

INTERMEDIATE EXAMINATION

GROUP I

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2014

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) 2×7 =14
- (a) Mr. Ranabir was laid off for 12 days and worked for 21 days in an entire Accounting year. Hence he is eligible for bonus under Payment of Bonus Act, 1965.
 - (b) one packet of beauty soap was delivered "on sale or return" basis to Mr. Lala who delivered the same to Mr. Mohan, Mohan delivered to Mr. Nathan. Soaps got stolen from Nathan but before he signifies his acceptance. Hence, Nathan is to bear the loss. Answer based on legal provision.
 - (c) Every person is competent to enter into a contract. Offer your view (Contract Act, 1872).
 - (d) Mr. Kunal was employed in a seasonal establishment and he was not employed throughout the year claimed gratuity at the rate of 10 days wages for each year of service. His employer refused because he was in seasonal employment.
 - (e) A person who buys goods for a consideration for resale or for any commercial purpose is not a consumer. Hence, Mr. Saxena who buys goods and uses such exclusively for the purpose of earnings his livelihood by means of self employment is not a consumer.
 - (f) Limited liability partnership is liable to be winded up when number of partners is reduced below Two (2).
 - (g) Mr. Asim engages Mr. Barin to collect rent of Mr. Asim's House. Mr. Barin fails to account for some receipts. Mr. Asim, therefore calls upon Mr. Barin to furnish security for his duly accounting. Mr. Chandan gives guarantee for Barin. Asim does not acquaint Chandan about Barin's previous conduct. Barin afterwards makes default. Hence, Chandan being guarantor is responsible.

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Answer:

1. a. As per sec 8 of the Payment of Bonus Act, every employee is eligible for bonus if he has worked in the establishment for not less than 30 working days in an accounting year. For the purpose of sec13, an employee, shall be deemed to have worked also on the days on which he has been laid off. Thus he is eligible for Bonus as his total period of working was 30 days and more. It may be noted, he may not receive Bonus if his total wages is more than ₹ 10,000 per month or he is disqualified from receiving Bonus i.e. he is dismissed from Service for fraud, or for theft, misappropriate or sabotage of any property.

- b. Under Sec 24, of Sale of Goods Act, when goods are delivered to the buyer on approval or 'on sale or return' or other similar terms, the property therein passes to the buyer –
1. When he signifies his approval or acceptance to the seller;
 2. When he does any other act adopting the transaction

In the given case, the property in goods passed to Lala when Lala delivered to Mohan and to Mohan, when Mohan delivered it to Nathan. But the soap packet was stolen from Nathan before he signifies his acceptance. So, at that point Mohan was the owner of the goods and he should bear the loss.

- c. One of the essentials of a valid contract is the competency of the parties to make a contract. As per sec 11, every person is competent to -Contract who is of the age of majority according to the law to which he is subject and who is of sound mind, and is not disqualified from contracting by any law to which-he is subject.

From the above provisions it means the following types of persons are not competent to contract.

- a) A Person who has not attained the age of majority i.e. a minor.
- b) A Person of unsound mind.
- c) A Person who is disqualified from contracting by some law.

Hence every person is not competent to contract.

- d. Sec 4 (2) of the payment of Gratuity Act 1972 provided that in the case of an employee who is employed in a seasonal establishment and who was not so employed throughout the year, the employer shall pay the gratuity @ of seven days wages for each season.

In view of above Employer shall pay gratuity @ seven days wages (not ten days) for each season, to Mr. Kunal. Wage shall include Basic and D.A.

- e. As per definition given in section 1(d) (i) of Consumer Protection Act, 1986 consumer does not include a person -who obtains goods (for a consideration) for resale or for any commercial purpose. Similarly sec 1(d) (ii) provides that consumer does not include a person who avails of services for any commercial purpose.

However as per Explanation for the purpose of this sub-clause commercial purpose' does not include use by a consumer of goods bought and used by him exclusively for the purpose of earnings his livelihood by means of self employment

In view of above Mr. Saxena is a consumer.

- f. Sec 6(2) of Limited Liability Partnership Act, 2008 defines that if at any time the numbers of partners of a limited liability partnership is reduced below two and the LLP carries on

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business for more than six months while the number is so reduced, the person, who is the only partner of the LLP during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the LLP incurred during that period.

Hence the LLP shall not be wound up.

- g. The guarantee is invalid because sec 143 of Contract Act 1872 provides that any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

In this case Asim did not acquaint Chandan as to Barin's past incidents. Hence the guarantee is invalid.

2. (a) **Commercial impossibility is not a valid excuse for the non-performance of a contract, justify.** 3
- (b) **Mahindra owes money to Narendra under a contract. It is agreed between Mahindra, Narendra and Ramendra that Narendra shall henceforth accept Ramendra as its Debtor instead of Mahindra.**
- Referring to the provisions of the Indian Contract Act, 1872, State whether Narendra can claim from Ramendra.** 3
- (c) **Explain "Agreement to sell at valuation" under Sale of Goods Act, 1930.** 2
- (d) **In an auction sale, a bid once given cannot be withdrawn—offer views based on provisions of Sale of Goods Act, 1930.** 2
- (e) **Give correct answer if following statements are wrong (Factories Act, 1948).** 3
- (i) **No child who has not completed his fifteen years shall not be required or allowed to work in any factory.**
- (ii) **No adult workers shall be required or allowed to work in a Factory for more than forty hours in any week.**
- (iii) **Subject to the provisions of Sec. 51, no adult workers shall be required or allowed to work in a Factory for more than 8 hours in any day.**
- (iv) **No women shall be required or allowed to work in any Factory except between the hours of 8.00 a.m. and 8.00 p.m.**
- (v) **No female child shall be required or allowed to work in any Factory except between 6.00 a.m. and 10.00 p.m.**
- (f) **An establishment having 18 employees agreed between Employer and Employee to opt. for EPF, whether it is permissible, answer with rule provision.** 4
- (g) **Mr. Mahindra met an accident while on duty on 01.06.2014 and was admitted to Hospital for treatment. He was discharged on 03.06.2014 after treatment. Hence, he claimed compensation under Workmen's Compensation Act towards partial disablement. Answer the validity of his claim.** 1

Answer:

2. a) Commercial impossibility means that if the contract is performed, it will result in loss to the promisor that extreme unforeseen cost or difficulty of performance. Commercial impossibility to perform a contract or less profitable does not discharge the contract. Impossibility must be physical impossibility by death or legal impossibility in reference to ability of circumstance to validate the non performance of contract, viz inherent impossibility, impossibility by death or disablement of parties, Subsequent illegality, declaration of war non existing or non occurrence of a particular state of things (sec56). It

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should be noted, impossibility of performance as a rule cannot be an excuse for non-performance unless performance becomes absolutely impossible.

- b) Sec 62 of Indian Contract Act, 1872 deals in the contract which need not be performed is effect on novation, rescission and alternation of contract.

Sec62 provides that if the parties to a contract agree to substitute a new contact for it and or to rescind or alter it, the original contract need not be performed. Here, in this given problem, novation has taken place as one of the parties has been replaced with a third party.

Therefore Narendra can claim the money from Ramendra.

- c) According to Sec 10 of, Sale of Goods Act 1930 Agreement to sell at valuation are

(1) Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of a third party and such third party cannot or does not make such valuation, the agreement is there by avoided provided that, if the goods or any part thereof have been delivered to, and appropriated by, the buyer, he shall pay a reasonable price there for.

(2) Where such third party is prevented from making the valuation by the fault of the seller or buyer ,the party not in fault may maintain a suit for damages against the party in fault.

- d) Sec 64 of sale of goods act 1930 provides that the sale is complete under auction sale when the auctioneer announces its completion by the fall of the hammer or the other customary manner and until such announcement is made any bidder may retract his bid.

In view of above the statement is wrong .Bid can be withdrawn before the fall of the hammer which is an indication for the acceptance of the bid by the auctioneer.

- e)

(i) 14 years

(ii) 48 hrs

(iii) 9 hrs

(iv) 6 A.M and 7 P.M

(v) 8 A.M and 7 P.M

- f) The Employees Provident Funds and Miscellaneous Provisions Act, 1952 is applicable to –

i) To every establishment which is a factory engaged in any industry specified in Schedule I and in which 20 or more persons are employed [Sec 1(3)(a)] and

ii) To any other establishment employing 20 or more persons or class of such establishments which the Central Government may, by notification in the Official Gazette, specify in this behalf [Sec 1(3)(b)].

Further the Central Government may after giving not less than 2 months' notice of its intention so to do, by notification in the Official Gazette, apply the provisions of the Act to any establishment employing less than 20 persons [Proviso to Sec 1(3)]

Notwithstanding anything contained in Sec 1(3) or Sec 16(1) where it appears to the Central Provident Fund Commissioner, whether on application made to him in this behalf or otherwise, that the employer and majority of the employees in relation to any establishment have agreed that the provisions of this Act should be applicable to the establishment, he may, by notification in the Official Gazette, apply the provisions of the Act to that establishment on and from the date of such agreement or from any subsequent date specified in such agreement.

Hence in light of the above provisions, the establishment in question may become a

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member of EPF even if the number of employees engaged is 18.

g) Claim is not valid because:

Sec 3 under Workmen Compensation Act, 1923 provides that the employer shall not be liable in respect of any injury which does not result in the total or partial disablement of the workmen for a period not exceeding three days.

In the given problem Mr. Mahindra's partial disablement was for a period not exceeding three days. Hence his claim cannot be entertained.

3.

- (a) Only Chartered Accountant, who is in practice and the legal practitioners can appear before the Commission under Competitions Act, 2002—Give correct answer. 1
- (b) Asim without the request of any one, extinguishes the fire of Nemai's house. Asim suffers injury thereby. Nemai promises to compensate Asim the whole amount he has spent for his treatment.
Can Asim enforce the promise of Nemai and recover the amount? 2
- (c) Malhotra, a minor, taken loan from Mr. Mukharjee by given a surety. Mr. Mukharjee claimed the refund of the amount from Malhotra's surety who refused.
Can Mukharjee recover the loan amount from surety as Malhotra is a minor. 2
- (d) Fill in the blanks: (as per Payment of Wages Act, 1936) 2
The wages of every person employed upon or in.
- (i) Any Railway, factory or industrial or other establishment upon or in which less than one thousand persons are employed, shall be paid before the expiry of the.....day.
- (ii) Any other Railway, factory or industrial or other establishment shall be paid before the expiry of the.....day, after the last day of the wage-period in respect of which the wages are payable.
- (iii) Provided that in the case of persons employed on dock, wharf jetty or in a mine, the balance of wages found due on completion of the final tonnage account of the ship or wagons loaded or unloaded, as the case may be, shall be paid before the expiry of.....day from the day of such completion.
- (iv) Where the employment of any person is terminated by or on behalf of the employer, the wages earned by him shall be paid before the expiry of.....working day from the day on which his employment is terminated.
- (e) (i) "Young person" and adult are same (Factories Act, 1948). Offer your views. 2
(ii) There is no time limit for payment of bonus to entitled employees. State correct position based on Rules. 2
(iii) What is the amount of EDLI (EDLI Scheme 1976) a nominee of a deceased member is entitled? 1
- (f) What is implied warranties? 2
- (g) Mr. Arun purchased 5 kg of potato from seller. After coming back to residence Mr. Arun found 1 kg of potato was rotten. Seller refused to exchange. Advice with legal provision whether Seller was justified. 2
- (h) Asim consigns goods to Barin for sale and gives him instructions not to sell below a fixed price. Chandan being ignorant of Asim's instruction enters into a contract with Barin to buy the goods at a price lower than fixed price. Asim cannot accept the contract. Do you agree? 2

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Answer:

3. a) Sec 35 of Competition Act 2002 provides that a person or an enterprise or the director general may either appears in person or authorize one or more chartered accountants or company secretaries or legal practitioners or any of his or its officers to present his or its case before the commission.
- b) Asim can seek enforcement of promise of Nimai.
An agreement made without consideration is void unless it is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do [Sec 25(2)]
- c) Mr. Mukharjee cannot recover for the amount from the surety.
Sec 128 deals with the nature of the surety's liability. It provides that, "the liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract". In other words, the quantum of obligation of the surety is the same as that of the principal debtor unless there is a contract to the contrary.
As per the above provisions, the surety's liability is nil as Malhotra is a minor. This has been upheld in a number of cases including Nambiar Vs Moolaki Raman (1957, Madras High Court)
- d) (i) Seventh day
(ii) Tenth day
(iii) Seventh day
(iv) Second day
- e) (i) Under section 2 of Factories Act, 1948 they are different; because 'Adult means a person who has completed his eighteenth year of age; 'young person' means a person who is either a child or an adolescent. Adolescent means a person who has completed his fifteen year of age but has not completed his eighteenth year and 'child' means a person who has completed his fifteenth year of age.
- (ii) Section 19, of Payment of Bonus Act, 1965 states the time for payment of Bonus as below:
(i) If there is a dispute regarding payment of Bonus, the bonus shall be paid within 1 month of:
(a) Award becoming enforceable; or
(b) Settlement coming into operation
(ii) In any other case:
(a) The bonus shall be paid within 8 months from the end of Accounting Year
(b) Appropriate Government may extend the time limit for payment of bonus. The total period of extension shall not exceed 2 years.
- (iii) The amount of EDLI is higher of 20 times of last twelve months average monthly wages or amount average monthly wages or amount of benefit as per para 22(1) of EDLI scheme 1976
The maximum amount of insurance payable on death of an employee is ₹1,30,000
- f) The Implied warranties in a contract of sale are as follows:

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- (i) Warranty of quite possession [Sec 14(b)]: In a contract of sale, unless there is a contrary intention, there is an implied warranty that the buyer shall have and enjoy quite possession of the goods.
- (ii) Warranty of freedom from encumbrances [Sec 14(c)]: In addition to the previous warranty the buyer is entitled to a further warranty that the goods are not subject to any charge or right in favour of third party.
- (iii) Warranty as to quality or fitness by usage of trade [Sec 16(4)]: An implied warranty as to quality of fitness for a particular purpose may be annexed by the usage of trade.
- (iv) Warranty to disclose dangerous nature of goods: Where a person sells goods, knowing that the goods are inherently dangerous or they are likely to be dangerous to the buyer and that the buyer is ignorant of the danger, he must warn the buyer of the probable danger, otherwise he would be liable in damages.
- g) In this case "Doctrine of caveat emptor" applies' it is the buyer to satisfy himself that the potato which he purchases are of quality required by him. The buyer must take care while purchasing the goods and if he makes a wrong selection he cannot blame the seller. This principle was applied in the. This case of WARD vs HOBBS.
Hence the seller can refuse.
- h) Asim is bound by the contract because:
Where an agent has without authority done acts or incurred obligations to third person on behalf of his principal the principal is bound by such acts or obligations if he has by his words or conduct induced such third person to believe that such acts and obligation were within the scope of the Agents Authority (sec 237)
4. (a) **On retirement, Mr. Saxena submitted required documents demanding pension but his payment was held up because the employer has not contributed Employer's share to Pension Fund. Whether his pension can be held up (EPF & MP Act, 1952).** 2
- (b) **State the correctness of the following statement:** 2
Foreign limited liability partnership is a LLP in which majority number of partners are Foreign Nationals.
- (c) **Based on Industrial disputes Act, 1947 fill in the following gap.** 2
- (i) **Every Industrial establishment employing.....or more workmen shall have one or more Grievance Redressal Committee for the resolution of disputes arising out of individual grievance.**
- (ii) **Total number of members of the Grievance Redressal Committee shall not exceed more than.....**
- (iii) **Grievance Redressal Committee may complete the proceedings within.....days on receipt of a written application by or on behalf of the aggrieved party.**
- (iv) **The workman who is aggrieved of the decision of the Grievance Redressal Committee may prefer an appeal to the employer against the decision of the Grievance Redressal Committee and the employer shall within.....from the date of receipt of such appeal dispose off the same.**
- (d) **State the provision to be complied with under Factories Act, 1948 in respect of worker's participation in safety management.** 2
- (e) **In connection with the delivery of goods, state the provisions of sale of Goods Act in respect of:**
- (i) **Time of delivery**
- (ii) **Goods in possession of third party**
- (iii) **Cost of delivery** 2×3=6

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- (f) Amit proposes to deliver goods to Bimal on a certain day on payment of ₹ 2000. Amit dies before that day. Hence, this agreement is void. Answer based on provision of Contract Act, 1872. 2
- (g) When a communication of a revocation of an offer is complete. 2

Answer:

4. (a) Mr. Saxena's pension cannot be held up:
As per provision of EPF & Misc provision Act 1952 EPFO guarantees pension to member even if the employer has not contributed to provident fund.
- (b) False.
Sec 2A(m) defines that " foreign limited liability partnership " means a limited liability partnership formed, incorporated or registered outside India which establishes a place of business within India
- (c) (a) 50
(b) 6
(c) 45
(d) One month
- (d) (i) Safety committee
The occupier shall in every factory where a hazardous process takes place or where hazardous substance are used or handled, set up a safety committee consisting of equal number of representatives of workers and management to promote co operation between the workers and the management in maintaining proper safety and health at work and to review periodically the measures taken in that behalf, provided that the state government may by order in writing and for reasons to be recorded exempt the occupier of any factory or class of factories from setting up such committee.
- (ii) The composition of the safety committee, the tenure of office of its members and their rights and duties shall be such as may be prescribed (Sec – 41G).
- (e)
- i) Time of Delivery: Where under the contract of sale the seller is bound to send the goods to the buyer, but no time for sending them is fixed, the seller is bound to send them within a reasonable time. [Sec 36(2)]. But where the contract uses the words like 'directly', 'without loss of time' or 'forthwith', quick and immediate delivery is contemplated. Demand or tender of delivery should be made at the reasonable hour. What is reasonable hour is a question of fact. [Sec 36(4)]
- ii) Goods in possession of a third Party: When at the time of sale the goods are with a third party, there is no delivery by the seller to the buyer until such third party acknowledges to the buyer that he holds them on his behalf. But where the goods have been sold by the issue or transfer of any document of title to goods e.g. Railway receipt or a bill of lading, such third party's consent is not required [Sec 36(3)].
- iii) Cost of Delivery: Unless otherwise agreed, all expenses of and incidental to making of delivery are borne by the seller, but all expenses of and incidental to obtaining of delivery are borne by the buyer [Sec 36(5)].
- (f) Under Sec 37, of Indian Contract Act 1872, the parties to a contract must either perform, or offer to perform, their respective promises, unless such performance is dispensed with or excused under the provisions of this Act, or of any other law.

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Promises bind the representatives of the promisor in case of the death of such promisors before performance, unless a contrary intention appears from the contract.

In the stated case, Amit's representatives are bound to deliver the goods to Bimal and Bimal is bound to pay ₹ 2000 to Amit's representative.

- (g) According to sec.4 of the Indian Contract Act, 1872 the communication of a revocation is complete
- (i) As against the person who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of power of the person who makes it,
 - (ii) As against the person to whom it is made when it comes to his knowledge

SECTION II (50 Marks) (Auditing)

5. **Comment on the following based on legal provisions (No mark for wrong reasons or justification):** **2×7= 14**

- (a) **Internal Audit cannot be avoided in certain companies.**
- (b) **Certificate issued by expert as to the valuation of assets can be relied upon by the Auditor.**
- (c) **Motor Lorries held for resale has been classified as Fixed Assets by a company.**
- (d) **Earning per share are disclosed as per AS-18 w. e. f. 01-04-2001, while depreciation accounting are dealt with as per AS-13.**
- (e) **Company talent which may include an "Administrative Staff only.**
- (f) **"Edit Test" is of no help under computer information system and internal control.**
- (g) **International financial reporting standards apply only to individual companies.**

Answer:

5. a) In the case of listed companies and other companies having a paid up share capital and reserves exceeding 50 lakhs as at the commencement of the financial year concerned or having an average annual turnover exceeding rupees five crores for a period of three consecutive financial year immediately preceding financial year concerned internal audit system is necessary and cannot be avoided. Hence the statement is true.
- b) Valuation of assets is the duty of management and the Auditor can rely on the certificate issued by an authorized valuer to the valuation of assets in the balance sheet.
Besides valuation of assets the auditor is required to go beyond that and verify the physical existence and evaluate the assets to arrive at the true and fair view of the state of affairs of business.
Checking of ownership, title possession, and presence of any charge on the assets cannot be avoided. Hence the statement is true.
- c) Motor lorries held for resale are stock-in-trade and be classified as current assets.
Hence classification as fixed assets was wrong.
- d) Earnings per share are disclosed as per AS-20 and Depreciation, Accounting are as per AS-6. Hence the statement is false.

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- e) Besides administrative staff, following are also included
- 1) an audit committee
 - 2) Officer on special duty-these personnel have sufficient knowledge of operations and talent necessary for the study have no vested interest and are acceptable to other persons responsible for the area.
- Hence the statement is false.
- f) "Edit test", financial control test etc help in correct data entry and the accurate processing by the computer information system. Hence the statement is false.
- g) IFRS apply to the general purpose of financial statements and other financial reporting by profit oriented entities JFRS apply to individual company and consolidated financial statements. Hence the statement is false.

- 6. (a) How an auditor shall report to comply with CARO in respect of** **2×2= 4**
- (1) Deposit of Statutory dues;**
- (2) Documents and records for secured loan given.**
- (b) As a Statutory Auditor how you will verify "copy right"?** **2**
- (c) State the purpose of "Audit Trails" which is a part of computer information system.** **2**
- (d) Why foreign collaborators conduct management audit?** **2**
- (e) What are the main functions covered at reviewing stage under scope of internal auditing?** **2**
- (f) Whether Auditor is liable to third party. Answer with reasons.** **2**
- (g) Statuary Auditor is responsible for the work done by the Branch Auditor. Do you agree? Answer with justification.** **2**
- (h) Fill in the blanks:**
- After appointment of statutory auditor, in AGM, Auditor is to be intimated within..... days and after receiving the intimation of appointment from company, the auditor withindays intimate his acceptance or refusal of the appointment to.....in Form No.....** **2**

Answer:

6. (a)(i) Deposit of Statutory Dues :

The company Auditor has to report that (a) Is the company regular in depositing undisputed statutory dues including provident fund, employees states insurance ,income tax ,sales tax, wealth tax, custom duty, excise duty, cess and any other statutory dues with appropriate authorities and if not ,the extent of arrears of outstanding statutory dues as at the last date of the financial year concerned for a period of more than six months from the date they seem payable ,shall be indicated by the auditor .(b) In case dues of income tax, sales tax, wealth tax ,custom duty, excise duty, cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending may be mentioned ,but he should ,while reporting ,remember that a mere representation to the department should not constitute a dispute.

- (ii) Documents and record for secured loan:

Whether adequate documents and record are maintained in cases where the company has granted loans and advances on the basis of security by way of pledge of shares debentures and others securities if not, the deficiencies to be pointed out.

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(b) Verification of copy right:

- i) Verify copy rights with agreement.
- ii) See whether revaluation of copy rights is made properly and profit or loss is properly accounted.
- iii) Obtain the certificate of approved valuer to that effect.
- iv) See that the balance exhibited on balance sheet can be traced from ledger account.
- v) Verify the opening balance from last year's audited balance sheet.

(c) Data protection is a core goal of information security; audit trails often keep a record of data accesses -- logging file creation, reading, updating and deleting ("CRUD" activities) for each user. Uses of system resources may also be logged, such as printing files or copying data from one storage location to another. Unsuccessful access attempts may also be tracked.

In other words, an audit trail keeps track of who did what, to what, and when they did it, as well as who tried to do something but was unsuccessful.

Audit trails are a fundamental part of computer security, particularly useful for tracing unauthorized users and uses. They can also be used to assist with information recovery in the event of a system failure.

(d) Foreign collaborators need management audit when investing in other organizations, foreign collaborators feel the necessity of management audit to ensure that the funds invested are to be used properly for growth and expansion and to avoid bad investment.

(e) At reviewing stage internal audit embraces the following main functions:

- (a) Scrutiny of the records of an undertaking to assess the reliability of the information contained therein.
- (b) Examination of the documentary evidence from which the records are written of
- (c) Detection and prevention of error and fraud
- (d) A general examination of the financial statement prepared from the records to ascertain whether a true and fair view has been given about the financial position at a specific date

(f) Auditors liability to third parties:

- (i) Generally, it appears that as there is no privacy of contract between auditor and third party he cannot be held liable and he is never appointed by third party he has nothing to do with such party and this was confirmed by the case of LE Lievre and Dennes vs. Gould 1893.
- (ii) No doubt there is no privacy of contract; the third party can hold the auditor liable for any fraud.
- (iii) Auditor has moral responsibility to third party.
- (iv) If anybody relying on the audited statement of a company takes any decision and suffers any loss because such statements were false, the auditor will be responsible to them.
- (v) If auditor had authorized the issue of prospectus containing misleading statements, he would be held liable for damages to third party, who has purchased the shares of the company on the strength of such misleading statement even though there might not have been any privacy of contract between the auditor and the share holder.

(g) The Council of the Institute of Chartered Accountants of India has reviewed the relationship between the statutory Auditor and the Branch Auditor and has come to the

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conclusion that the statutory auditors would not be responsible in respect of work entrusted to the Branch Auditors.

Section 228(2) of the Companies Act provides that where the accounts of any branch office are audited by a person other than the company's auditor the company's auditor shall be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor. He shall also have access at all times to the books and accounts and vouchers of the company maintained at the branch office.

- (h) Seven day
30 days
Registrars of Companies
23B

7. (a) Is it true that foreign branch in India are audited by the Statutory of foreign company only. 2
- (b) As an auditor of a company how you will verify the imported plant and machinery? 2
- (c) How an auditor shall report in his audit report to comply with CARO in respect of "Loan"? 2
- (d) Describe the circumstances of materiality. 2
- (e) What are the activities considered for management audit process in its review of sales management? 2
- (f) If the following statements are not correct, give correct answer. 2
- (1) Clause 49 of the listing agreement is applicable to all the companies.
- (2) Quarterly compliance report are submitted to Registrar of companies.
- (3) This compliance report is signed by the Finance Director of the company.
- (4) This report is submitted within 30 days from the close of the Quarter.
- (g) What are the three systematic approaches to carry out information system Audit? 2
- (h) As an internal Auditor of a Company, how you will verify the "Depreciation" of Fixed Assets? 2
- (i) As an internal Auditor, list out documents that would be covered in 'Auditing in depth' of the payment of wages of daily rated workers working in a large stone quarry engaging 8000 workers of which 6000 are paid on daily basis. 2

Answer:

8. (a) Audit of foreign branch of a company:

As per section 228(1) of the companies Act 1956, where a company has branch office, the accounts of that office shall be audited by the company's auditor appointed under section 224 or by a person qualified for appointment as auditor of the company under section 226. Where the branch office is situated in a country outside India, any of the above or an Accountant qualified to act as auditor in the country concerned can be appointed as branch auditor. Hence the statement is false.

- (b) Verification of imported plant and machinery:

- (i) The Auditor should examine the minutes of board of directors meeting for the resolution passed authorizing the purchases.
- (ii) The Auditor should check the RBI,s permission and the import license/advance authorization.
- (iii) The Auditor should examine the agreement with the foreign supplier particularly check the terms of payment, interest rates and the basis of deferred payment.
- (iv) The Auditor should vouch the bill and receipts relating to purchases, customs duty

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- payment, clearing and shipping charge, insurance premium etc.
- (v) The Auditor should check the entries made in the books of account.
- (c) Loans: In the case of loan revised ,organized to firm etc. covered in the register maintained u/s 301 of the companies Act 1956,auditor has to make comments on the following
- Has the company either granted or taken any loans, secured or unsecured to /from companies, firms or other parties covered under the register maintained u/s 301 of the companies act 1956.If so, give the number of parties and amount involved in transactions.
 - Whether the rate of interest and other terms and conditions of loans given or taken by the company, secured or unsecured are prima facie prejudicial to the interest of the company.
 - Whether the payment of the principal amount and interest are also regular.
 - If over payment is more than one lakh, whether reasonable steps have been taken by the company for recovery/payment of the principal and interest.
- (d) According to the ICFAI the circumstances of materiality are
- Mistake discovered like valuation of stock calculation of interest, estimation of liability etc.
 - Non -disclosure of abnormal and unusual items or non-recurring income or expenditure etc.
 - Non -disclosure of items violating the statutory provisions etc
- (e) The activities to be undertaken by management for review of sales management include:
- Collection and analysis of relevant statistics and reports used by the management.
 - Establishment of priorities for various functional activities to be reviewed
 - Interview and meeting with senior, middle and supervisory management levels in order to ascertain (1) how plans are developed. (2) how resources are controlled and (3) how performances are evaluated.
- (f)
- CL-49 of listing agreement is applicable to listed companies
 - False : quarterly reports are' submitted to SEBI
 - Quarterly compliance reports are signed by compliance officer or by CEO
 - This report is submitted within 15days and not 30days
- (g) There are three systematic approaches to carry out an IT audit which are
- Technological innovation process Audit: The aim of this approach is to construct a risk profile for existing and new project by asserting the length and depth of company experience in it.
 - Innovative comparison Audit
 - Technological position Audit
- This review the technologies needed by the business and places them in one of the four categories of base key packing and emerging.
- (h) Following are to be examined
- Examine the policy of the company for charging of depreciation.
 - Examine whether the method of depreciation and the rates of depreciation are reasonable and sound considering the nature of assets, its operation and estimated life.

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- c) Examine whether the rates of depreciation applied and the assets classification are correct according to accounting manual, in case such manual exists.
- d) Examine the depreciation schedule prepared for annual accounts to see whether depreciation for all the existing assets in operation has been included. Also see whether advantage has been taken of the provisions of Income Tax Act and Rules to get maximum depreciation allowable.
- e) Review the compliance of Schedule VI of the Companies Act 1956. Compliance of Section 205 Payment of dividend out of profit only and Section 350 (Ascertainment of depreciation) of the Companies Act 1956.

(i) Points to be covered in auditing in depth of the payment of wages in a large stone quarry:

In respect of daily-rated workers:-

- (i) Appointment of workers,
- (ii) Identity/time card,
- (iii) Maintenance of permanent record of workers with up to date entries including entries for dismissals, resignation death change in the rate of pay, promotion, etc
- (iv) leave absence and daily attendance records,
- (v) wages sheets and checking of the calculations including various deductions,
- (vi) drawing cheque for the monthly wages,
- (vii) record of pay having been disbursed,
- (viii) Record of undisbursed wages,
- (ix) Payment of back wages. etc

9. (a) Under what circumstances the Management Audit are useful to the company? 2
- (b) Explain the Audit in the case of Electronics data interchange FDI. 4
- (c) The pattern and degree of internal control may vary between organization to organization due to certain variable factors. State such factors. 4
- (d) What are expected to make the Audit committee effective and purposeful? 3
- (e) State whether the following are correct. Give correct answer if wrong. 1×3=3
- (i) ABC Ltd., appointed Mr. G. K. Rathore a practicing Chartered Accountant from UK as Auditor for Financial year 2013-14.
 - (ii) J. K. Roy Chartered Accountant (ICAI) who is an Accounts Manager of XYZ Ltd., has been appointed as Statutory Auditor of XYZ Ltd.
 - (iii) The said Mr. J. K. Roy has also been appointed as Statutory Auditor for financial year 2013-14 by the RKS Ltd., which is a subsidiary company of XYZ Ltd.
- (f) Why financial Institute demand for conducting Management Audit? 2

Answer:

8. (a) The following are the circumstances where in the management audit useful
- (i) To overcome the human limitation of top management
 - (ii) To improve the management's production.
 - (iii) Circumstances of corporate planning deficiencies, organization structured defects Ineffective management control system etc. warrants the necessity of management audit.
 - (iv) In the circumstances of acquisition of another business entity, the acquiring organization need to evaluate financial aspect technical aspects and management aspects and analysis of these aspects takes the form of management

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- audit.
- (v) To be assured that the top and middle level management discharge their functions efficiently and to the best advantage to the society and others
 - (vi) To assess the manager's performance and link an incentive system to the result of such assessment.
- (b) Auditor, with usual procedures, should give consideration to the following aspects while Auditing In case of Electronic Data Interchange Environment:
- (a) There should be detailed and clear provision for electronic data interchange between the concerned parties. There should be clear provision for ordering, delivery, acceptance, rejection of interchange of electronic data. It is also clearly mentioned in the agreement that the supply of electronic data through this interchange system shall have the same effect on ordinary supply made on the basis of a purchase order.
 - (b) There should be full proof controls in the system to avoid modifications in the data by third party while the data interchange is in transit and for encryption, i. e. mixing of data by third party while it unreadable to third party is used and the receiver can decrypt the data for his use.
 - (c) Due to the built in control in the EDI system the recipient acknowledges the receipt of the data and his confirmation certain key information of original data is repeated.
 - (d) The parties exchange the logs frequently and used for logging, the receipted and sent data. This process is helpful and nobody can deny the receipt or transmission of data.
 - (e) To avoid adverse effect on the business due to failure of contingency planning are introduced in the EDI system.
- (c) The factors are stated below:
- i) Magnitude of organization
 - ii) Facilities available
 - iii) Nature of business operations
 - iv) Type of business
 - v) Nature of organizational structure
 - vi) Capabilities and future potentialities of personnel
- (d) To be effective and purpose full the Audit committee should maintain the following
- a) Audit committee should have the independent of management, statutory Auditor and internal Auditor.
 - b) The boards of directors allow full freedom to investigate into any areas of operations.
 - c) Relation between the Audit committee and management should be cordial and congenial towards optimum efficiency and healthy growth of the organization.
 - d) There should be regular line of communication through periodical meeting and discussion with management
 - e) There should be good communication relationship inter woven among management internal auditor and statutory auditor.
- (e) (i) Wrong
Statutory Auditor shall be a member of the ICAI, Chartered accountant of foreign

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countries are not permitted (see 226(1))

(ii) JK Ray being an employee of the company, the appointment is invalid, as per sec 226(3)(b).

(iii) JK Ray is an employee of XYZ and who is the holding company of RKS. Hence Mr. Ray's appointment is not valid (sec 226(4)) Sec 226(3)(b) provides that a person who is officer or employee of the company cannot be appointed as an Auditor of that company or as auditor of its Holding Co. or its subsidiary co. or a subsidiary of its Holding co.

(f) Financial Institutions conduct Management Audit which participating in equities of a company to avoid possible losses arising from inefficient management, or even for advancing advance loans, financial Institutions demand management Audits