

**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]**

(i) S induced R to buy his motorcycle saying that it was in a very good condition. After taking the motorcycle, R complained that there were many defects in the motorcycle. S proposed to get it repaired and promised to pay 40% cost of repairs. After a few days, the motorcycle did not work at all. Now R wants to rescind the contract.

(ii) Z & Co. through a newspaper advertisement announced a season end sale of woolen garments and exhibited the articles in their showroom with the original and the reduced prices marked on them. H, who had read the advertisement, picks up a woolen sweater marked ₹ 500/- as original price and ₹ 200/- as reduced price. But when H offers ₹ 200/- at the counter, the salesman refuses to accept the amount and hand over the article to H. State the rights of H against Z & Co.

(iii) B buys goods from A on payment but leaves the goods in the possession of A. A then pledges the goods to C who has no notice of the sale to B. State whether the pledge is valid and whether C can enforce it. Decide with reference to the provisions of the Sale of Goods Act, 1930.

(iv) XYZ Ltd is running into losses and is unable to pay minimum rates of wages to its employees. The employees pleaded that employer is under obligation to pay the wages at minimum rates. XYZ Ltd. Intends to go to the court challenging the constitutional validity of the Minimum Wages Act, 1948. Will the company succeed?

(v) Safety officers in any factory are optional and not mandatory. Comment

(vi) P purchased from Q 5000 tins of canned fruit to be packed in cases, each containing 50 tins but Q supplied cases containing 25 tins. Does P have right to reject the goods?

(vii) Gratuity can be attached by an order of the court. Comment

**Answer:**

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(i) The aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872]. The aggrieved party loses the right to rescind the contract if he, after becoming aware of the misrepresentation, takes a benefit under the contract or in some way affirms it. Accordingly in the given case R could not rescind the contract, as his acceptance to the offer of S to bear 40% of the cost of repairs impliedly amount to final acceptance of the sale [Long v. Lloyd, (1958)].

(ii) Price quotations and price tags do not amount to an offer but are only an invitation to an offer. Therefore, H's picking up the woolen sweater with price tag of ₹ 200/- as reduced price amounts to an offer by H to purchase the same at that price. It remains to be accepted by the seller- the salesman of Z & Co. to result in a concluded contract. The sales man has every right to accept or refuse the offer. Thus H shall have no remedies.

(iii) This is based on the provisions of Section 30 (1) of the Sale of Goods Act, 1930 which provides an exception to the general rule that no one can give a better title than he himself possesses. As per the provisions of the section, if a person has sold goods but continues to be in possession of them or of the documents of title to them, he may pledge them to a third person and if such person obtains them in good faith without notice of the previous sale, he would have good title to them. Accordingly, C, the pledgee who obtains the goods in good faith from A without notice of the previous sale, gets a good title. Thus the pledge is valid.

(iv) Minimum wages are required to be paid whether the company is in profit or loss. Section 3 of the Minimum wages Act, 1948 lays down that appropriate Government shall fix minimum wage and Section 22 says that employer is liable for penalty if minimum wages are not paid as per provisions of the Act. (Kamani Metals vs workers 1967 AIR 1175, 1967 SCR (2) 463).

(v) As per Sec 40-B of The Factories Act, 1948 in every factory (i) wherein 1000 or more workers are ordinarily employed, or (ii) wherein, in opinion of the State Government, any manufacturing process or operation is carried on, which involves any risk or bodily injury, poisoning or any other hazard to health, to persons employed in factory, the occupier shall if so required by State Government by notification in Official Gazette, employ such number of safety officers as specified in the notification [Sec 40B(1)]. The duties, qualifications and conditions of service of Safety Officers are to be prescribed by State Government. [Sec.40 B(2)].

(vi) This is based on the provisions of Section 15 of the Sale of Goods Act, 1930. P is entitled to reject the goods because the goods were not packed according to the description. It is to be noted that if the goods do not correspond with the description but such goods are fit for buyer's purpose, even then the buyer may reject the goods and the seller cannot take defense by saying that the goods will serve buyer's purpose.

(vii) No gratuity payable under the Act and no gratuity payable to an employee in any establishment, factory, mine, oilfield, plantation, port, railway company or shop exempted under Section 5 shall be liable to attachment in execution of any decree or order of any Civil, Revenue or Criminal Court.

### **Question 2:**

**(i) Mr. Saxena received cheque dated 02.05.2014 for ₹10,000 from Mr. Malhotra towards cost of furniture. On 13.11.10 Mr. Malhotra closed the Bank Account. What action Mr. Saxena can take to receive the amount against the cheque which is still with him.**

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(ii) Jayanta, the owner of a car handovers the car with key to Partha (the mercantile agent) to sell the car at a price not below ₹ 1, 00,000. Partha (the agent) sold at ₹ 90,000 to Amitava, who buys in good faith and without notice of reserve price/or any fraud. Partha misappropriated the money also. Jayanta filed a suit against Amitava to recover the car. Advice with reason whether Jayanta can succeed.

(iii) Write short notes on 'Forfeiture' based on Gratuity Act, 1972

(iv) Under what circumstances pension under E.P.F can be applied for by an employee?

(v) Amit draws a bill on Raja for ₹ 10,000 payable to his order. Raja accepts the bill but subsequently dishonours it by non-payments. Amit sues Raja on the bill. Raja proves that it was accepted for value as of ₹ 8,000 and as accommodation to Amit for ₹ 2,000. How much can Amit recover from Raja? Decide in the light of the provisions of the Negotiable Instruments Act, 1881?

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

### Answer:

(i) If the period of validity of the cheque is not specified in the cheque, the cheque must have been presented to the Bank within a period of three months from the date of cheque. In this case, the validity of the cheques expired on 2.08.2014 whereas the account was closed on 13.11.2014 i.e., after expiry of validity of the cheque. Mr. Saxena failed to present the cheque within the validity of the cheque; the cheque would be dishonoured if this was presented after 2.08.2014 for which Mr. Malhotra is not responsible. He may however request Mr. Malhotra for fresh cheque stating the circumstances of delay in presenting by 2.08.2014.

(ii) In the instant case, Amitava has purchased the car in good faith for ₹ 90,000/-. The agent, Partha on the one hand has concealed the information as to the reserve price fixed by the owner of the car on the other hand misappropriated the money also. The principal is liable for any fraud or misrepresentation done by the agent with in his authority regardless of the fact that Act has resulted in benefit to the agent or the principal. No liability where agent exceeds the authority. The principal is not liable for acts of agent done in excess of authority. Sometimes the acts can be separated as within the authority and beyond the authority. Principal is bound for those acts which are within the authority. But where acts are not separable, the principal may repudiate the entire transactions.

(iii) The gratuity payable under the Payment of Gratuity Act, is liable to full or partial forfeiture under different circumstances. Section 4(1) of Payment of Gratuity Act, 1972 deals with payment of gratuity; Whereas Section 4(6) of the Act, deals with forfeiture of gratuity.

Gratuity can be forfeited for any employee whose services have been terminated for any act, willful omission or negligence causing damage or destruction to the property belonging to the employer under this Act. It can also be forfeited for any act which constitutes an offence involving moral turpitude. Where services have not been terminated on any of the above grounds, the employer cannot withhold gratuity due to the employee. Where the land of the employer is not vacated by the employee, gratuity cannot be withheld.

(iv) Pension under E.P.F can be applied for under 4 situations given below:

- A. On superannuation - on attaining the age of 58 years or more and at least ten (10) years of service. A member can be continuing in services while receiving this pension.

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- B. Before superannuation - on attaining the age between 50 and 58 years and at least 10 years of service.
- C. Death- death while in service or while not in service.
- D. Permanent disablement - permanently and totally unfit for employment which the member was doing at the time of such disablement.

No pensioner can receive more than one E.P.F. pension.

(v) According to the provisions of section 44 of Negotiable Instruments Act, 1881, when there is a partial absence or failure of money consideration for which a person signed a bill of exchange, the same rules applicable for total absence or failure of consideration will apply. Thus, the parties standing in immediate relation to each other cannot recover more than the actual consideration. Accordingly Amit can recover only ₹ 8000.

### **Question 3:**

(i) Saxena lets to Mr. Menon for hire a horse for his own riding but Mr. Menon drives the horse in his carriage. What action Saxena can take?

(ii) As per order, Mr. Malhotra sent some goods to Mr. Paul at Kolkata through Rail. The Station Superintendent of Howrah station informed Mr. Paul that Goods are held at the Station at Paul's risk and cost. In the mean time, Mr. Paul became insolvent. Mr. Malhotra wants to enforce right as an unpaid seller. Comment.

(iii) Ashim sells 1600 kgs. of wheat out of large quantity lying in his godown forwarded to Bablu. Out of these, Bablu sells 600 kgs. to Chandan (wheat yet to be ascertained). Then Chandan the delivery order signed by Bablu to Ashim who confirmed that wheat would be dispatched in due course. Bablu then becomes insolvent. Ashim refused to deliver to Chandan. Advice Chandan based on rules. Comment

(iv) Mr. Batliboi bought 50 kgs. of potato against cash payment from Mr. Joshi under a Contract of Sale but half of consignment was rotten and Mr. Joshi refused to change the rotten potato nor refunded the value. Comment.

(v) 'A' (workman) is laid-off by his employer 'B' because of strike in another part of 'B's establishment. 'A' is entitled to get compensation for lay off under the Industrial Disputes Act, 1947. Comment

(vi) A workman while returning home after duty was murdered within the premises of the employer. A's widow is not entitled to compensation under the Workmen's Compensation Act 1923. Comment

(vii) Maker of a cheque is not liable under N.I. Act for dishonor of cheque under certain conditions. State such conditions.

(viii) While discussing, Rajib told his friends that, 'Contracts need not be performed under certain circumstances'. Deepak objected to it. State the correct position.

[(7 × 2) +4 =18]

### **Answer:**

(i) Where the contract stipulates a certain mode of acceptance, it must be executed in that manner. In the instant case, Mr. Menon is under obligation to use the horse only for this personal

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riding not otherwise. Since he has violated the very stipulation in agreement, Saxena got right to terminate the agreement and take back his horse and proceed against Menon for the damages caused if any.

**(ii)** As per Section 46 of the Sale of Goods Act, 1930 an unpaid seller has the right of stopping the goods in transit in case of insolvency of a buyer. In addition his other remedies Mr. Malhotra has got the right of withholding delivery of the goods and repudiate the contract and proceed against the buyer for the damages (Section 46)

**(iii)** According to Section 46 of the Sale of Goods Act, 1930 Mr. Ashim has a lien on the goods for the price which he is in possession of them. Since the wheat bags are still in his possession, he got every right to withhold the delivery as Bablu has become insolvent. In the instant case Chandan has to proceed against Bablu for specific performance of the contract.

**(iv)** As per Section 16 of the Sale of Goods Act, 1930, where the goods are brought by description from a seller who deals in goods of that description, there is an implied condition that the goods shall be merchantable quality. This condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract repudiated. In the instant case Batliboi got the right to proceed against Mr. Joshi for recovery of the loss sustained due to the damage of goods.

**(v)** Section 25 E provides that no compensation shall be payable to a work man who has been laid off if such laying off is due to a strike or slowing down of production on the part of workmen in another part of the establishment whether one establishment is part of another establishment or not depend upon several factors. As such no compensation is payable to 'A'.

**(vi)** In this case, there was casual and approximate connection between the accident and the employment. Since the workman was on the spot only for his employment and accordingly his wife/legal heirs is/are entitled for compensation (Naima Bibi v Lodhne Colliery)

**(vii)** Maker of the cheque will not be liable for dishonor in following cases—  
1. If the cheque is not presented to the Bank within the validity of the cheque.  
2. Where the cheque is issued not for the purpose of discharge of any debt or other liability. A cheque given as a gift or for any other reason but not for satisfaction of any debt and/or liability.

**(viii)** Sections 62 to 67 of the Contract Act are listed under the heading "Contracts which need not be performed". The relevant provisions are as follows:

- A. If by mutual agreement there is Novation, Rescission or Alteration, the original contract need not be performed (Sec 62).
- B. Where the promisee waives or remits the performance of promise made to him, wholly or in part or extends the time of performance or accepts any other satisfaction for it (Sec 63).
- C. When a voidable contract is rescinded, the other party need not perform his promise (Sec 64).
- D. If the promisee neglects or refuses to afford the promisor reasonable facilities of the performance of his promise, the promisor is excused by such neglect or refusal as to any non-performance caused thereby (Sec 67).

Under the Law of Contract, the following agreements need not be performed.

- A. Unlawful consideration and object - Sec 23.
- B. Where the performance is unlawful or illegal - Sec 56.
- C. When performance become impossible.

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In view of the above, it is possible that a Contract need not be performed under certain circumstances.

### Question 4:

**(i) Comment on the following based on legal provisions (no mark for wrong reasons or justification):**

**A. Mr. Menon offered on 1st December, 2013 to sell his house to Mr. Pandey at ₹ 35, 00,000. Mr. Pandey accepted by email on 2nd December, 2013 at 8 AM. and at 10 A.M. Mr. Pandey sent a Fax revoking the acceptance. Both email (i.e. acceptance) and Fax (i.e. revocation) revoked Menon at the same time. Hence this was valid. Comment.**

**B. Provisions of Indian Partnership Act 1932 are applicable to LLPs and the body Corporate may be partner of LLP.**

**C. On 01.10.2014 Mr. Barun kept his Cow under the custody of Mr. Tarun for one month and paid ₹ 1000 for maintenance. On 15.10.2014, the Cow gave birth of a Calf. On 30.10.2014. Tarun returned the Cow retaining the Calf. Justify Tarun's action.**

**D. A surety is discharged from his liability where there is failure of Consideration between the Creditor and the Principal Debtor in a Contract of Guarantee. Comment**

**E. Whether Mr. Sham who joined the company on 1.7.2010 and died on 30.11.2014 is entitled Gratuity. Answer citing Rules.**

**F. Manager of ABC Ltd. told that total amount of deduction which may be made from (he wages of any workman during a month shall not exceed 90% of such wages. - State Legal provisions.**

**G. 'A' the buyer ordered a patent smoke consuming furnace by its Patent name for his brewery on 'B'. Furnace received was however found to be unsuitable for the purpose. Hence seller is responsible.**

**H. ABC Ltd. who incurred heavy loss during 2013-14 has not paid Bonus to any of its employees.**

**I. Works Manager has deducted ₹ 500 from wages towards the cost of tools and raw materials supplied to workers for purpose of employment (Payment of Wages Act).**

**[9 × 2 = 18]**

### Answer:

**(i)**

**A.** In case both the letter of acceptance (e-mail) and the revocation (Fax) reached Menon at the same time, the formation of contract would depend on the fact that which of the two was opened first by Menon.

If Menon read the Fax first then revocation was valid otherwise if he read the e-mail first, then revocation was not possible.

**B.** As per the provisions of the Limited Liability Partnership Act, 2008, an LLP may be formed by individual and/or by Body Corporate. In view of the explicit provision in the LLP Act, a Body Corporate may be a Partner of an LLP.

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Limited Liability Partnerships in India are governed by the Provisions of the Limited Liability Partnership Act, 2008. Therefore, Indian Partnership Act is not applicable to LLPs.

**C.** As per The Contract Act, in the absence of any contract to the contrary, the bailee (i.e. Tarun) is under obligation to deliver to the bailor (i.e. Barun) or according to his directions, any increase or profit which may have accrued from the goods bailed. Hence, Mr. Tarun is obliged to return both Cow & Calf.

**D.** A contract without a consideration is void as per Provisions of the Contract Act. Therefore, the presence of Consideration is one of the essential elements for a valid contract. In the instant case, the Contract of Guarantee between the Creditor and Principal Debtor is not supported by the consideration. Hence, the surety is discharged from his liability.

**E.** Payment of Gratuity Act provides that gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous services for not less than 5 years.

However provided further that incase of death, completion of continuous services of 5 years shall not be necessary. Hence Mr. Sham's nominee is entitled to gratuity although Mr. Sham has worked for less than 5 years.

**F.** The total amount of deduction which shall be made in any wage period from the wages of any employed person shall not exceed.

In cases where such deduction are wholly or partly made for payment to co-operative societies 75% of such wages and in any other case 50% of such wages provided that where the total deduction authorised under the sub-sec (2) of section 7 of payment of Wages Act, 1936 exceed 75% or as the case may be prescribed.

**G.** In this case, specific item under its patent name as per buyer's specification was supplied by 'B'. Hence, the implied condition as to its fitness is not applicable. Therefore, the buyer had no cause of action against the seller under the Patents Act, 1970 as patented goods was purchased. (Chanter Vs Hopkins).

**H.** The Payment of Bonus Act, 1965 provides for payment of at least minimum bonus @ 8.33% to a certain class of employees even if there is no or inadequate profit. Therefore, the action taken by the ABC Ltd., not to pay Bonus for the year 2013-14 is not tenable and in violation of the relevant provisions as to payment of bonus under the Act.

**I.** As per Section 7 of the Payment of Wages Act, 1936 the employer may make deductions for damage to or loss of goods expressly entrusted to the employed person for custody or for loss of money for which he is required to account where such damage or loss is directly attributable to his neglect or default. Therefore, the Works Manager is authorized to deduct ₹ 500.

**Section-II  
(50 Marks)  
(Auditing)**

**Question 5: Answer all questions**

**[2 X 7 = 14]**

**Comment on the following:**

- (i) Procedural error arises as a result of transactions having been recorded in a fundamentally incorrect manner.**
  
- (ii) Test checks refer to the out of routine checks that are carried out in the normal course of Audit.**
  
- (iii) The auditor examines debit notes to vouch sales return.**
  
- (iv) Inventory turnover ratio is calculated by the auditor to obtain evidence concerning management to ascertain about valuation of inventory?**
  
- (v) Year end stock ready for exports are proposed to be valued at realizable value.**
  
- (vi) An adverse report is one where an auditor gives an opinion subject to certain reservation.**
  
- (vii) 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. Company contends that this practice is in order.**

**Answer:**

- (i)** Errors of omission and errors of commission constitute Procedural Errors. If transaction is basically recorded in the books in an incorrect manner, it is an error of principle. These errors do not affect the Trial Balance. Hence, the given statement is incorrect.
  
- (ii)** The statement is False. Test checking is an accepted auditing procedure wherein only a part of its transactions is checked to form an opinion instead of checking all the transactions.
  
- (iii)** The statement is false. The auditor examines purchase return transaction with reference to copies of debit notes issued to suppliers and outward return notes to vouch purchase return.
  
- (iv)** The statement is true. Calculation of inventory turnover ratio and its comparison with those of previous year's ratio will provide evidence on correct valuation of slow-moving, defective and obsolete items included in inventories.
  
- (v)** As per AS-2, closing stock is to be valued at cost or market price, whichever is lower. The stock is question cannot be valued at realizable value.
  
- (vi)** The statement is false. A qualified report is one where an auditor gives an opinion to certain reservation. An adverse report is given when the auditor concludes that based on his examination, he does not agree with the affirmation made in the financial statements/ financial report.



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**(vii)** The statement is 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.

### **Question 6:**

**(i)** 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, based on Companies Act, 1956.

**(ii)** How will you vouch / verify stock lying with job-worker?

**(iii)** State the difference between India's GAAP & US GAAP regarding Related Party Transaction.

**(iv)** Briefly list out the points of distinction between the Companies Auditor's Report Order (2003) (CARO) and section 227 of the Companies Act, 1956.

**(v)** How will you verify imported plant & machinery?

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

### **Answer:**

**(i)** 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 :

1. Payment is authorized by the Articles or by special resolution of shareholders in general meeting;
2. Payment is approved by the Central Government;
3. 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.
4. The rate shall not exceed 12% p.a. or such other rate as may be prescribed by the Government;
5. 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.

**(ii)** Semi-Finished Goods may be lying with the third parties for further processing. The Auditor's responsibility in relation to such goods can be summarised as under —

1. Delivery Chalan and Excise Records - Verify the quantity of the goods despatched to the third party and to know the value of the goods sent at the time of despatch.
2. GRN of Contractor - Confirm whether the goods despatched to third parties have been actually received by them, by examining GRN issued by them.
3. Confirmation from processor – it is to be done in the following way:
  - Verify the quantity lying with the processor at the year-end, by obtaining a confirmation showing quantity of materials and date of receipt.
  - Confirm whether goods sent have been received back within reasonable time and are in accordance with the agreed specifications.

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### 4. Valuation and Disclosure -

- Ensure that the goods are valued properly at each stage of completion in respect of WIP, inclusive of expenses incurred in sending the goods for processing.
- Where the amount is material, disclose the same separately as "Stock in hands of Processors or Contractors".

### **(iii) Related Party Transactions:**

In India - 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

In USA - Disclosures are stringent and require descriptions of nature of relations and control, transactions, amounts involved, and amounts due

**(iv)** 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, 1956 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:

1. While CARO exempts certain classes of companies from its application, the provisions of sub-sections (1A), (2), (3) and (4) of section 227 are applicable to all companies; and

2. The provisions of sub-section (1A) 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.

### **(v)**

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.

### **Question 7:**

**(i) 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. Justify.**

**(ii) 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.**

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**(iii) Subsequent to the issue of audit opinion, the auditor of a company came to know about an important matter about the company. Had he known about this earlier, he would have given a different opinion. How you will as an auditor deal under this situation?**

**(iv) State the scope of Audit Committee in a big public limited company**

**(v) 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.**

**[4+4+4+3+3 = 18]**

### **Answer:**

**(i)** 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 – a) ₹ 2 lakhs or b) 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.

**(ii)** 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 company but he cannot be at the same time be 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 (ie) 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.

**(iii)** Section 231 of the Companies Act, 1956 empower the auditors of a company to attend any general meeting of the company, to receive all the notices and other communications relating to the general meeting, which members are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.

Where the auditor has reason to believe that the directors concealed deliberately a serious fact from the shareholders which came to his notice after issuance of the audit report, he should exercise this right. Normally speaking, an auditor considers subsequent events only upto the date of issuance of the audit report.

The discovery of a fact after the issuance of the financial statements that existed at the date of the audit report which would have caused the revision of the audit report requires that the auditor may bring this to the notice of shareholders.

Likewise, it may be advisable for the auditor to attend the meeting with a view to bringing to the notice of the shareholders, any matter which came to his knowledge subsequent to his signing

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the report and if it had been known to him at the time of writing his audit report, he would have drawn up the report differently, or where the accounts have been altered after the report was attached to the accounts.

**(iv)** The scope of audit committee are as follows :

1. To review of annual financial statement before submission to the Board of Directors.
2. Selection of statutory auditor.
3. To Act as liaison between the statutory auditor and the Board of Directors.
4. To review of internal control functions.
5. To review and approve financial information for publication.
6. To review proposed changes in accounting systems and procedures.
7. To help resolve differences between management, internal and statutory auditor.
8. To report on the audit committee's activities in the corporation's ANNUAL REPORT.
9. To ensure reliability of the organisation's financial statements and operational activities.

**(v)**

1. 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.
2. 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.
3. 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.

### **Question 8:**

**(i) Write a note on 'Audit in Depth'.**

**(ii) What are the advantages of Working Papers?**

**(iii) Write short note on – Types of CAATs.**

**(iv) List the areas in which internal audit operate.**

**(v) What are the internal control aspects in relation to Bank Reconciliation Statement?**

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

### **Answer:**

**(i)** When an auditor plans to gather evidence of the completeness, validity or accuracy of a particular account balance, without detailed examination of underlying classes of transaction, the approach for that account balance assertion is referred to as a non in-depth approach. Where the auditor chooses to examine transactions which underlie the account balance (that is, chooses to perform transaction testing) the approach is an in-depth approach or examination in depth. In other words, in depth approach implies examination of few selected transactions from beginning to the end and through the entire flow of the transaction, i.e. from initiation to the completion of the transaction by receipt or payment of cash and delivery or receipt of the goods.

The general rule is the higher the quantity and quality of evidence required in relation to an account balance assertion, the greater the need for an in-depth approach. It is to be noted

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that when auditors gather evidence in relation to revenue and expense account balances, there is often little evidence available at the account balance level. This means that auditors will often adopt an in-depth approach for those revenue and expense account balances that have been selected for examination in order to gather the quantity and quality of evidence required to form an opinion as to the extent of misstatements in the account balance.

**(ii)** Working Papers are necessary to —

1. Aid in planning and performance of the audit,
2. Aid in the supervision and review of the audit work,
3. Provide evidence of the audit work performed to support the Auditor's opinion,
4. Record and demonstrate the audit work from one year to another,
5. Plan the timing and extent of audit procedures to be performed,
6. Draw conclusions from the evidence obtained,
7. Standardise the Working Papers and audit procedures to improve the efficiency of the audit,
8. Facilitate the delegation of work as a means to control quality of work performed,
9. Provide guidance to the audit staff with regard to the manner of checking the schedules,
10. Fix responsibility on the staff member who signs each schedule checked by him, and
11. Act as evidence in a Court of law when a charge of negligence is brought against the Auditor.

**(iii)** CAAT's can be broadly categorised into the following three types :

1. Generalised audit software (GAS) - These are also referred as Package Programmes. GAS refers to generalised computer programmes designed to perform data processing functions such as reading data, selecting and analysing information, performing calculations, creating data files and reporting in a format specified by the auditor. GAS is standard off-the-shelf audit software, which can be used across enterprises and platforms.

2. Specialised audit software (SAS) - These are also referred to as Purpose-Written Programmes. They perform audit tasks in specific circumstances. These are specifically written for performing audit tests for specific type of applications. These programmes may be developed by the auditor, the entity being audited or an outside programmer hired by the auditor. In some cases, the auditor may use an entity's existing programmes in their original or modified state because it may be more efficient than developing independent programmes.

3. Utility software - These are used by an entity to perform common data processing functions, such as sorting, creating and printing files. Utility software also includes utility programmes available in system programmes for performing debugging or analysis of various aspects of usage/access. These programmes are generally not designed for audit purposes but can be used for performing specific tests.

**(iv)** Internal Audit covers the following areas:

1. Review of accounting system and related internal controls.
2. Examination of financial and operating information, on behalf of management.
3. Examination of economy, efficiency and effectiveness of operations, including non-financial controls of the organization.
4. Physical examination and verification of Tangible Assets.

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

1. Receipt of Bank Statement - Decision regarding handing over/ receipt of Bank Statements.

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2. Frequency of reconciliation - How frequently reconciliation should be performed.
3. 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.
4. Attention points - Special attention to be given for long standing unpresented cheques, stop payment notices, examination of the sequence of cheque numbers and comparison of cheque details with details recorded in the Cash Book.