

INTERMEDIATE EXAMINATION

SUGGESTED ANSWER TO QUESTIONS

DECEMBER 2011

PAPER – 6 : COMMERCIAL AND INDUSTRIAL LAWS AND AUDITING

Time Allowed : 3 Hours

Full Marks: 100

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

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)

Answer Question No 1 which is compulsory and answer any two from the rest.

Question No. 1

1. **Comment on the following based on legal Provisions (no marks for wrong reasons or justification) [2×7]**
- (a) An employee desirous to contribute 20% of salary as against 12% towards P.F. contributions (8% being voluntary) and demand that employer shall also contribute 20%.
- (b) An young employee disagreed to work on dangerous machines in a factory.
- (c) Mr. A. B. Roy a dissatisfied worker willfully causing damage of a machine. Employer had to spent ₹10,000/- to get the machine rectified. Hence his gratuity was forfeited. - Whether justified.
- (d) A stock of bark was sold at an agreed price per tonne. The bark was to be weighed by the agent of seller as also by the buyer for ascertainment of price. A part of the bark was weighed and carried away by the buyer's agent on 12.11.11. On 13.1 1.11, the remaining stock was swept away by flood. Who will bear the loss and why ?

- (e) Mr. Ray made a contract with Mr. Basu to grow vegetables on Mr. Ray's land and to deliver to Mr. Basu at a fixed rate. Mr. Karmakar guarantees Mr. Ray's performance of this contract. Mr. Basu diverts stream of water which is necessary for production thereby prevented Mr. Ray to grow vegetables. Mr. Ray fails to supply as per contract. Hence Mr. Basu sues Mr. Karmakar (guarantor), for non-performance.-Advise.
- (f) A minor can neither undertake liabilities nor receive benefit under the contract.-Comment.
- (g) All the members of a limited partnership firm are "designated members".

Answer to Qus. No. 1

- 1a As per section 6 of the EPF & Misc Provisions Act 1952, the Employees may opt to contribute voluntarily over and above, the statutory rate of 12 % / 10 %.
However employer does not have to match the voluntary contribution over and above the statutory rate.
Hence the Employee cannot demand for matching contribution.
- 1b A young employee cannot be allowed to work at any machine unless
- i) he was been fully instructed to the dangers arising in connection with the machine and the precautions to be taken;
and
 - ii) he has received sufficient training in work at the machine,
or
 - iii) he has under adequate supervision by a person who has thorough knowledge and experience in the machine. (Section 23 of Factories Act, 1948).
 - iv) State Government may prescribe / specify such machines which in its opinion are of such dangerous character that young persons ought not work on them unless foregoing requirements are complied with.
- 1c. The Employer cannot withhold or forfeit gratuity since his services were not terminated for the damages caused by the worker. (Sec 4(6) of the Payment of Gratuity Act, 1972).
- 1d. Goods must be ascertained for property in goods to be transferred to buyer. (Sec 18 of Sale of Goods Act, 1930). The loss of the remaining stock be borne by the seller as the property in the remaining stock was not passed because the required weighing was not completed.

- 1e. As per Section 67 of the Indian Contract Act, 1872, contracts need not be performed when promisee neglects or refuses to afford the promisor reasonable facilities for performance of promise. Mr. Karmakar is no longer liable on his guarantee as Mr. Basu violated the contract by not supplying stream of water to Mr. Roy.
- 1f. The minor below the age of 18 years is not competent to contract but there is nothing which prevents a minor from being a promisee or a beneficiary. The law does not regard a minor as incapable of accepting a benefit. (Sec 3, the Indian Contract Act, 1872)
- 1g. **Designated partners.**
According to Section 7 of Limited Liability Partnership Act, 2008, (1) Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India:
Provided that in case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners.
(2) Subject to the provisions of sub-section (1), --
(i) if the incorporation document-
(a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; or
(b) states that each of the partners from time to time of limited liability partnership is to be designated partner, every partner shall be a designated partner;
(ii) any partner may become a designated partner by and in accordance with the limited liability partnership agreement and a partner may cease to be a designated partner in accordance with limited liability partnership agreement.
(3) An individual shall not become a designated partner in any limited liability partnership unless he has given his prior consent to act as such to the limited liability partnership in such form and manner as may be prescribed.

Question No. – 2

2. (a) Mr. Ardhendu and Mr. Barun entered into a contract to build a house for a specified consideration Clause 14 of contract provides that in case of disputes, neither party may move Court of Law but must accept the decision of an Arbitrator named in the contract. Does this clause violate the provisions of law? [3]

(i) An illegal agreement is void but void agreement is not necessarily illegal.-Explain. [3]

- (ii) Mrs. Kamini purchased a tin of standard quality kerosene oil from a dealer of repute. When part of the kerosene was put to use in a stove for cooking, an explosion occurred causing damage. Mrs. Kamini claims damages from the dealer who refuses, to pay damages. Offer your views based on provisions of sale of Goods Act. [4]
- (iii) Mr. Malhotra purchased one micro oven on 30.03.11 at a cost of ₹18,000/- with one year guarantee through an authorized dealer. Some defects were occurred in the month of November, 2011. You are to answer:
- (i) Whether Mr. Malhotra can submit complain, if so to whom he is to file? [1]
- (ii) Whether appeal can be filed by the aggrieved consumer/complainant if the decision of the Authority is not favourable? The time limit if any for submission of appeal. [1+1]
- (iv) Under Payment of Bonus Act number of days actually worked is one of the conditions and therefore state the method of calculation of working days. [3]
- (v) Bill of Exchange dated 1st February, 2011 payable two months after date – was presented to the maker for payment 10 days after maturity. What is the date of maturity? [2]

Answer to Qus No. 2(a)

Section 28 of the Indian Contract Act provides that every agreement by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract by the usual legal proceedings in the ordinary tribunals or which limits the time within which he may thus enforce his rights is void to that extent.

However exception 1 to sec 28 provides that the section shall not render illegal a contract by which two or more persons agree that any dispute which may arise between them in respect of any subject or class of subjects shall be referred to arbitration and that only the amount awarded in such arbitration shall be recoverable in respect of the dispute so referred.

The fact of the case seem to be covered by the aforesaid exception to sec 28 and therefore the contact in question is a valid and enforceable contract.

Answer to Qus No. 2(b)

An illegal agreement is one which is against a law in force in turn and is also void. On the other hand void agreement is not necessarily illegal. An agreement may not be contrary to law but may still be void. An agreement the terms of which are uncertain is void but such a contract is not illegal.

Further when an agreement is illegal other agreements which are incidental or collateral to it are void. If the main agreement is void (but not illegal) agreements which are incidental or collateral to it may be valid.

Answer to Qus No. 2(c)

The condition as to merchantability (Sec 16(2) of the Sale of Goods Act, 1930) has been breached in this case. This condition requires that goods should be capable of being used as the goods of the defined description.

Thus in the given case, Kerosene purchased should have been usable as Kerosene. Hence u/s 16 (2) Mrs. Kamini shall be entitled to receive back the price as well as compensation for the loss.

Similar decision was given under similar circumstances in Wilso vs Reckett Cockerred & Co. Ltd (1954).

Answer to Qus No. 2(d)

- (i) As per the provision of Consumer Protection Act, 1986 Mr. Malhotra being a consumer may file complain. Since the value is less than ₹20 Lakhs a complain shall be instituted in the district forum within the local limit of jurisdiction.
- (ii) Aggrieved persons may file an appeal before the State Commission within 30 days from the date of impugned orders.

Answer to Qus No. 2(e)

In addition to actual attendance following shall also be considered in computation of numbers of working days :-

Sec 14, of the Payment of Bonus Act, 1965 provides that an employee shall be deemed to have worked in an establishment in any accounting year also on the days on which --

- a) he has been laid off under an agreement or as permitted by standing orders under the Industrial Employment (Standing Orders) Act 1946 (20 of 1946) or under the Industrial Disputes Act 1947 (14 of 1947) or under any other law applicable to the establishment;
 - b) he has been on leave with salary or wages;
 - c) he has been absent due to temporary disablement caused by accident arising out of and in the course of employment;
- and
- d) the employee has been on maternity leave with salary or wage, during the accounting year.

Answer to Qus No. 2(f)

If a bill is made payable a stated number of months after date, it becomes payable three days after corresponding date of months after the stated number of months (sec 23 read with sec 22 N I Act 1881). Therefore in this case the date of maturity of the bill is 4th April 2011 provided it is not Sunday or Public Holidays (1st April + 3 days).

Question No. – 3

- (a) "Void Agreement" and "Void Contract" are same.-Offer your views based on Rule Provision. [4]
- (b) Mr. Barick owe Banker a debt guaranteed by both Mr. Arora and Mr. Bora. The Banker releases Mr. Arora one of the co-surities. Hence the remaining i.e. other surity (Mr. Bora) is also released automatically. Offer views. [2]
- (c) Mr. Ambika an agent of a buyer obtained goods from Railways and loaded such goods on his truck on 02.11.11. In the meantime, the Railways received a Notice from the seller (i.e. consignor) for stopping goods in transit as the Buyer become insolvent. Referring to the provisions of the Sale of Goods Act, 1930 decide whether the Railways can stop goods in transit as instructed by the seller? [2]
- (d) Mr. Paul sold to Mr. Ray certain quantity of foreign refined palm oil warranted equal to sample. The samples consisted of palm oil mixed with vegetable oil. The oil tendered corresponds with the sample but it was not such as is known in market as foreign refined palm oil. Mr. Ray wants to reject the oil on the ground that the oil supplied was not in accordance with the foreign refined palm oil. Advise Mr. Ray. [2]
- (e) Mr. Singh is engaged in two types of jobs in a factory that of a welder and security guard. As the wage rates are different for two different jobs, the employer calculates his minimum wages at an average rate. -Whether this is correct. [2]
- (f) The employer is not liable to pay any wages or compensation to workman when an undertaking closes down.-State legal position. [2]
- (vi) Mr. Saxena on superannuation on 30.09.2011 submitted an application in prescribed form to his employer on 05.10.2011 for payment of gratuity of ₹15,00,000 /- He has not received any payment till 10.12.2011 in spite of reminders. Advise the steps to be taken by him and the benefits which he may receive. [4]

Answer to Qus No. 3 (a)

'Void agreement' and 'void contract' are not same. Difference are as follows :

Void contract : According to sec 2(J) of the Indian Contract Act, 1872 a contract which ceases to be enforceable by law becomes void when it ceases to be enforceable. It is a contract without any legal effect and is a nullity. A contract is not void from its inception. It is valid and binding upon the parties when

made. But subsequent to its formation due to certain reasons, it becomes unenforceable and thus treated as void.

A contract may become void due to (i) impossibility of performance, (ii) change of law or some other reasons. For example A promised to marry B. Later on B dies. This contract becomes void on death of B. Void contract should be distinguished from void agreement.

Sec 2(g) of the Indian Contract Act, 1872 states that an agreement not enforceable by law is said to be void. In the case of void agreement, no contract comes into existence. Such an agreement confers no right on any person and creates no obligation.

It is 'void ab-initio' i.e. from the very beginning. For example a contract with minor is void because a minor is incompetent to contract.

Therefore void agreement is not the same thing as a void contract. A void agreement never matures in to a contract, it is void from the beginning.

A void contract on the other hand was valid when it was entered into but subsequently, because of one reasons or the other became void.

A contract can not be 'void ab-initio', it is only an agreement which can be 'void ab-initio'.

Answer to Qus No. 3 (b)

Where there are co-sureties, a release by the creditors of one of them doesnot discharge the others, neither does it free the surety so released from his responsibility to other sureties (Sec 138 of the Indian Contract Act, 1872). Hence Mr. Bora is not discharged from his suretyship.

Answer to Qus No. 3 (c)

The right of stoppage in transit can be exercised only so long as the goods are in the course of transit. In the given case, the transit came to an end as soon as the Agent of the Buyer obtained goods from the Railways. Therefore Railways can not act as instructed by the seller who lost the right of stoppage of goods in transit as provided in Sec 50 of Sale of goods Act 1930.

Answer to Qus No. 3 (d)

Mr. Ray can reject the goods. In case of sale by sample as well as by description, goods must not only correspond to sample but also to description i.e. foreign refined palm oil. (Section 15 of the Sale of Goods Act, 1930)

No amount of exemption clauses can compel a person to buy a thing different from contracted to buy.

Answer to Qus No. 3 (e)

Where an employee perform two or more classes/types of work having different minimum rates of wages 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 can not pay him at simple average rate of both wages of both classes of job. (Sec 16 of the Minimum Wages Act, 1948)

Answer to Qus No. 3 (f)

Where the employment of any person in an establishment is terminated due to the closure of the establishment for any reason other than weekly or other recognised holiday, the wages earned by him shall be paid before expiry of the second day from the day on which his employment is so terminated. (Sec 5(2) of the Payment of Wages Act, 1936)

Answer to Qus No. 3 (g)

The employer was to pay the amount of gratuity within 30 days from the date it becomes payable. Hence employer has failed.

As per Payment of Gratuity Act, 1972 Maximum ceiling of gratuity is actual amount but not exceeding ₹10,00,000/-. Hence Mr. Saxena is entitled to maximum amount of ₹10,00,000 or the amount based on year of service and his wages whichever is less.

Since Employer has failed to pay, Mr. Saxena shall submit appeal to the controlling authority for direction to pay

- a) Principal amount of gratuity
- b) Interest for delayed period till the date of payment.

Question No. – 4

4. (a) Write short notes on any four:

[4×4]

- (i) Agency by ratification;
- (ii) Transfer of Property in Unascertained Goods;
- (iii) Safety Officers (Factories Act);
- (iv) Information (RTI Act, 2005);
- (v) When Compensation is not Payable (Workmen's Compensation Act, 1923).

- (b) Room air conditioner which was purchased by Mr. Rajesh a practising Cost Accountants for his office stopped working within 3 months of purchase. There was a warranty of free service for one year. Both the dealer and manufacturer refused to attend the defect. Advice Mr. Rajesh whether he can make complaint under Consumers Protection Act. [2]

Answer to Qus No. 4 (a)

(i) Agency by Ratification :

Where an agent act for his principal but without his knowledge or authority or where he exceeds the given authority, the principal is not bound by the transactions.

However Sec 196 of the Indian Contract Act, 1872 permits the principal, if he so desires to ratify the act of the agent. If he so selects, it will have the same effect as if the act was originally done by his authority.

Agency in such a case is said to be created by ratification. Agency in such a case is taken to have come into existence from the moment the agent first acted and not from the date of Principal's ratification.

The rule is that every ratification relates back and is equivalent to previous command or authority.

The case of Bolton Partners v. Lambart is a good illustration on this point.

Requisites of valid ratification :

- (i) The agent must purport to act as agent for a principal who is in contemplation and is identifiable at the time of contract.
- (ii) The principal must be in existence at the time of contract.
- (iii) The principal must have contractual capacity both at the time of contract & ratification.
- (iv) Ratification must be with full knowledge of facts.
- (v) Ratification must be within reasonable time.
- (vi) The act to be ratified must be lawful.
- (vii) The whole transaction should be ratified.
- (viii) Ratification must be communicated.
- (ix) Ratification can be of acts which principal has power to do.
- (x) Ratification should not put third party to damages.

(ii) Transfer of property of unascertained goods : (Sec 23 of the Sale of Goods Act, 1930)

Where there is a contract for the sale of unascertained or future goods by description and the goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the consent of the buyer or by the buyer with the consent of seller, the property in the goods there up on passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.

As per section 18 of Sale of goods Act where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained.

'Ascertainment' is the process by which the goods answering the description are identified and set apart.

(iii) Safety officers : (Sec 40B of the Factory Act, 1948)

In every factory,

- i) wherein one thousand or more workers are ordinarily employed or
- ii) wherein, in the opinion of the State Govt, any manufacturing process or operation is carried on, which process or operation involves any risk of bodily injury, poisoning or diseases or any other hazard to health, to the persons employed in the factory, the occasion shall, if so required by the state government by notification in official gazette, employ such number of safety officer as may be specified in that notification.

The duties, qualification and conditions of service of safety officer shall be such as may be prescribed by the State Government.

- (iv) **Information :** (Sec 2(f) of Right to Information Act, 2005)
Information means any material in any form, including records , documents, file noting, memos, emails, opinions advices, Press release, circulars, orders log books contract reports, papers, samples, models, data material held in any electronic form and any information relating to a private body which can be accessed by a public authority under any law.

- (v) **Compensation not payable :**

Compensation is not payable when

- (i) the disablement due to injury is less than 4 days;
- (ii) the employee was under the influence of drugs / alcohol at the time of accident;
- (iii) workman willfully disobeys any safety rule;
- (iv) workman willfully removes / disregards any safety guards/ equipments;
- (v) workman has refused to get himself medically examined cost of which is borne by the employer.

- 4b. Mr. Rajesh purchased the Air Conditioner for use in his office i.e. for commercial purpose. Hence he is not a consumer. Since the AC was for commercial purpose Mr. Rajesh will not succeed under Consumers Protection Act, 1986

However he can take shelter under Sale of Goods Act, 1930.

SECTION II (50 Marks)
(Auditing)

Question No. – 5

5. Comment on the following statements based legal provisions (no mark for wrong reasons or justification) : [2×7]

- (a) Ratio analysis only highlights symptoms.-Comment.
- (b) Automated data Processing Audit and Information Technology Audit are same.
- (c) Vouching can be avoided.
- (d) When a company appoints Joint Auditor, auditors' liability and responsibility are increased because an auditor is made responsible for the audit work of another auditor.
- (e) Best Ltd. has not deposited provident fund contributions of ₹10,00,000/- to the Provident Fund Authority but accounted for in the Accounts.
- (f) For an internal audit function to be effective, the same must be independent of the activities to be audited.
- (g) Financial Institutions conduct Management Audit of a company.-State under what circumstances.

Answer to Qus No. 5

- 5a. 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.
- 5b. Yes. Automated data processing audit (ADP) is also known as Information Technology Audit. It is an examination of the control within information technology infrastructure.
- 5c. Vouching can not 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.
- 5d. According to the statement issued by the ICAI, it would not be correct to hold an Auditor responsible for the work of another and each joint auditor will be responsible only for the work allotted to him. The statement is false.
- 5e. As per CARO 2003, Auditor has to report that whether the company is regular in depositing undisputed statutory dues including Provident Fund with Appropriate authorities and if not the

extent of arrears of outstanding dues as at the last date of the financial year concerned for a period of more than six months from the date they deem payable shall be indicated by the Auditor.

- 5f. The statement is true. It is imperative that the control to be exercised by the organization on the Internal Audit department shall not include the functional area of auditing. If internal audit function is desired to serve as a real management tool it must be allowed to function independently to achieve better efficiency and productivity.
- 5g. Financial Institution conduct the management audit while participating in equities of a company to avoid possible loss arising from the inefficient management and before granting any loan to the company.

Question No. – 6

6. (a) **Explain the concept of materiality in auditing.** [2]
- (b) Find out the difference between India GAAP and US GAAP in respect of "financial statements". [2]
- (c) ABC Ltd. requested the Statutory Auditor for issue of certificate to comply with the conditions of corporate governance under clause 49 of listing agreement. What points shall be checked before issue of such certificate. [2]
- (d) Mr. A. B. Ray, Chartered Accountants in practice has been appointed as the Statutory Auditor by ABC Ltd. in its AGM held on 30.09.2011. The Auditor purchased goods from the said company. The amount outstanding exceeded ₹ 2,000 /-. Similar credit facilities is allowed to other customers also. State the legal consequences. [2]
- (e) How the following are dealt with in the Audit Report under CARO, 2003:
(i) Fixed Assets,
(ii) Guarantees for loan taken by others. [2+2]
- (f) What are the items to be checked in connection with physical verification of Fixed Capital Assets. [2]

- (g) What are the factors to be considered to determine the effect of computer information system on audit. [2]
- (h) Scope of Management Audit is limited to achieve better means of control only. Do you agree? Give correct answer. [2]

Answer to Qus No. 6

- 6a. 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, the support of material items. He also has to ensure that such items are properly and distinctly disclosed in the financial statement.
- 6b. India GAAP.
- Prepared in accordance with the presentation requirement of schedule VI to the Companies Act 1956 (Schedule VI).
- US GAAP
- Not required to be prepared under any specific format as long as they comply with the disclosure requirement of US Accounting Standards.
- 6c. Auditor shall examine the following :
- (i) Minute book of Board of Directors.
 - (ii) Minute book of General Body meeting.
 - (iii) Minute book of committee
 - (iv) Corporate Governance Report
 - (v) Mandatory Annual intimation filed by each director about the Directorships in other companies.
 - (vi) Consistency of segment wise information disclosed in financial statement in accordance with AS 17.
 - (vii) Discussions on internal Control system and their adequacy and consistence with the opinion expressed by him under CARO 2003.

- 6d. Sec 226 (3) (d) of Companies Act 1956 states that a person indebted to the company for an amount exceeding Rs. 1000 is not qualified for appointment as an Auditor.

A question of indebtedness may also be raised where an Auditor purchases goods or services from the company audited by him. In such case if the amount outstanding exceed Rs. 1000 /- irrespective of the nature of the purchase or period of credit allowed to other customers, the provisions concerning disqualification of an auditor as contained in sec 226 (3) (d) will be attracted. Hence Mr. A.B. Ray cannot be Statutory Auditor of the Company.

- 6e (i) (a) Auditor should comment whether the company has maintained proper records of fixed assets, (b) the management verified the fixed assets frequently and (c) the material discrepancies found accounted properly (d) the substantial dispose of fixed assets has affected considerably the going concern.

- 6e (ii) Whether (a) the company has given any guarantee for loans taken by other from Bank, or Financial Institutions (b) the term and conditions where of are prejudicial to the interest of the company.

- 6f. (i) To examine whether there is any system of physical verification of assets at regular intervals.
- (ii) Examine and compare the equipment history card as maintained by the engineering department with the assets register as maintained by the accounts dept.
- (iii) Obtain a list of the absolute/discarded assets and see whether the assets declared absolute or discarded have been deleted from the asset register, see whether these assets have been disposed off promptly at the best price.

6g. The factors to be considered are as follows :

- (i) The extent to which CIS environment is used to record, compile and analyze accounting information
- (ii) The system of internal control in existence with regard to :-
- a) Flow of authorized, correct & complete data to the processing centre.
- b) Processing, analyzing and reporting task under taken in the installation.
- (iii) The impact of computer based accounting system on the audit trail trace a transaction, from input to output data. A proper electronic trail helps in tracking the transaction properly.

6h. This statement is false. Scope of management audit can be as broad as the management process itself. It is concerned with the whole field of activities of business concern from top to bottom. Management Audit is concerned with the appraisal of an organization to achieve better means of control, improved methods, efficient operations, greater use of humans & physical facilities and to avoid waste and deficiencies.

Question No. – 7

- (a) What are the activities considered by the Management Auditor in its review of industrial engineering management? [2]
- (b) Board of Directors of Evershine Ltd. in its meeting held on 11.08.2011 declared and paid final dividend of 30% for 2010-11. As an Auditor how you will react? [2]
- (c) As a statutory auditor of a company, how you will verify the petty cash? [2]
- (d) Statutory auditor cannot avoid the generally accepted fundamental assumption underlying the preparation of financial statements. State such assumptions and actions to be taken if not followed. [2]
- (e) What is expected under CARO in respect of
- (i) Default in repayment of dues,
- (ii) Application of term loans? [2+2]
- (f) Advise with reasons whether CARO 2003 is applicable to ABC Pvt. Ltd. which is having following balances in Balance Sheet on 31.03.2011: [2]

	₹
Paid up Capital	55 lacs
Reserve & Surplus	5 lacs
Assets	40 lacs
Misc. Expenses not written-off	20 lacs

(g) What are the general internal control and application control in a computer based system? [4]

Answer to Qus No. 7

- 7a. Following activities are generally considered –
- i) Collection and analysis of relevant statistics and reports used by the management.

- ii) Establishment of priorities for various functional activities to be reviewed.
 - iii) Interviews and meetings with the seniors middle and supervisory management levels to ascertain.
 - a) How plans are developed
 - b) How resources are controlled
 - c) How performances are evaluated.
- 7b. As per provisions of Companies Act 1956, on the basis of Board of Director's recommendation the shareholders in the Annual General Meeting declare the final dividend. Board has power to declare interim dividend and not final dividend.
- It is presumed (i) the company transferred the amount of dividend to a separate bank account within 5 days of declaration.
- (ii) Paid or issued dividend warrant to all the entitled shareholders or their mandates within 30 days of declaration.
- Since action of the board of directors is not in accordance with the law, the auditor shall check whether ex post facto approval of the share holders has been obtained.
- The Auditor should qualify his report to this effect.
- The Auditor should also to confirm whether the provision for the same has been made in Part II of Schedule VI to the Companies Act, 1956 and all deviations shall be reported / qualified through his audit report without fail.
- 7c. Generally following steps are taken :
- 1) To count the cash physically on the closing date of the year and compare it with the balance shown in petty cash book.
 - 2) If not possible, (a) visit on any day and count the cash balance (b) to see if it tallies with petty cash book balance (c) check the accounts from the year end to the date of counting (d) to count the balance on main cash book simultaneously and (e) check the accounts from the year end to the date of counting.
 - 3) See whether it is shown properly on balance sheet including cash in hand.
- 7d. General accepted fundamental accounting are :
- i) **Going concern** : the enterprise is normally viewed as continuing its operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or curtailing materiality the scale of its operations.

- ii) **Consistency** : It is assumed that consistency accounting policies will be consistent from one period to another.
- iii) **Accrual** : Revenues & cash are recognized as they are earned or incurred. Disclosure is necessary with details if these are not followed.
- 7e. i) Whether the company has defaulted in repayment of dues to a financial institutions or bank or debenture holders. If so the period and amount of default to be reported.
- ii) Whether the term loan were applied/utilised for the purpose for which the loans were obtained.
- 7f. CARO 2003 is not applicable to a private limited company which has a paid up capital and reserves of not more than ₹ 50 lakhs.
- However if the paid up capital and reserves are more than ₹ 50 lakhs but misc. expenditure to be written off are to the tune that if written off paid up capital & reserve balance together will go below ₹ 50 Lakh then this order is applicable.
- In this case therefore CARO is applicable although paid up capital & reserves after written off misc. Expenditure comes to ₹ 40 Lakhs.
- 7g. Following types of General Internal Control & Application control are available in a computer based system.
- A. General Internal Control : These control includes
- i) Administrative / Organisational control.
- The control which are designed to ensure the acceptable standard of discipline and maintenance of the efficiency of the computer department are known as Administrative control. This includes division of responsibilities , control over operations and file control.
- ii) System Development Control are those which are designed to ensure a satisfactory standard of designing and testing system and programming and of implementing and documenting them. This includes file conversion & system etc.

- iii) Procedural Control are those exercised over separate computer application, different techniques will be appropriate for different applications. Thus includes input controls processing controls output controls and master file controls.
- iv) Access Control
- v) Hardware control etc.

Application Control –

Over & above general control, control over the application of the computer information system is very important. These controls include (a) input control (b) processing control & (c) output control.

Question No. – 8

8. (a) Balance Sheet of holding company to include certain particulars as to its subsidiaries.-State such particulars u/s. 212. [4]
- (b) Central Government issued order for audit of Cost Accounts of ABC Ltd. u/s. 209(i)(d). In view of this, state the following:
- (i) Who appoints the Cost Auditor?
 - (ii) Whether Company's Statutory Auditor can conduct Cost Audit?
 - (iii) To whom the Cost Audit report is submitted?
 - (iv) Time limit within which such report is submitted by the Cost Auditor. [4]
- (c) (i) The patterns and degree of internal control may vary between organisation to organisation due to certain variable factors. Name at least six such factors. [3]
- (ii) As an internal auditor how you will verify the amount due to subsidiary companies? [2]
- (d) (i) What are the points an auditor should consider for IT Audit in respect of system development? [2]
- (ii) There is no need to design better internal controls in an EDP or computerised system.-State the correct position. [3]

Answer to Qus No. 8

- 8a. Balance Sheet of the holding company shall include the following particulars : (sec 212)
- i) Copy of subsidiary company's Balance Sheet.
 - ii) Copy of subsidiary company's P/L A/c.
 - iii) Copy of subsidiary company's Board of Directors report
 - iv) Copy of subsidiary company's Audit Report
 - v) Statement of holding company's interest in the subsidiary
 - vi) (a) Whether the financial years are different.
(b) Change if any in the holding company's interest in the subsidiary between the end of the financial year of the subsidiary and the end of holding company's financial year.
(c) Details of any material changes due to the change in financial year in respect of following
 - i) Subsidiary's fixed assets
 - ii) Its investment
 - iii) The money lent by it
 - iv) Money borrowed by it for any purpose other than that of meeting current liabilities etc.
- 8b
- i) Cost auditor is appointed by Board of Directors of the company with the previous approval of the Central Government (233 B)
 - ii) The statutory auditor of the company cannot be appointed as cost auditor.
Cost Auditor shall be a cost accountant within the meaning of the Cost & Works Accountants Act 1959 (sec 233 B)
 - iii) Cost audit report is submitted to the central government with copy to the company in such form as may be prescribed. (sec 233 B)
 - iv) Report shall be submitted to the central govt. within such time as may be prescribed.
- 8c
- i) The main factors are given below
 - 1. Magnitude of organization
 - 2. Facilities available.
 - 3. Nature of business operations
 - 4. Types of business
 - 5. Nature of organizational structure
 - 6. Capabilities and future potentialities of personnel.

Due to such variables, the formulation and effectiveness of control measures will not be the same in all the organizations. Because of this, the pattern of appraisal and recommendation by the internal auditor will also vary. Each situation under which control measures are formulated adopted and developed must form part of the subject for separate study.

- 8c. ii)a) to examine whether the subsidiary company is authorized by its memorandum of association to advance the loan to the holding company.
- b) to verify the interest rate at which the loan has been obtained and particulars of the securities that has been furnished for confirming the amount of interest and disclosure of the charge in the Balance Sheet
- c) to inspect the documents executed by the holding company which constitute the basis of the loan and the provision in the memorandum under which the loan has been raised.
- 8d. i) An audit to verify that the system under development meet the objectives of the organization and to ensure that the systems are developed in accordance with generally accepted standards for system development.
- ii) The statement is false. Computerization automatically implies a constant review of the system to increase the efficiency in producing reliable data. As a result the internal control are normally better designed under computerized system. Automatic checks are instituted and the responsibilities of various people are clearly stated.

