

# Answer to PTP\_Intermediate\_Syllabus 2008\_Jun 2015\_Set 2

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## 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) Mr. "E" joined as supervisor on monthly salary of ₹ 9,900 on 01.02.2014 and resigned from his job on 28.02.2014. The company declared a bonus of 20% to all eligible employees and paid to on time. Mr. "E" knowing the facts made a claim to HRD, which in turn rejected the claim. Examine the validity in the light of the provisions of the Payment of Bonus Act, 1965.
- (b) A bank when gives a guarantee on behalf of a principal debtor, is called a guarantor.
- (c) As per Industrial Dispute Act, 1947, the Charitable Institutions are not industry.
- (d) Drawee in case of need and Acceptor for honour is the same.
- (e) An hirer, who obtains possession of a car from its owner under a hire purchase agreement, sells the car to a buyer who buys in good faith and without notice of the right of the owner. The buyer gets good title to the car.
- (f) Stop payment instruction can stop prosecution (N.I.Act).
- (g) When contract becomes impossible to perform subsequent to the agreement, it is called "Doctrine of Frustration".

Answer:

1. (a) The claim of Mr. E is not valid:

- Since he has not worked for at least 30 working days in the Accounting Year 2013-14 (Sec. 8);
- Although he is covered in the definition of 'employee', i.e., he is employed on a salary or wage not exceeding ₹ 10,000 per month [Sec. 2(13)].

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- (b) When a Bank issues a guarantee on behalf of a principal debtor to a creditor, it is a contract of guarantee and the Bank is called a "Surety" not "Guarantor".
- (c) As per Industrial Disputes Act institutions owned or managed by organizations wholly or substantially engaged in any charitable, social or philanthropic service are not covered in the definitions of "Industry".
- (d) The statement is not correct.  
"Drawee in case of need" is a person whose name is specified in a bill and to whom the holder should present the bill for acceptance in case the original drawee refuses to accept it.  
"Acceptor for honour": [When a bill of exchange has been noted or protested for non-acceptance or for better security], and any person accepts it supra protest for honour of the drawer or of any one of the endorser, such person is called an "acceptor for honour".
- (e) A hirer is not the owner of the goods and does not possess title deed. He therefore has no right to confer ownership to anyone. Since sale involves transfer of ownership and a hirer, being a non-owner, cannot transfer ownerships in the given case, buyer shall not get a good title.
- (f) False. Once a cheque is issued by the drawer, a presumption u/s 139 follows and merely because the drawer issues a notice thereafter to the drawee or to the Bank for stoppage of payment, it will not preclude an action u/s 138 (Modi Cement Ltd. – vs – KK Nandi – AIR 1998 SC – 1057). Otherwise it would provide escape route to unscrupulous people and make the section inactive.
- (g) True, when a contract becomes impossible to perform at a due date subsequent to the agreement, it is called "Doctrine of Frustration" e.g. a contract with an alien enemy during war is void ab initio. Subsequent destruction of the subject matter essential to the performance makes the contract impossible to perform.
- 2 (a) R of New Delhi sends his agent M to purchase certain goods from Global Enterprise, Mumbai on credit for him. Later on R pays the amount for the goods purchased. On another occasion, he again sends M to purchase goods but this time pays sufficient cash to M for the purpose. M, however again purchases the goods from Global Enterprises but on credit and soon thereafter he dies. Global Enterprise files a suit against R for recovery of the said amount. Decide whether Global Enterprise would be given any relief by the Court under the provisions of the Indian Contract Act, 1872. [2]**
- (b) Examine the entitlement of a dismissed employee to receive bonus under the Payment of Bonus Act, 1965. [4]**
- (c) A issues an open 'bearer' cheque for ₹ 10,000 in favour of B who strikes out the word 'bearer' and puts crossing across the cheque. The cheque is thereafter negotiated to C and D. When it is finally presented by D's banker, it is returned with remarks 'payment**

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countermanded' by drawer. In response to this legal notice from D, A pleads that the cheque was altered after it had been issued and therefore he is not bound to pay the cheque. Referring to the provisions of the Negotiable Instruments Act, 1881, decide whether A's argument is valid or not? [3]

(d) S is employed in Golden ice-cream factory, a seasonal establishment. The factory was in operation for four months only during the Financial year 2013-14. S was not in continuous service during this period. However, he has worked only sixty days. Referring to the provisions of the Payment of Gratuity Act, 1972 decide whether S is entitled to gratuity payable under the Act, would you answer be the same in case S works for 100 days? [3]

(e) A, B and C are partners in a firm. They jointly promise to pay ₹ 1,50,000 to P. C became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts. A is compelled to pay the whole amount to P. Examining the provisions of the Indian Contract Act, 1872, decide the extent to which A can recover the amount from B. [2]

(f) Distinguish between lock-out and closure. [4]

**Answer:**

**(a) R is liable to Global Enterprise for goods purchased by M:**

- since the principal is bound to third parties for all such acts of the agent as are within the scope of authority of the agent;
- since on a previous occasion, purchase of goods by M on behalf of R, and subsequent payment for such goods by R, established that it was within the scope of authority of M to purchase goods on credit on behalf of R.

**(b)** As per section 9, an employee shall be disqualified from receiving bonus, if the following two conditions are satisfied:

(a) The employee has been dismissed from service.

(b) The employee was dismissed because –

(i) he had committed fraud; or

(ii) of his riotous or violent behaviour while on the premises of the establishment; or

(iii) theft, misappropriation or sabotage of any property of the establishment.

It is evident that every case of dismissal of an employee does not disentitle him to receive bonus under section 9. Section 9 is attracted only if an employee is dismissed from service as a consequence of such reasons as are specifically mentioned under section 9.

Conclusion: A dismissed employee is not entitled to bonus. However, if an employee is dismissed for any reason other than the reasons given under section 9, he shall be entitled to bonus provided he is employed on a salary or wage not exceeding ₹ 10,000 and he has worked in the establishment for 30 days or more.

**(c)**

Effects of striking off the word 'bearer'	<ul style="list-style-type: none"><li>• It amounts to a material alteration.</li><li>• However, such material alteration is authorised by the Act.</li><li>• Therefore, the cheque is not discharged; it remains valid.</li></ul>
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Effects of crossing the cheque	<ul style="list-style-type: none"> <li>• It amounts to a material alteration.</li> <li>• However, such material alteration is authorised by the Act.</li> <li>• Therefore, the cheque is <u>not</u> discharged; it remains valid.</li> </ul>
A's argument is not valid	<ul style="list-style-type: none"> <li>• since the reason for dishonour of cheque is not 'material alteration', but 'payment countermanded by drawer'.</li> <li>• Therefore, A is liable for the payment of the cheque, and he shall also be liable for dishonour of cheque in accordance with the provisions of Sec. 138.</li> </ul>

(d) S is not entitled to gratuity since he has actually worked for less than 75% of the number of days on which the establishment was in operation during such period.

If S had worked for 100 days then he would have been entitled to gratuity since the number of days on which he would have worked, in that case, would have been 75% or more of the total working days.

(e)

Liability of A, B and C	is ₹ 50,000 each since joint promisors are jointly liable to fulfill the promise.
Payment made by C	is ₹ 10,000 only.
Deficiency of C to be shared by A and B	is ₹ 20,000 each.
Amount recoverable from B by A	is ₹ 70,000 only.

(f) The points of difference between a lock-out and closure are as follows:

- (i) In the case of lock-out it is only the place of business which is closed (and not the business itself), while in the case of closure of a business not only the place of business but the business itself is closed [Express Newspapers (Pvt.) Ltd. v. Their Workmen, A.I.R. (1963) S.C. 569]. The closure of a business indicates the final and irrevocable termination of the business itself. Lock-out, on the other hand, indicates the closure of the place of business or the place of employment and not the closure of the business itself.
- (ii) Lock-out is a weapon of coercion in the hands of employer; closure is generally for trade reasons.
- (iii) In closure there is severance of employment relationship whereas in lock-out there is no severance but only suspension of such relationship.
- (iv) A lock-out is caused by the existence or apprehension of an industrial dispute whereas
- (v) a closure need not be in consequence of an industrial dispute.

3. (a) In an Auction sale, a bid once made can be withdrawn by the Bidder. Comment citing rules. [2]

(b) Has the property in the goods passed in the following cases?

- (i) B offers for a specific horse ₹ 20,000, the horse to be delivered on 5th January, and the price to be paid on the 1st February following
- (ii) B orders A, a boat-builder, to make him a boat. While the boat is being built, B pays to A money from time to time on account of price.

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(iii) A, having a quantity of sugar which is more than twenty quintals, contracts to sell to B ten quintals out of it. Afterwards A puts ten quintals of sugar in sacks and gives notice to B that the sugar is ready and requires him to take it away, B says he will take it as soon as he can. [1+1+1]

(c) Write down the specific responsibility of the occupier in relation to hazardous processes under Section 41 –C of the Factories Act. [4]

(d) State the grounds upon which a contract may be discharged under the provisions of the Indian Contract Act, 1872. [2]

(e) State the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 regarding the following:

(i) rate of interest on amount due from the employer under the Act

(ii) maximum limit of interest rate

(iii) the period for which the employer is liable to pay the said interest. [1+1+1]

(f) State eligibility and disqualification for bonus under the Payment of Bonus Act, 1965. [4]

### Answer:

(a) In the case of sale by Auction, the sale is complete only when the auctioneer announce its completions by the fall of a hammer or in other customary manner and until such announcement is made any bidder may retract/withdraw his bid.

(b)

(i) The property in the horse would pass to B as soon as the seller accepts the offer. The fact that the time of delivery and of payment of price is postponed does not prevent the property from passing at once.

(ii) No. The property in the boat would pass to B when the boat is ready and A gives a notice to B to this effect (Sec. 21)1.

(iii) Yes. The property in sugar passes to B when A gives notice to B (Sec. 21).

(c) Every occupier of a factory involving any hazardous process shall—

a. maintain accurate and up to date health records or, as the case may be, medical records, of the workers in the factory who are exposed to any chemical, toxic or any other harmful substances which are manufactured, stored, handled or transported. Such records shall be accessible to the workers subject to such conditions as may be prescribed;

b. appoint persons who possess qualifications and experience in handling hazardous substances and are competent to supervise such handling within the factory and to provide at the working place all the necessary facilities for protecting the workers in the manner prescribed;

Where any question arises as to the qualifications and experience of a person so appointed, the decision of the Chief Inspector shall be final.

c. provide for medical examination of every worker—

(i) before such worker is assigned to a job involving the handling of or working with a hazardous substance, and

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- (ii) while continuing in such job, and after he has ceased to work in such job, at intervals not exceeding 12 months in such manner as may be prescribed.

**(d) Modes of discharge of a contract:**

- (i) Discharge by performance
- (ii) Discharge by impossibility of performance
- (iii) Discharge by mutual agreement
- (iv) Discharge by lapse of time
- (v) Discharge by operation of law
- (vi) Discharge by breach of contract

**(e) Rate of interest for delayed payment:**

For any delay in payment of any amount due from the employer, the employer shall be liable to pay simple interest at the rate of 12% p.a. or at such higher rate as may be specified in the Scheme.

**Maximum limit on rate of interest:**

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

**Period for which interest is payable:**

The interest is payable from the date on which the amount has become due till the date of its actual payment.

- (f) Eligibility for bonus (Sec. 8).** Every employee shall be entitled to be paid by his employer in an accounting year, bonus, in accordance with the provisions of the Act, provided he has worked in the establishment for not less than 30 working days in that year (Sec. 8). Where an employee has not worked for all the working days in any accounting year, the bonus payable to him under Sec. 10 shall be proportionately reduced (Sec. 13).

**Disqualification for bonus (Sec. 9).** Notwithstanding anything contained in the Act, an employee shall be disqualified from receiving bonus under the Act, if he is dismissed from service for

- (a) fraud, or
- (b) riotous or violent behaviour while on the premises of the establishment, or
- (c) theft, misappropriation or sabotage of any property of the establishment.

**4. (a) Answer any Four:**

**[4 × 4]**

- (i) Restrictive trade practice
- (ii) Bid rigging
- (iii) Sale and Contract for work and material (Sale of Goods Act).
- (iv) Service (Consumer Protection Act, 1986).
- (v) Negotiation and Endorsement of a Negotiable Instrument.

**(b) A limited liability Partnership is a body corporate. Comment.**

**[2]**

**Answer: (a)**

- (i) Restrictive trade practice:**

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It means a trade practice which tends to bring about manipulation of price or its conditions of delivery or to affect flow of supplies in the market relating to goods or services in such a manner as to impose on the consumers unjustified costs or restrictions and shall include -

- (a) delay beyond the period agreed to by a trader in supply of such goods or in providing the service which has led or is likely to lead to rise in the price ;
- (b) any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as condition precedent to buying, hiring or availing of other goods or services.

### **(ii) Bid rigging:**

Bid rigging' means any agreement, between enterprises or persons referred to above engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding.

An agreement which causes or is likely to cause an appreciable adverse effect on competition includes the following agreements also:

- (a) tie-in arrangement;
- (b) exclusive supply agreement;
- (c) exclusive distribution agreement;
- (d) refusal to deal; and
- (e) resale price maintenance.

### **(iii) Sale and Contract for work and material (Sale of Goods Act):**

The Sale of Goods Act applies to a contract of sale and not to a contract for work and materials. A contract of sale contemplates the delivery of goods whereas a contract for work and material involves exercise of skill and labour by one party in respect of materials supplied by another, the delivery, of goods being only subsidiary or incidental [State of Gujarat v. Variety Body]] Builders, A.I.R. (1976) S.C. 2109].

**Example-** A dentist agreed to supply a set of artificial teeth to a patient. The material was wholly found by the dentist. Held, the contract was for the sale of goods [Lee v. Griffin, (1861) 3 L.J.Q.B. 252]

### **(iv) Service (Consumer Protection Act, 1986):**

"service" under Consumer Protection Act means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, board or lodging or both, <sup>1</sup>[housing construction,] entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service;

1. Inserted by the Consumer Protection (Amendment) Act, 1993, w.e.f. 18-6-1993

### **(v) Negotiation and Endorsement of a Negotiable Instrument:**

When a promissory note, bill of exchange or cheque is transferred to any person who becomes the holder, the instrument is said to be negotiated through the process of negotiation.

Endorsement is the details process of negotiation when the market or holder of an instrument for the purpose of negotiation on its face or back, or on paper attached to the instrument or on a stamped paper for the same purpose, in favour of a person who is

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called the endorsee, the process is called "endorsement".

- (b) A limited liability partnership is a body corporate with legal personality separate from that of its members. It is formed by being incorporated under the Limited Liability Partnership Act 2008.

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

5. **Comment on the following statements based on legal provisions: (No mark for wrong reasons or justification) [2X7]**

- (a) **Retiring Auditor is always reappointed automatically.**
- (b) **The directors of a company object to the critical examination of a particular entry by the auditor, on the ground that the impugned entry is merely a "book entry", not having any bearing on the Company's results. Is the objection sustainable?**
- (c) **Capitalisation of Borrowing Costs would continue during extended periods in which active development is interrupted.**
- (d) **A chartered accountant who has taken a loan of ₹ 10,000 from a Kolkata Branch of a Nationalised Bank can audit the accounts of Chennai Branch of the same Bank.**
- (e) **In the case of amalgamation by takeover, the statutory reserves of the transferor company need not be shown in the financial statements of transferee company.**
- (f) **Materials in the inventory are to be valued always at cost.**
- (g) **Shareholders of Hide Ltd. pass a special resolution that the Branch Auditor of the company need not verify the stock and cash balances at the branches.**

**Answer:**

- 5 (a) Though the retiring auditor is eligible for reappointment, it cannot be said that reappointment is always automatic. The retiring auditor may be removed and some other person is appointed in his place at the AGM after complying with the provisions laid in the Companies Act, 2013 in this regard.
- (b) The objection is not sustainable  
Section 143(1)(b) requires an auditor to inquire whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company. Thus the auditor is duly bound to inquire into any book entry. Only if he makes a critical examination of the said book entry, he will be in a position to examine whether they are not prejudicial to the interests of the company.  
The directors are bound to furnish the necessary explanations sought for by the auditor.
- (c) Partly true. Though capitalization of borrowing cost should be suspended during extended periods in which active development is interrupted [(AS-16), Para 17], it is not



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suspended during a period when substantial technical and administrative work is being carried out, capitalization of borrowing costs is also not suspended when there is temporary delay as a necessary part of getting an asset ready for its intended use or sale. Example: High water level delaying or stopping the construction of a bridge for temporary period.

- (d) The proposed appointment is correct. As per section 30 of the Banking Regulation Act, 1949, the auditor of a Bank shall be qualified under the provisions of the Companies Act, 2013. As per section 141(3) of the Companies Act, 2013, any person who is indebted to the company for more than ₹ 5,00,000/- or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for more than ₹ 1,00,000/- shall not be qualified for appointment as auditor of a company.
- (e) When amalgamation is by way of takeover, treatment of reserves shall vary between statutory reserves and other reserves, in the case of statutory reserves, the reserve will retain its identity and shall be disclosed in the Balance Sheet of transferee company under the head 'Reserves and Surplus'. For this purpose, a corresponding entry is made to the debit of the 'Amalgamation Adjustment Account' which will be disclosed in the assets side of the Balance Sheet under the head 'Miscellaneous Expenditure' / or as may be prescribed in the scheme of sanction under statute/court of law.
- (f) Normally inventory of materials is valued at cost. However, in case of declining prices, if the cost of finished product exceeds the selling price, the inventory should be valued at 'Net Realisable Value'. Further, if the inventory has become partly or wholly obsolete, it should be written down to net realizable value (to depict a true carrying value).
- (g) The scope of branch auditors duty is prescribed under section 143 of the Companies Act, 2013 and it cannot be extended, enlarged or abridged or curtailed by the shareholder by even passing a special resolution. The auditor should ignore the special resolution as otherwise, he will be failing in his duty.

6. (a) Can a Limited Liability Partnership be appointed as an auditor? [2]
- (b) How as an Auditor you will verify the 'Sales Tax/VAT ? [4]
- (c) As an Auditor, how you will audit in case of data processing through computer service centre? [4]
- (d) Explain the procedure for appointment of first auditor, as per Companies Act, 2013. [4]
- (e) Find out the difference between India's GAAP & US GAAP in respect of:  
(i) Goodwill;  
(ii) Foreign currency transaction. [2+2]

**Answer:**

- (a) "Firm" to include 'Limited Liability Partnership' [Explanation to Sec 139(4)]:

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For the purpose of Section 139 to 148, of Companies Act, 2013, the word 'Firm' shall include a Limited Liability Partnership incorporated under Limited Liability Partnership Act, 2008.

### **(b) Sales Tax / VAT:**

- (1) Compare the current years' ratio of sales Tax / VAT to sale affected with that of previous years.
- (2) Vouch the payment of central Tax and VAT with challans / return of payment.
- (3) See whether VAT audit is applicable if so is the Audit completed within prescribed time limit?
- (4) See that the Accounts of set off, if any, of payment of Tax is properly made and exhibited properly in final Accounts.
- (5) Verify the assessment order to calculate the short or excess payment and accounting done accordingly.
- (6) Check the assessment year in regard to payment of tax.

### **(c) Auditor should**

- (i) Follow the provisions laid down in auditing and assurance standard 24.
- (ii) Verify that the Vender is reliable and suitable having the skills, experience and reputation.
- (iii) Evaluate the suitability of the contracted terms with regard to fixed cost, variable cost, the scope and timing of audit activities, the service centers, responsibilities in terms of maintaining data integrity and providing suitable back up and recovery.
- (iv) Check the compliance with the terms of contractors.
- (v) Seek to ensure that his ability to collect and evaluate evidence in relation to the attainment of the objective of outsourcing is not inhibited.

**(d)** The first auditor/s of a company (other than a Government company) shall be appointed by the Board of Directors within 30 days from the date of registration of the company. If the Board fails to appoint such auditor, the Board shall inform the members of the company and then auditor will be appointed within 90 days at an Extra- ordinary General Meeting.

Such auditor shall hold office till the conclusion of the first Annual General Meeting – Sec 139(6) of 2013 Act.

Remuneration of first auditor shall be fixed by the Board – proviso to section 142(1) of Companies Act, 2013.

### **(e)**

#### **(i) Goodwill**

##### Indian GAAP

Purchased goodwill is capitalized and amortised over the expected period of benefit or charged against available capital reserves.

No standard except for brief references is AS-10, Fixed Assets and AS-14, Accounting for Amalgamations. Goodwill arising from amalgamations can be written off over 5 years.

##### US GAAP

Treated as any other intangible asset, and is capitalized and amortised. The maximum carry forward period is 40 years.

#### **(ii) Foreign currency Transaction**

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### Indian GAAP

Exchange fluctuations on liabilities incurred for fixed assets can be capitalized.

### US – GAAP

Exchange gain/loss is taken to the income statement. The concept of capitalization of exchange fluctuations arising from foreign currency liabilities incurred for acquiring fixed assets does not exist.

- 7 (a) How you will conduct the:
- (i) Physical verification of Fixed Capital assets; [2+2]
  - (ii) Idle facilities.
- (b) Write short notes on 'Audit in Depth'. [4]
- (c) How will you verify Goods in Bond? [4]
- (d) Dividends can be distributed out of reserves. Comment. [2]
- (e) State with reasons whether you, as an auditor, would approve the payment of dividend if the company has incurred losses in the current financial year. [4]

Answer:

**(a) (i) Physical verification - Fixed Assets.**

- i. To examine whether there is any system of physical verification of assets at regular interval.
- ii. To examine and compare the Assets history card as maintained by the Engineering or Production Dept. with the Assets register, maintained by the Accounts Dept. Whether the total agree with the amount shown in the Assets Register.
- iii. To obtain a list of obsolete / discarded assets and see whether a declared, obsolete or discarded asset have been deleted from the Assets Register. To see whether these assets have been disposed off promptly at the best price.

**(ii) Idle Facilities:**

- i. Find out the reasons for idle facilities.
- ii. Review the plans, procedures for control of idle facilities.
- iii. Examine the scope for utilisation of the idle facilities. Can the facilities be leased out ?
- iv. See whether any review report is made periodically for facilities remaining idle etc

- (b)** When an auditor plans to gather evidence of the completeness, validity or accuracy of a particular account balance, without details examination of underlying classes of transaction, the approach for that account balance assertion is reference 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

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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 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.

**(c)** For goods in bond, the auditor should –

- (i) Ascertain – (a) the reason for goods remaining in bonded warehouse  
(b) period for which it remains there and  
(c) the date of subsequent removal/ clearance.
- (ii) Ensure that there are separate stock sheets for goods in bond
- (iii) Examine the bond warrants as acknowledgement of goods lying in the bonded warehouse, and trace the same into bond stock sheet.
- (iv) Obtain bankers' certificate when such goods are pledged with banks.
- (v) Ensure that the bonded goods are valued at the lower of cost or market value.
- (vi) Test check 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.

**(d)** If owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of accumulated profits earned by it in previous years and transferred by the company to reserves, such declaration of dividend shall be in accordance with prescribed rules – second proviso to section 123(1) of the Companies Act, 2013.

**(e) Payment of Dividend if the company has incurred losses in the current financial year.**

If the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years – proviso to section 123(3) of the Companies Act, 2013

Of course, the surplus in profit and loss account and the free reserves should be sufficient to justify declaration of dividend.

After it is declared, the amount must be deposited in a separate bank account within five days of its declaration – Sec 123(4) of the Companies Act, 2013.

Interim dividend is really a mode of keeping shareholders happy and keeping good image of company in stock market.

**8. (a) What are the types of internal controls likely to be found in a computer based system? [3]**

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- (b) What are the major phases in the audit of computerized accounts? [4]
- (c) Audit procedures and audit techniques are not the same thing – Discuss. [3]
- (d) How Internal Audit become an important Management tool? [4]
- (e) Auditors are to observe certain standards in field work and reporting under GAAP/GAAS. Explain. [4]

**Answer:**

**(a) Internal Control in Computer Based System.**

In a computer based system, internal control can be classified as:

- (i) Procedural Controls
- (ii) System Development Controls
- (iii) Administrative Controls.

Procedural Controls are exercised over separate computer application, different techniques will be appropriate for different application.

System Development Controls are those which are designed to ensure a satisfactory standard of designing and testing of systems and programmes and of implementing them, whereas Administrative Controls are those which ensure a standard of discipline and efficiency for running of Computer Department.

**(b)** The audit of computerized 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 organization charts, internal control questionnaires, inquires, and EDP application controls. It must be recognized 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

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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.

Internal control in Computer based System.

(c)

Particulars	Audit Procedures	Audit Techniques
1. Meaning	They represent the broad frame of the manner of handling the audit work. Procedure may comprise a number of techniques.	Techniques refer to the methods employed for carrying out the procedure. For example, in vouching procedure, the techniques employed are inspection and checking, computation of documentary evidence.
2. Types	Audit procedures generally comprise – (a) Compliance Procedures, and (b) Tests of Details. [Note: Test of Details includes – (i) Substantive Audit Procedures, and (ii) Analytical Review Procedures.]	Audit Techniques are generally inter-dependent. A combination of techniques is applied in a particular procedure. For example, in verification of assets, the audit techniques involved are physical examination, confirmation from their parties, etc.

(d)

- (i) It ensure compliance of companies (Auditor's Report) order, 2003.
- (ii) Internal Audit is a specialized service to look into the standard of efficiency of business operation.
- (iii) It can evaluate various problems independently in term of over all management control and suggest for improvement.
- (iv) It's independent appraisal and review can ensure the reliability and promptness of MIS and the management reporting for taking decision.
- (v) It makes sure the internal control system/n including accounting control system.
- (vi) Internal control ensures the adequacy, reliability and accuracy of financial and operational data, by conducting appraisal and review from and independent angle.
- (vii) Internal audit is an internal part of management by system.
- (viii) Internal Audit can break through the power ego and personality factors and possible conflicts of interest.
- (ix) ensure compliances of accounting producers and accounting policies.
- (x) Internal Auditor is valuable assistance to management in acquiring new business in promoting new products and in lunching new projects for expansion or diversification or business.

(e) While conducting audit and reporting under GAAP / GAAS the Auditor is to follow norms of Auditing as per provision of law, accounting standards or auditing and assurance standard or pronunciation, guidance notes, research monograms act the Auditors should observe the standard in field work and Reporting Viz.

### 1) General Standard

- (i) To follow independence attitude.
- (ii) To exercise due care.

### 2) Field work standards

- (i) Before beginning of an audit, the audit work shall be properly planned and the

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work assigned to assistant be carefully supervised.

- (ii) The internal control in the enterprise be studied and evaluated before hand.
- (iii) To collect evidential documents to afford reasonable basis for forming an opinion on the financial statements.

### **3) Reporting standard - to report / mention.**

- (i) To report whether the Financial statement are prepared according to GAAP.
- (ii) Whether the principles / standards are consistently followed including current year.
- (iii) Disclosure - financial statements are taken as reasonably adequate if there is no adverse comment in his report.
- (iv) To submit report when the work is finished stating clearly his opinion when it is impossible to form an opinion that shall be supported with reasons.