment.**

[5+4+3+4+2 = 18]

Answer:

- (i)** The audit of computerised accounts can be divided into two major phases:
 - 1. Review of internal controls ; and
 - 2. Examination of records produced by the data processing system.

Review of internal controls : The auditor's review of internal controls involves ascertaining the system, testing compliance through the performance of compliance procedures, and finally, making an evaluation of the system as a basis for ascertaining the degree of reliance which he can place on the system in determining the nature, timing and the extent of his substantive procedure. The auditor can obtain any document on understanding of the internal controls through the use of organisation charts, internal control questionnaires, inquires, and EDP application controls. It must be recognised that general EDP controls have pervasive effect on all facets of the system. Thus, if these controls are not effective, it is possible that material errors might occur and remain undetected. The auditor should review the various general EDP controls as well as the EDP application controls, i.e. controls over input, processing output, etc.

Examination of records produced by the data processing system: The next step for auditor is to select and examine the records produced by the data processing system with a view to assessing their accuracy, validity and completeness. In doing so, the auditor has to deal with a problem peculiar to EDP systems, namely, lack of a complete and visible audit trail.

The audit trail refers to the links by which an original transaction can be traced forward to its final output or whereby each item of the output can be traced back to the source documents. The vouchers, journal, ledger, and other books of account provide the links in the audit trail. These are important for an auditor since he can trace the final impact of all transactions on the financial statements only through such links.

- (ii)** When the auditor does not have sufficient information (for example, where books of accounts are with the tax authorities) to serve as the basis of his opinion, he may disclaim an opinion on the accounts and balance sheet and profit and loss account. Accordingly, the auditor may state that he is unable to form an opinion on the financial statements. An example of the disclaimer of the opinion can be s statement by the auditor that "we have been unable to state whether the Balance Sheet shows a 'true and fair' view....." In certain circumstances, the auditor may not get access to all the books of account for certain reasons. There may also exist very material items, the value of which may be totally uncertain. In many cases certain

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material information or explanations may not be forthcoming. Whenever an auditor disclaims an opinion he should give reasons for the same

An adverse or negative opinion will be given when there is a sufficient basis for the auditor to form an opinion that the accounts and financial statements, taken as a whole, do not present a true and fair view of the financial statements and the operating results of the enterprise. Thus, the rule is that where the reservations are so material that rendering a qualified opinion would not serve the purpose, the alternative is to make an adverse report.

(iii) As per Companies Act, 1956, section 224(8) the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein: Provided that the Board may fix remuneration of the first auditor appointed by it.

The remuneration 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.

(iv) Issue of application forms for Securities [Section 33, Except sub-section (3)]:

1. No form of application for the purchase of any of the securities of a company shall be issued unless such form is accompanied by an abridged prospectus:
Provided that nothing in this sub-section shall apply if it is shown that the form of application was issued
 - a. in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to such securities; or
 - b. In relation to securities which were not offered to the public.
2. A copy of the prospectus shall, on a request being made by any person before the closing of the subscription list and the offer, be furnished to him.

(v) The concept of materiality is fundamental to the process of aggregation, classification and presentation of accounting information. It is an important and relevant consideration for an auditor who has to constantly judge whether a particular item of transaction is material or not. Obviously, an auditor requires more reliable evidence in support of material items.