

Revisionary Test Paper_ Intermediate_ Syllabus 2008_ June 2013

Paper 6 – Commercial and Industrial Laws and Auditing

Section I(Commercial and Industrial Laws)

1) Comment on the following:

A) G invites F (an actor popular among children for his acts) to his son H's birthday party. F accepts the invitation and promises to attend the party. G made special arrangement for the party and H was very excited about this fact. However F did not turn up for the party. H was very upset and refused to cut the cake. G enraged with F's behavior, wanted to sue for loss incurred in making special arrangements and spoiling the party. G seeks your advice.

Ans: According to section 2(h) of the Indian Contract Act, 1872, 'an agreement enforceable at by law is a contract.' The parties must intend to create a legal relationship. Agreements of social or domestic nature do not contemplate legal relationship, so they are not contracts.

Here G cannot sue F for loss. Agreement was a kind of social nature and therefore lacked the intention to create legal relationship.

B) D offered to pay Rs 50,000 to any person would swim a hundred yards on Gopalpur sea coast on New Year's day of 2013. B, a fisherman without any information about the offer, claimed Rs 50,000 on swimming the distance to save his life after he was accidentally thrown overboard by the rough sea waves. D needs your views.

Ans: An offer made to world at large or public in general can be accepted by any person **having knowledge** of the offer by fulfilling the terms of offer. Here B acted without any information as to the offer. How can a person accept an offer unless he is aware of it?. Therefore, the offer cannot be said to have been accepted thereby resulting in a contract. Similar decision was given in *Lalman Shukla v. Gauri Datt Allahabad High Court (1913) 11 ALJ 489*.

C) X, a minor wanted to become a professional cricket player. He entered into a contract with Y, a cricket coach and agreed to pay him Rs 10000/- per month to learn the game. Is X liable to pay the amount?

Ans: Education in India has been held as a necessity of life and as per to section 68 of the Indian Contract Act 1872, "If a person, incapable of entering into a contract, or any one whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person." So X will be liable to pay the amount provided he has properties existing in his name.

D) G, the holder of an over due bill of exchange drawn by P as surety for Q, and accepted by Q, contracts with X to give time to Q. Is P discharged from his liability ?

Ans: According to Section 136 of the Indian Contract Act, 1872, where a contract to give time to the principal debtor is made by the creditor with a third person and not with the principal debtor, the surety is not discharged. In the given question the contract to give time to the principal debtor is made by the creditor with X who is a third person. X is not the principal debtor. Hence P is not discharged.

E) A white elephant of rare kind was entrusted by ABC Zoo to the Indian Railway for carriage to Kolkata from Assam. The cage broke by jolts received during the journey and the elephant escaped. The elephant mowed down a herd of sheep belonging to X before being crushed under the wheels of the engine. Discuss the liability of Railway administration to ABC Zoo and X.

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Ans: The liability of Railway administration in India is that of an ordinary bailee . A bailee should take reasonable care of the goods as a man of ordinary prudence would take of his own goods under similar circumstances.[Sec 151 of the Indian Contract Act, 1872] If the cage is broken by jolts during journey, it is fault of ABC Zoo . The railway administration is therefore not liable to ABC Zoo. It is also not liable to X as there is no fault on its part.

F) R sells the goodwill of his shop to S for Rs10,00,000 and promises not to carry on such business forever and anywhere in India. Examine the validity of the contract.

Ans: As per Section 27 of the Indian Contract Act, 1872 an agreement in restraint of trade is void. However, a buyer can put such a condition on the seller of good will, not to carry on same business. However, the conditions must be reasonable regarding the duration and the place of the business.

Here, agreement not to carry on similar business anywhere in India forever is unreasonable and hence void.

G) Q sent a consignment of goods worth Rs. 160,000 by railway and got railway receipt. He obtained an advance of Rs. 130,000 from the bank and endorsed and delivered the railway receipt in favour of the bank by way of security. The railway failed to deliver the goods at the destination. The bank filed a suit against the railway for Rs.1 60,000. Decide in the light of provisions of the Indian Contract Act, 1872, whether the bank would succeed in the said suit?

Ans: As per Sections 178 and 178A of the Indian Contract Act, 1872 the deposit of title deeds with the bank as security against an advance constitutes a pledge. As a pledge, a banker's rights are not limited to his interest in the goods pledged. In case of injury to the goods or their deprivation by a third party, the pledgee would have all such remedies that the owner of the goods would have against them. In *Morvi Mercantile Bank Ltd. vs. Union of India*, the Supreme Court held that the bank (pledgee) was entitled to recover not only the amount of the advance due to it, but the full value of the consignment. However, the amount over and above his interest is to be held by him in trust for the pledgor. Thus, the bank will succeed in this claim of Rs. 160,000 against Railway.

H) P directs Q, his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. Q names R, an auctioneer, to conduct the sale and also allows him to receive proceeds of sale. R becomes insolvent without handing over the proceeds. Is 'Q' liable to 'P'?

Ans: According to Sec 194 of the Indian Contract Act, 1872 when an agent, holding an express or implied authority to name another person to act for the principal in the business of the agency, has named another person accordingly, such person is not a sub-agent, but an agent of the principal for such part of the business of the agency as is entrusted to him.

So here R is not a sub-agent, but is P's agent for the conduct of the sale. Q will not be responsible to P as he has discharged his duties as a man of ordinary prudence and diligence.

I) X, Y and Z jointly borrowed Rs.180,000 from A. The whole amount was repaid to A by Y. Decide in the light of the Indian Contract Act, 1872 whether:

i) Legal representatives of X are liable in case of death of X,

ii) Y can recover the contribution from the assets, in case Z becomes insolvent.

Ans: Section 42 of the Indian Contract Act, 1872 requires that when two or more persons have made a joint promise, then, unless a contrary intention appears by the contract, all such persons jointly must fulfill the promise. In the event of the death of any of them, his representative jointly with the survivors and in case of the death of all promisees, the representatives of all jointly must fulfill the promise.

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Section 43 allows the promisee to seek performance from any of the joint promisors. The liability of the joint promisors has thus been made not only joint but "joint and several". Section 43 provides that in the absence of express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise.

Section 43 deals with the contribution among joint promisors. The promisors, may compel every joint promisors to contribute equally to the performance of the promise (unless a contrary intention appears from the contracts). If any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

As per the provisions of above sections,

- (I) Legal representative of X are liable to pay the contribution to Y. However, a legal representative is liable only to the extent of property of the deceased received by him.
- (II) 'Y' also can recover the contribution from Z's assets.

J) R proposed to sell his car to S. S sent his acceptance by e-mail. Next day, S sends a Fax withdrawing his acceptance. Examine the validity of the acceptance in the light of the following:

- (i) The Fax of revocation of acceptance was received by R before the email of acceptance.**
- (ii) The Fax of revocation and email both reached together.**

Ans: The problem is related with the communication and time of acceptance and its revocation. As per Section 4 of the Indian Contract Act, 1872, the communication of an acceptance is a complete as against the acceptor when it comes to the knowledge of the proposer.

An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

Referring to the above provisions

- (i) Yes, the revocation of acceptance by S (the acceptor) is valid.
- (ii) If R reads the Fax first , the acceptance stands revoked. If he opens the email first and reads it, revocation of acceptance is not possible as the contract has already been concluded.

2A) Explain the concept of 'misrepresentation' in matters of contract.

Ans: According to Section 18 of the Indian Contract Act, 1872, misrepresentation is there:

- i. When a person positively asserts that a fact is true when his information does not warrant it to be so, though he believes it to be true.
- ii. When there is any breach of duty by a person, which brings an advantage to the person committing it by misleading another to his prejudice.3. When a party causes, however, innocently, the other party to the agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

The aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872]. The aggrieved party loses the right to rescind the contract if he, after becoming aware of the misrepresentation, takes a benefit under the contract or in some way affirms it.

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B) Distinguish between Contract of Indemnity and Contract of Guarantee.

Ans:

Contract of indemnity	Contract of Guarantee
i). There are two parties to the contract viz. indemnifier (promisor) and the Indemnified (promisee).	There are three parties to the viz. creditor, principal debtor and the surety
ii) Liability of the indemnifier to the indemnified is primary and independent.	Liability of the surety to the creditor is collateral or secondary, the primary liability being that of the principal debtor.
iii) There is only one contract in case of a contract of indemnity, i.e., between the indemnifier and the indemnified.	In a contract of guarantee there are three contracts, between principal Debtor and Creditor; between creditor and the surety and between surety and principal debtor.
iv) It is not necessary for the indemnifier to act at the request of the indemnified.	It is necessary that surety should give the guarantee at the request of the debtor.
v) The liability of the indemnifier arises only on the happening of a contingency.	There is usually an existing debt or duty, the performance of which is guaranteed by the surety.
vi) An indemnifier cannot sue a third party for loss in his own name, because there is no privity of contract. He can do so only if there is an assignment in his favour.	A surety, on discharging the debt due by the principal debtor, steps into the shoes of the creditor. He can proceed against the principal debtor in his own right

C) When is communication of revocation complete ?

Ans: According to section 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 the power of the person who makes it;

ii) as against the person to whom it is made, when it comes to his knowledge.

Example: P revokes his proposal by email. The revocation is complete as against P when the email is sent. It is complete as against Q when Q opens his mail box and receives it.

D) "An agreement made without consideration is void. "State the exceptions .

Ans: The general rule is that an agreement made without consideration is void (Section 25). In every valid contract consideration is very important. A contract may only be enforceable when an adequate consideration is there. However, the Indian Contract Act, 1872 contains certain exceptions to this rule. In the following cases, the agreement though made without consideration, will be valid and enforceable.

I) Natural Love and Affection: A written and registered agreement based on Natural Love and Affection between the parties standing in near relation (e.g., husband and wife) to each other is enforceable even

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without consideration. A contract in writing, registered on account of natural love and affection between parties standing near relation to each other are the essential requirements for valid contract though it is without consideration. (*Rajlukhee Devve vs. Bhootnath*).

II) Compensation for past voluntary services: A promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable under (Section 25(2)). In order that a promise to pay for the past voluntary services is binding, the following essential factors must exist:

- (i) the services should have been rendered voluntarily.
- (ii) the services must have been rendered for the promisor.
- (iii) the promisor must be in existence at the time when services were rendered.
- (iv) the Promisor must have intended to compensate to the promisee.

III) Promise to pay time barred debt: Where a promise in writing signed by the person making it or by his authorized agent, is made to pay a debt barred by limitation it is valid without consideration [Section 25(3)].

IV) Agency: According to Section 185 of the Indian Contract Act, 1872 no consideration is necessary to create an agency.

V) Completed gift: In case of completed gifts, the rule no consideration no contract does not apply. Explanation (1) to Section 25 of the Act states "Nothing in this section shall affect the validity as between the donor and donee, of any gift actually made." Thus, gifts do not require any consideration.

E) Who cannot enter into a contract?

Ans: Section 11, of Contract Act ,1872 lays down the qualifications that make a person competent to contract. Accordingly, the following persons cannot enter into a contract:

- i) Minor, who has not attained 18 years of age.
- ii) A person with unsound mind-lunatics, idiots, drunken or intoxicated persons.
- iii) A person who is disqualified by law from contracting partially or wholly. Incompetency may arise from political status, corporate status or legal status.

Contract with a person who is resident of a hostile nation is void.(political status)

A company cannot enter into a contract which is ultra vires its Memorandum of Association.(Corporate status)

An insolvent person cannot enter into a contract unless discharged.(legal status)

3A) Goods are delivered by P to Q on 'sale or return' basis. They are further delivered by Q to R and then by R to S. The goods are stolen in custody of R. Examine who is/are to bear the loss and why?

Ans: As per Section 24 of the Sale Of Goods Act, 1930, 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-

- (i) when he signifies his approval or acceptance to the seller to does not other act adopting the transaction;
- (ii) if he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and, if not time has been fixed, on the expiration of a reasonable time.

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In the given case the property in the goods passed from *P* to *Q* when *Q* transferred them to *R* and from *Q* to *R* when *R* transferred them to *S*. The goods got stolen from *S* before *S* signified his acceptance. So *R* is the owner of goods and shall bear the loss.

B) X sold a stock of wheat to Y at an agreed price per ton. The wheat was to be weighed by the agents of X and Y for ascertainment of price. A part of wheat was weighed and carried away by Y's agent but remainder was swept away by the flood. Who will bear the loss for the remainder?

Ans: According to Sec 22 of the Sale Of Goods Act , 1930, where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof.

Here, The remainder was not weighed as per agreement between X and Y. So the property in goods remained with X and he has to bear the loss. However he is eligible to get price for the goods taken away by Y's agents.

C) P bought a Television set from Q, the local distributor of HDB Ltd. for Rs 16000/- with one year warranty for satisfactory service. The TV set proved to be defective and had to be repaired by local distributor twice and once by the manufacturer within 9 months of purchase. P now claims refund of price. Examine whether his claim is maintainable?

Ans: As per Sec 59 of the Sale Of Goods Act, 1930 , breach of warranty only entitles the buyer to claim damages. The seller has already made compensation by effecting free repairs. So P cannot claim refund of price.

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

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

E) A contracts with B for sale of 50 quintals of 'Desi Ghee', delivery to done in batches within a specified period. A delivers 40 quintals of ghee but doesnot supply the residue. A claims price for the quantity supplied, and refuses to supply the remainder unless price is paid for the quantity delivered. Decide .

Ans: According to section 34 of the Sale of Goods Act, 1930, a delivery of part of goods, in progress of the delivery of the whole has the same effect, for the purpose of passing the property in such goods, as a delivery of the whole, but a delivery of part of the gods, with an intention of severing it from the whole, does not operate as a delivery of the remainder.

Thus A cannot insist on the payment of the price of the ghee supplied by him before supplying the entire quantity of 50 quintals of ghee.

4A) What are the implied conditions in a contract of 'Sale by sample' under the Sale of Goods Act, 1930?

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Ans: The following are implied conditions in a contract of sale by sample in accordance with Section 17 of the Sale of Goods Act, 1930;

- (i) that the bulk shall correspond with the sample in quality;
- (ii) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample.
- (iii) that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on a reasonable examination of the sample [Section 17(2)].

B) State the essential elements of a contract of sale under the Sale of Goods Act, 1930. Do you consider that there should be an agreement between the parties in order to constitute a sale under the said Act.

Ans: The following elements must co-exist so as to constitute a contract of sale of goods under the Sale of Goods Act, 1930.

- (i) There must be at least two parties as a person cannot sell goods to himself. However there may be a contract of sale between one part-owner and another.
- (ii) There must be a transfer or agreement to transfer the **ownership** of goods from one person to another. Mere transfer of possession is not sale.
- (iii) The subject matter of sale must be 'goods' and movable. The transfer of immovable property is not governed by Sale of Goods Act, 1930.
- (iv) The consideration for sale is called price which should be stated in terms of 'money'. Exchange of 'goods' for 'goods' is barter and not sale. However price may be paid partly in terms of money and partly in kind.
- (v) All essential elements of a valid contract must be present in a contract of sale.

The Supreme Court has held in the case of "*Stare of Madras Vs. Gannon Dunkerley and Co. AIR (1858) S (500)*" that according to the law in order to constitute a sale, it is necessary that there should be an agreement between the parties for the purpose of transferring title of goods which of course presupposes capacity to contract, that it must be supported by money consideration that as a result of transaction the property in the goods must actually pass etc.

C)'Receipt of goods by buyer does not necessarily result in acceptance of goods by him under contract of sale.' State when can a buyer be deemed to have accepted the goods ?

Ans: Acceptance means the final assent by the buyer that he has received the goods, and in performance of, the contract of sale.

According to section 42 of the Sale of Goods Act, 1930 the buyer is deemed to have accepted the goods :

- i) when he intimates to the seller that he has accepted them, or ;
- ii) when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller, or ;
- iii) when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.

D) When can an unpaid seller of goods exercise his right of lien over the goods under the Sale of Goods Act? Can he exercise his right of lien even if the property in goods has passed to the buyer? When such a right is terminated? Can he exercise his right even after he has obtained a decree for the price of goods from the court?

Ans: A lien is a right to retain possession of goods until the payment of the price. [Sec 46(1)(a) of the Sale Of Goods Act, 1930] It is available to the unpaid seller of the goods who is in possession of them where-

- (i) the goods have been sold without any stipulation as to credit;
- (ii) the goods have been sold on credit, but the term of credit has expired;
- (iii) the buyer becomes insolvent. [Sec 47(1) of the Sale Of Goods Act, 1930]

The unpaid seller can exercise 'his right of lien even if the property in goods has passed on to the buyer. He can exercise his right even if he is in possession of the goods as agent or bailee for the buyer.

Termination of lien: [Sec 49(1) of the Sale Of Goods Act, 1930]

The unpaid seller of goods loses his lien thereon-

- (i) when he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods;
- (ii) when the buyer or his agent lawfully obtains possession of the goods;
- (iii) by waiver thereof.

The unpaid seller of goods, having a lien thereon, does not lose his lien by reason only that he has obtained a decree for the price of the goods. [Sec 49(2) of the Sale Of Goods Act , 1930]

E) At an auction sale, Q made the highest bid for an article of P. State the legal position in the following cases:

- i) Q is allowed to take away the article P by giving a cheque and signing an agreement that ownership would not pass until the cheque is cleared. The cheque was dishonoured but meanwhile Q sold the article to R.**
- ii) Q's highest bid is less than reserve price but was mistakenly accepted by the auctioneer. Later the auctioneer refused to deliver the goods.**

Ans: i) R has a good title because the property passed to Q on fall of hammer [Sec 64(2) of the Sale of Goods Act, 1930]. The ownership of specific goods in a deliverable state passes on the completion of the contract of sale. [sec 20 of the Sale of Goods Act, 1930]

- ii) If the sale is notified to be subject to a reserved or upset price, every bid should be accepted conditionally on reserve price being reached. [Sec 64(5) of the Sale of Goods Act, 1930] So the sale is not valid and Q is not entitled to the article P. The auctioneer could not effectively accept a bid lower than reserve price as he could not make a contract so as to bind the principal to accept less than the reserve price.

5A) Progressive Ltd. is a navratna undertaking having its factories throughout India. The company have an impeccable record of best welfare measures and working conditions. Do the company require to appoint welfare officers?

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Ans: According to Section 49(1) of The Factories Act , 1948, in every factory wherein five hundred or more workers are ordinarily employed the occupier shall employ in the factory such number of Welfare officers as may be prescribed. The State Government may prescribe the duties, qualifications and Conditions of service of officers employed under sub-section (1).[Sec 49(2)].

In the given question Progressive Ltd. is a navratna undertaking having its factories throughout India. If the company has five hundred or more workers it is required to appoint welfare officers.

B) ABC Ltd bought butter from various sources. Butter so bought were sampled chemically, analysed and packed in tins for transportation to various stock points to be sold in market. Does this amount to manufacturing process under the Factories Act, 1948?

Ans: As per section 2(k) of The Factories Act, 1948, manufacturing process means any process for -

- (i) Making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing, or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal, or
- (ii) Pumping oil, water, sewage or any other substance; or;
- (iii) Generating, transforming or transmitting power; or
- (iii) Composing types for printing, printing by letter press, lithography, photogravure or other similar process or book binding;
- (iv) Constructing, reconstructing, repairing, refitting, finishing or breaking up ships or vessels; (Inserted by the Factories (Amendment) Act, 1976, w.e.f. 26-10-1976.)
- (v) Preserving or storing any article in cold storage;

The process of sampling , analyzing and packing of butter for sale in market is a manufacturing process as per the definition under the Factories Act, 1948.[*Shri Laxmi Das Premji Ghee Merchant v. R. Inspector of Factories(1960) I LLJ*]

C) PQR Ltd. orders *ex parte* dismissal of A , an employee for unauthorized absence without leave for more than 10 days. Examine the validity of the order under the Industrial Dispute Act, 1947.

Ans: Before taking any action against any employee, proper opportunity needs to be given to him. As per law, proper reconciliation proceeding be started. Holding of formal inquiry is necessary before dismissing an employee on the ground of misconduct. The employee should be given an opportunity of being heard.

In the given case , the order is valid if proper inquiry has been made before dismissal even if the dismissal order is *ex parte*.

D) X was engaged as a car driver by Y , Manager of BOK Bank who received an allowance in this regard. Examine whether X can be held as an employee of the Bank under the Industrial Dispute Act, 1947 , if the car is maintained at the Bank's expenses.

Ans: According to section 2 of the Industrial Disputes Act, 1947, "workman" means any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, whether the terms of employment be express or implied.

X cannot be regarded as workman or an employee under the said act as the control of him was not with bank, as held in case of *PNB v Ghulam Dastagir, (1978) 2 SCC 358*.

E) X, an employee of FBG Works Ltd. lost mental balance in an accident while reporting to work early and committed suicide. Is the employer liable to pay compensation under the Employees' Compensation Act, 1923?

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Ans: According to Section 3(1) of the Employees' Compensation Act, 1923, if personal injury is caused to an employee by accident arising out of and in the course of his employment, his employer shall be liable to pay compensation in accordance with the provisions of this act.

The theory of notional extension of the term employment was laid down by Supreme Court in *Saurashtra Salt Mfg. Co. v Bai Valu Rajr, A.I.R(1958) S.C. 881*. According to this theory in certain circumstances, an employer is liable to pay compensation even when employee is not at premises at the time of accident.

In the present case the employee lost his mental balance while coming to work early and committed suicide. Suicide is effect of injury sustained by him while trying to report early (on management's instruction as may be implied from the circumstances) for work. To succeed in claim it must be proved that the accident arose out of and in the course of his employment as compensation is given only for those injuries which occur in accident out of and in the course of his employment.

6A) ABC(P) Ltd. imposed a fine on Q, one of its employees for irregular attendance. No prior notice specifying this particular act in respect of which could be imposed was exhibited. ABC(P) Ltd deducted the fine in four installments from salary of Q. Is the employer justified?

Ans: According to Section 8 of the Payment of Wages Act, 1936:

i) A notice specifying such acts and omissions shall be exhibited in the prescribed manner on the premises in which the employment carried on or in the case of persons employed upon a railway (otherwise than in a factory) at the prescribed place or places. [Sec 8(2)]

ii) No fine imposed on any employed person shall be recovered from him by installments or after the expiry of sixty days from the day on which it was imposed. [Sec 8(6)]

Thus ABC(P) Ltd violates the provisions of Secs. 8(2) and 8(6) of the Payment of Wages Act, 1936.

B) W is engaged in two types of job in a factory, that of a mechanic and watchman. The wage rates are different for two different jobs. The employer calculates his minimum wage at an average rate.

Ans: According to Sec 16 of the Minimum Wages Act, 1948, where an employee does two or more classes of work to each of which a different minimum rate of wages is applicable, the employer shall pay to such employee in respect of the time respectively occupied in each such class of work, wages at not less than the minimum rate in force in respect of each such class.

Thus in the given case employer just cannot pay him at simple average rate of both wages of both classes of job.

C) DEF Ltd discontinued deduction towards contribution to provident fund from its employees salary and stopped remitting contribution of its share of provident fund when the number of its employees on its roll fell to thirteen. Do the provisions of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 cease to be applicable under such circumstances?

Ans: According to sec 5(1) of the Employees Provident Fund and Miscellaneous Provisions Act, 1952, an establishment to which this Act applies shall continue to be governed by this Act notwithstanding that the number of persons employed therein at any time falls below twenty.

As such the provisions of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 continue to be applicable to DEF Ltd.

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D) Employees of XYZ Ltd increased their contribution to PF by 0.5% and demanded the same from management. Is the demand tenable?

Ans: Section 6 of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 provides that an employee can at his will contribute beyond 10% if the scheme makes provision therefor subject to the condition that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under this section.

7A) X drawing a salary of Rs 9900/- per month is dismissed from service on ground of misconduct. . Since there were no adverse findings 'X' was re-instated in service, later, when the bonus was to be paid to other employees, the employers refuse to pay bonus to 'X', even though he has worked for the remaining ten months in the year. Referring to the provisions of the Payment of Bonus Act, 1965 examine the validity of employer's refusal to pay bonus to 'X'.

Ans: Section 2(13) under the Payment of Bonus Act, 1965 defines an employee as any person (other than an apprentice) employed on a salary or wage not exceeding ten thousand rupees per mensem in any industry to do any skilled or unskilled manual, supervisory, managerial, administrative, technical or clerical work for hire or reward, whether the terms of employment be express or implied.

Section 8 under the same act states , every employee shall be entitled to be paid by his employer in an accounting year, bonus, in accordance with the provisions of this Act, provided he has worked in the establishment for not less than thirty working days in that year.

Thus every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than 30 working days in the year on a salary which doesnot exceed than Rs. 10,000 per month. *[Section 2(13) read with Section 8]*

If an employee is prevented from working subsequently reinstated in service, employer's statutory liability for bonus cannot be said to have been lost and the employee concerned shall be entitled to the bonus. *[ONGC v. Sham Kumar Sahegal]*.

Thus based on the above ruling and the provisions of the Act as contained in Section 8, the refusal by the employers to pay bonus to X is not valid and he (X) is entitled to get bonus in the given case for the reasons given above in the provisions, i.e. he has worked for more than 30 days in a year, drawing salary of less than Rs. 10000 and not disqualified for any other reason.

B) Examine whether the Payment of Bonus Act, 1965 be applicable to D, an employee employed by an establishment engaged in an industry carried on by a department of the Central Government.

Ans: According to Sec 32(iv) of the Payment of Bonus Act, 1965, employees employed by an establishment engaged in any industry carried on by or under the authority of any department of the Central Government or a State Government or a local authority are not covered by the Act.

Thus the act is not applicable to D who is a Central Government employee.

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C) R was occupying service quarters of ABC Ltd at the time of retirement. He didnot vacate the quarters inspite of reminders. In retaliation, the company with held the gratuity payable to him. Is action of the company justified?

Ans: Gratuity cannot be withheld for non-vacation of service quarters by retiring employees. Gratuity can only be forfeited to the extent of damage or loss where services have been terminated for any act of willful omission or negligence causing damage /loss/destruction of employer's property and not for non-vacation of service quarters.

Gratuity is exempted from attachment in execution of any decree or order in any Civil, Revenue or Criminal Court.

So action of ABC Ltd is not justified.[*Travancore Plywood Ltd. v Regional Joint Labour Commissioner, Kerala(1996) LLJ 14*]

D) K made a complaint before the Consumer Disputes Redressal Forum for seeking compensation against the State Electricity Board contending that due to fluctuations and fall in electricity voltage in his KBC Enterprise, a small scale industrial unit, he had suffered production loss. Will K succeed?

Ans: As per Sec 2 (d) of the Consumer Protection Act , 1986 consumer includes any person hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who 'hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person *but does not include a person who avails of such services for any commercial purposes;*

For the purposes of this clause, "commercial purpose" does not include use by a person of goods bought and used by him and services availed by him exclusively for the purposes of earning his livelihood by means of self-employment;

As per Sec 2(o) of the Consumer Protection Act , 1986 'service' means service of any description which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing insurance, transport, processing, **supply of electrical or other energy**, board or lodging or both, 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;

Sec 2(g) of the same act defines 'deficiency' as any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service;

Going by the above definitions K is a consumer under the Consumer Protection Act , 1986 and he has suffered deficiency in service. So his claim is maintainable. [*Kerala State Electricity Board v Raveendran*]

8A) Discuss the general duties of an 'occupier' under the Factories Act, 1948.

Ans: General duties of an 'occupier' are discussed in sec 7A of the Factories Act, 1948.

These are as follows:

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(1) Every occupier shall ensure, so far as is reasonably practicable, the health, safety and welfare of all workers while they are at work in the factory.

(2) Without prejudice to the generality of the provisions of sub-section (1), the matters to which such duty extends, shall include –

(a) the provision and maintenance of plant and systems of work in the factory that are safe and without risks to health;

(b) the arrangements in the factory for ensuring safety and absence of risks to health in connection with the use, handling, storage and transport of articles and substances;

(c) the provision of such information, instruction, training and supervision as are necessary to ensure the health and safety, of all workers at work;

(d) the maintenance of all places of work in the factory in a condition that is safe and without risks to health and the provision and maintenance of such means of access to, and egress from, such places as are safe and without such risks;

(e) the provision, maintenance or monitoring of such working environment in the factory for the workers that is safe, without risks to health and adequate as regards facilities and arrangements for their welfare at work.

(3) Except in such cases as may be prescribed, every occupier shall prepare, and, as often as may be appropriate, revise, a written statement of his general policy with respect to the health and safety of the workers at work and the organisation and arrangements for the time being in force for carrying out that policy, and to bring the statement and any revision thereof to the notice of all the workers in such manner as may be prescribed.

B) Distinguish between 'Young person' and 'adult' under the Factories Act, 1948.

Ans: According to sec 2(d) of the Factories Act, 1948 "young person" means a person who is either a child or an adolescent. According to sec 2(a) of the Factories Act, 1948 "adult" means a person who has completed his eighteenth year of age.

C) Discuss Adjudication as a method of settling industrial disputes under the Industrial Dispute Act, 1947.

Ans: The Industrial Dispute Act, 1947 provides for three tier system of adjudication of industrial disputes. The cases either may be referred by government to court after the receipt of failure report from conciliation officer or directly by any party. Labour courts and Industrial Tribunal may be constituted by State Governments while National Tribunal is constituted by Central Government.

Labour Courts (Sec 7)

The appropriate Government may, by notification in the Official Gazette, constitute one or more Labour Courts for the adjudication of industrial disputes relating to any matter specified in the Second Schedule and for performing such other functions as may be assigned to them-, under this Act.

Industrial Tribunal (Sec 7A)

The appropriate Government may, by notification in the Official Gazette, constitute one or more Industrial Tribunals for the adjudication of industrial disputes relating to any matter, whether specified in the Second

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Schedule or the Third Schedule and for performing such other functions as may be assigned to them under this Act.

National Tribunal (Sec 7B)

The Central Government may, by notification in the Official Gazette, constitute one or more National Industrial Tribunals for the adjudication of industrial disputes which, in the opinion of the Central Government, involve questions of national importance or are of such a nature that industrial establishments situated in more than one State are likely to be interested in, or affected by, such disputes.

D) Distinguish between the terms 'Lay-off' and 'Lock-out' under the Industrial Disputes Act, 1947.

Ans:

'Lay-off'	'Lock-out'
i) Defined under Sec 2(kkk) of the Industrial Disputes Act, 1947	Defined under Sec 2(l) of the Industrial Disputes Act, 1947
ii) Means the failure, refusal or inability of an employer on account of shortage of coal, power or raw materials or the accumulation of stocks or the breakdown of machinery or natural calamity or for any other connected reason] to give employment to a workman whose name is borne on the muster rolls of his industrial establishment and who has not been retrenched.	Means the temporary closing of a place of employment], or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him.

9A) What do you understand by the term 'partial disablement' under the Employees' Compensation Act, 1923?

Ans: According to sec 2(1)(g) of the Employees' Compensation Act, 1923, "partial disablement" means, where the disablement is of a temporary nature, such disablement as reduces the earning capacity of an employee in any employment in which he was engaged at the time of the accident resulting in the disablement.

Temporary partial disablement reduces the earning capacity of workman in **any** employment in which he was engaged at the time of employment.

Permanent partial disablement reduces the earning capacity in every employment the worker was capable of doing at the time of employment; provided that every injury specified [in Part II of Schedule I] shall be deemed to result in permanent partial disablement.

B) Explain the theory of notional extension of employment under the Employees' Compensation Act, 1923.

Ans: The principal behind compensation to the injured worker under the Employees' Compensation Act, 1923 is considered according to the Doctrine of Notional Extension. This doctrine throws light on the course of employment of a worker.

Section 3(1) Employee's Compensation Act, 1923 provides that the injury must be caused to workman by an accident arising out of and in the course of employment. Employment does not necessarily ends when the tool down signal is given or when the workman leaves the actual workshop. There is a notional extension at both the

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entry and exit time and space. As employment may end or may begin not only when the employee begins to work or leaves his tools but also when he used the means of access and egress to and from the place of employment.

As a rule, the employment of an employee does not commence until he has reached the place of employment and does not continue when he has left the place of employment, the journey to and from the place of employment being excluded. It is now well-settled, however, that this is subject to the theory of notional extension of the employer's premises so as to include an area which the workman passes and repasses in going to and in leaving the actual place of work. There may be some reasonable extension in both time and place and a workman may be regarded as in the course of his employment even though he had not reached or had left his employer's premises. The facts and circumstances of each case will have to be examined very carefully in order to determine whether the accident arose out of and in the course of the employment of an employee, keeping in view at all times this theory of notional extension.

C) State the provisions of the Payment of Wages Act, 1936 regarding deduction from wages for absence from duty.

Ans: Deductions may be made on account of absence of an employed person from duty [Sec 7(2)(b) of the Payment of Wages Act, 1936] from the place of employment where he is required to work.

As per Sec 9 of the Act,

(1) Deductions may be made under clause (b) of sub-section (2) of section 7 only on account of the absence of an employed person from the place or places where by the terms of his employment , he is required to work such absence being for the whole or any part of the period during which he is so required to work.

(2) The amount of such deduction shall in no case bear to the wages payable to the employed person in respect of the wage-period for which the deduction is made in a larger proportion than the period for which he was absent bears to the total period within such wage-period during which by the terms of his employments he was required to work :

Provided that subject to any rules made in this behalf by the State Government if ten or more employed persons acting in concert absent themselves without due notice (that is to say without giving the notice which is required under the terms of their contracts of employment) and without reasonable cause such deduction from any such person may include such amount not exceeding his wages for eight days as may by any such terms be due to the employer in lieu of due notice.

For the purposes of this section an employed person shall be deemed to be absent from the place where he is required to work if although present in such place he refuses in pursuance of a stay-in strike or for any other cause which is not reasonable in the circumstances to carry out his work.

D)What do you understand by the term 'industrial establishment' under the Payment of Wages Act, 1936?

Ans: According to Section 2(ii) of the Payment of Wages Act, 1923, "industrial or other establishment" means any -

(a) tramway service or motor transport service engaged in carrying passengers or goods or both by road for hire or reward;

(aa) air transport service other than such service belonging to or exclusively employed in the military naval or air forces of the Union or the Civil Aviation Department of the Government of India;

(b) dock wharf or jetty;

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(c) inland vessel mechanically propelled;

(d) mine quarry or oil-field;

(e) plantation;

(f) workshop or other establishment in which articles are produced adapted or manufactured with a view to their use transport or sale;

(g) establishment in which any work relating to the construction development or maintenance of buildings roads bridges or canals or relating to operations connected with navigation irrigation or to the supply of water or relating to the generation transmission and distribution of electricity or any other form of power is being carried on;

(h) any other establishment or class of establishments which the Central Government or a State Government may have regard to the nature thereof the need for protection of persons employed therein and other relevant circumstances specify by notification in the Official Gazette.

10A) With whom does the responsibility of fixing minimum rates of wages lie?

Ans: This is provided in Sec 3 of the Minimum Wages Act, 1948. The responsibility of fixing minimum wages lies with appropriate government. The appropriate government shall in the manner hereinafter provided -

(a) fix the minimum rates of wages payable to employees employed in an employment specified in Part I or Part II of the Schedule and in an employment added to either Part by notification under section 27 :

Provided that the appropriate government may in respect of employees employed in an employment specified in Part II of the Schedule instead of fixing minimum rates of wages under this clause for the whole State fix such rates for a part of the State or for any specified class or classes of such employment in the whole State or part thereof;

(b) review at such intervals as it may think fit such intervals not exceeding five years the minimum rates of wages so fixed and revise the minimum rates if necessary :

Provided that where for any reason the appropriate government has not reviewed the minimum rates of wages fixed by it in respect of any scheduled employment within any interval of five years nothing contained in this clause shall be deemed to prevent it from reviewing the minimum rates after the expiry of the said period of five years and revising them if necessary and until they are so revised the minimum rates in force immediately before the expiry of the said period of five years shall continue in force.

B) Define the term 'Cost of living index number' in relation to Minimum Wages Act , 1948.

Ans: According to Sec 2(d) of the Minimum Wages Act, 1948, 'Cost of living index number 'in relation to employees in any scheduled employment in respect of which minimum rates of wages have been fixed means the index number ascertained and declared by the competent authority by notification in the Official Gazette to be the cost of living index number applicable to employee in such employment.

C) What are the power of an "Inspector" under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952?

Ans: Under Section 13 of the Employees Provident Funds and Miscellaneous Provisions Act, 1952 the Inspector is appointed by the appropriate Government for the purpose of the Act and the Scheme. Under sub-section (2) of the said section, the Inspector has the following powers:

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- I. To collect information and require the employer or any contractor from whom any amount is recoverable under section 8A to furnish such information, as he may consider necessary.
- II. To enter and search any establishment or any premises connected therewith.
- III. To require any one found in charge of the above - mentioned establishment or premises to produce before him for examination any accounts, books, registers or other documents.
- IV. To examine the employer or contractor from whom any amount is recoverable.
- V. To make copies of or take extract from any book, register or any other document maintained in relation to the establishment and also to seize such documents as he may consider relevant.
- VI. To exercise such other powers as the scheme may provide.

D) Is the amount standing to the credit of a member of the Provident Fund attachable in the execution of decree or order of the Court? State the provisions as laid down in the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.

Ans: According to Section 10 of E.P.F. & M.P. Act, 1952 the amount standing to the credit of any member in the fund or of any exempted employee in a provident fund shall not in any way be capable of being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member or the exempted employee, and neither the official assignee appointed under the Presidency Towns Insolvency Act nor any receiver appointed under the Provincial Insolvency Act shall be entitled to or have any claim on, any such amount.

The amounts standing to the credit of aforesaid categories of persons at the time of their death and payable to their nominees under the scheme or the rules vest in nominees, and the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or of the exempted employee and shall also not be liable to attachment under any decree or order of any court.

11 A) Under the Payment of Bonus Act, 1965 how is the number of days computed for determining the amount of minimum bonus payable to an employee. How is proportionate reduction in bonus made?

Ans: Section 14 of the Payment of Bonus Act, 1965 provides how to compute the number of working days for purposes of Section 13. Section 13 in turn prescribes a scale whereby bonus can be proportionately reduced in certain cases. Under Section 14 following days shall be deemed to be the working days of an employee and shall be counted while calculating the total working days on which he has been on work for the purpose of bonus:

- (i) Day when he has been laid off under an agreement or by a standing order under the Industrial Employment (Standing Orders) Act, 1946 or Industrial Disputes Act, 1947 or any other law.
- (ii) He has been on leave with salary or wage.
- (iii) He has been absent due to temporary disablement caused by accident arising out of and in the course of his employment and
- (iv) The employee has been on maternity leave with salary or wages during the accounting year.

According to Section 13, where an employee has not worked for all the working days in an accounting year, the minimum bonus of Rs. 100 or, as the case may be of Rs 60, if such bonus is higher than 8.33% of his salary or wage for the days he has worked in that accounting year, shall be proportionately reduced.

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B) Explain 'forfeiture of Gratuity' under the Payment of Gratuity Act, 1972.

Ans: Section 4(6) of the Payment of Gratuity Act, 1972 provides the following provisions for forfeiture of gratuity:

(a) The gratuity of an employee, whose services have been terminated for any act, willful omission or negligence causing any damage or loss to, or destruction of, property belonging to the employer, shall be forfeited to the extent of the damage or loss so caused.

(b) The gratuity payable to an employee may be wholly or partially forfeited -

(i) if the services of such employee have been terminated for his riotous or disorderly conduct or any other act of violence on his part, or

(ii) if the services of such employee have been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment.

C) Can suit be filed against a Medical Practitioner for deficiency in service under the Consumer Protection Act, 1986?

Ans: Yes, a **medical practitioner can be sued under the Consumer Protection Act 1986** for his or her *professional negligence resulting in damage to patient*. Sec 2 (d) in defining a consumer in Clause (ii) uses the expression 'hires and avails of'. The word "hire" means employ of wages or fees". Secondly the words "any service" in sec . 2 (d) (ii) in Consumer Protection Act. A eloquent to bring the delinquent medical practitioners within the ambit of *Consumer Protection Act*. Thirdly, sec . 2 (o) of Consumer Protection Act which defines service exempts only two types of services, one "service free of charge" and another "contract of personal service" postulates a relationship of master and servant. A medical man whose service is requisitioned for a patient answers the clause " contract of service" but never "a contract of personal service". So, a negligent medical professional can be proceeded under the Consumer Protection Act 1986.

12 A) ABC LLP had 3 partners A, B, and C. C died on 3rd January 2010. The firm continued with the same name. H extended a loan to the firm on basis of the goodwill of the firm. Are legal representatives of C liable to H? Explain the position with respect to the Limited Liability Partnership Act ,2008.

Ans: According to Sec 29(2) of the Limited Liability Partnership Act ,2008, where after a partner's death the business is continued in the same limited liability partnership name, the continued use of that name or of the deceased partner's name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the limited liability partnership done after his death.

So legal representatives of C are not liable to H.

B) SEVA Trust , a charitable organization not for profit wants to convert to LLP. Advice.

Ans: The essential requirement for setting LLP is 'carrying with a view **to earn profit**.'So SEVA Trust cannot convert to a LLP.

C) The residents of HBC locality wanted one street in the area to be repaired before monsoon which was in highly dilapidated state. They approached the local MLA who expressed inability due to exhaustion of MLA Funds. The residents refuse to believe . Advice them in context of Right to Information Act, 2005.

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Ans: The resident may apply to Public Information Officer under RTI Act in writing or through electronic means in English or Hindi or in the official language of the area, to the PIO, specifying the list of works sanctioned using their MLA's funds and also the balance amount enclosing the prescribed fee.

The PIO is required to supply information within 30 days from the date of application. Based on information supplied the residents can satisfy themselves about the truth of their MLA's statement.

D) PIO under the RTI Act , 2005 rejected X's application because he wanted too many information which PIO found difficult to handle.

Ans: The RTI Act , 2005 does not permit rejection of application simply because it relates to large number of documents. In any case , in practice officials should consider the processing of applications as a cooperative activity, such that the official should work with the applicants to assist them to get information they need. If a large number of records are involved in relation to a request , the PIO can contact the requestor and clarify their request to see if they can reach a mediated solution that will give the requestor what they want without unnecessarily burdening the PIO. This recognises that in some cases at least , a broad application may be simply because the requestor was not sure what was available. No penalty is shall lie against PIO for anything which is in good faith done or intended to be done under this Act or any rule made thereunder.(Sec 21)

If some information requested work relates to the work of another public authority within the same department or in another department, The PIO has the power to transfer those part of the application to such public authority under Sec 6(3) of the Act.

13 A)How can a existing partner cease to be a partner of LLP?

Ans: According to Sec 24(1) of the Limited Liability Partnership Act, 2008, A person may cease to be a partner of a limited liability partnership in accordance with an agreement with the other partners or, in the absence of agreement with the other partners as to cessation of being a partner, by giving a notice in writing of not less than thirty days to the other partners of his intention to resign as partner. Sec 24(2) of the Act states the additional ground on which a partner ceases to be a partner:

A person shall cease to be a partner of a limited liability partnership-

- (a) on his death or dissolution of the limited liability partnership; or
- (b) if he is declared to be of unsound mind by a competent court; or
- (c) if he has applied to be adjudged as an insolvent or declared as an insolvent.

Notice is required to be given to ROC when a person becomes or ceases to be partner or for any change in partners.

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B) Explain the concept of 'whistle blowing' with respect to the Limited liability Partnership Act, 2008.

Ans: The concept has been discussed in Sec 31 of the Limited liability Partnership Act, 2008. As per the sec-

(1) The Court or Tribunal may reduce or waive any penalty leviable against any partner or employee of a limited liability partnership, if it is satisfied that-

(a) such partner or employee of a limited liability partnership has provided useful information during investigation of such limited liability partnership; or

(b) when any information given by any partner or employee (whether or not during investigation) leads to limited liability partnership or any partner or employee of such limited liability partnership being convicted under this Act or any other Act.

(2) No partner or employee of any limited liability partnership may be discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against the terms and conditions of his limited liability partnership or employment merely because of his providing information or causing information to be provided pursuant to sub-section (1).

C) Explain the term 'right to information' under the RTI Act, 2005.

Ans: Sec 2(j) of the Right to Information Act, 2005 states "right to information" means the right to information accessible under this Act which is held by or under the control of any public authority and includes the right to—

(i) inspection of work, documents, records;

(ii) taking notes, extracts or certified copies of documents or records;

(iii) taking certified samples of material;

(iv) obtaining information in the form of diskettes, floppies, tapes, video cassettes or in any other electronic mode or through printouts where such information is stored in a computer or in any other device;

D) How is Central Information Commission constituted under the RTI Act, 2005?

Ans: This is discussed under Section 12 of the RTI Act, 2005.

(i) Central Information Commission to be constituted by the Central Government through a Gazette Notification.

(ii) Commission includes 1 Chief Information Commissioner (CIC) and not more than 10 Information Commissioners (IC) who will be appointed by the President of India.

(iii) Oath of Office will be administered by the President of India according to the form set out in the First Schedule.

(iv) Commission shall have its Headquarters in Delhi. Other offices may be established in other parts of the country with the approval of the Central Government.

(v) Commission will exercise its powers without being subjected to directions by any other authority.

14 A) An arrangement has been made among the jute producers that the cotton produced by them will not be sold to mills below a certain price. The arrangement was in writing but it was not intended to be enforced by legal proceeding. Examine whether the above arrangement can be considered as an agreement within the meaning of Section 2(b) of the Competition Act, 2002.

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Ans: As per Section 2(b) of Competition Act, 2002 an 'agreement' includes any arrangement or understanding or action in concert, -

- Whether or not, such a arrangement or understanding or action is formal or in writing; or
- Whether or not, such a arrangement or understanding or action is intended to be enforceable by legal proceedings.

In the given case the understanding reached among the cotton produces not to sell below a certain price shall amount to an agreement as defined under Section 2(b) notwithstanding the fact that arrangement is writing but no intended to enforce by legal proceeding.

B) P by inducing Q obtains a Bill of Exchange from him fraudulently in his (P) favour. Later, he enters into a commercial deal and endorses the bill to R towards consideration to him (R) for the deal. R takes the bill as a Holder-in-due-course. R subsequently endorses the bill to P for value, as consideration to P for some other deal. On maturity the bill is dishonoured. P sues Q for the recovery of the money. With reference to the provisions of the Negotiable Instruments Act, decide whether P will succeed in the case?

Ans: The problem stated in the question is based on the provisions of the Negotiable Instruments Act as contained in Section 53. The section provides: 'Once a negotiable instrument passes through the hands of a holder in due course, it gets cleansed of its defects provided the holder was himself not a party to the fraud or illegality which affected the instrument in some stage of its journey.' Thus any defect in the title of the transferor will not affect the rights of the holder in due course even if he had knowledge of the prior defect provided he is himself not a party to the fraud. (Section 53).

Thus applying the above provisions it is quite clear that P who originally induced Q in obtaining the bill of exchange in question fraudulently, cannot succeed in the case. The reason is obvious as P himself was a party to the fraud.

15 A) Examine with reference to the relevant provisions of the Competition Act, 2002, whether a person purchasing goods not for personal use, but for resale can be considered as a 'consumer.'

Ans: The term 'consumer' is defined in Section 2(f) of Competition Act, 2002. Accordingly 'consumer' means any person who buys any goods for a consideration, which has been paid or promised or partly paid and partly promised, whether such purchase of goods is for resale or for any commercial purpose or for personal use.

Hence, it is not necessary that a person must purchase the goods for personal use in order to be considered as a 'consumer' under Competition Act, 2002. Even a person purchasing goods for resale or for any commercial purpose will also be considered as a 'Consumer' within the meaning of Section 2(f) of Competition Act, 2002.

B) When is presentment of an instrument not necessary under the Negotiable Instruments Act?

Ans: According to Section 76 of the Negotiable Instruments Act 1881, no presentment to payment is necessary in any one of the following cases:

- (i) if the maker, drawee or acceptor intentionally prevents the presentment of the instrument, or
- (ii) if the instrument being payable at his place of business, he closes such place on a business day during the usual business hours, or
- (iii) if the instrument being payable at some other specified place, neither he nor any other person authorised to pay it attends at such place during the usual business hours, or
- (iv) if the instrument not being payable at any specified place, if he (i.e. maker etc) cannot after due search

be found;

- (v) as against any party sought to be charged therewith, if he (i.e maker, etc.) has engaged to pay notwithstanding non-presentment;
- (vi) as against any party if after maturity, with knowledge that the instrument has not been presented —
he makes a part payment on account of the amount due on the instrument, or promises to pay the amount due thereon in whole or in part, or otherwise waives his right to take advantage of any default in presentment for payment;
as against the drawer, if the drawer could not suffer damage from the of such presentment.

Section II(Auditing)

16) Comment on the following statements based on legal provisions:

A) Foreign branch of a company can be audited only by an auditor of that country.

Ans: The statement is false. 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.

B) According to Sec 227(1) of the Companies Act, 1956 , the auditor can call for *any* explanations or information from the officers and employees of the company.

Ans: The statement is false. Companies Act, 1956 The auditor can call for explanations or information which he thinks is **relevant** for the purpose of audit and proper discharge of his duties.

C) Sec 292A of the Companies Act, 1956 lays down auditor's duty as a member of Audit Committee.

Ans: The statement is false. Auditor is not a member of the Audit Committee constituted under section 292A of the Companies Act, 1956 and has no right to vote. However, he shall attend and participate at the meetings of the Audit Committee.

D) The scope of verification is much wider than that of vouching.

Ans: The statement is true. Vouching enable the auditor to know whether the transactions are genuine and valid to enable the auditor to report on the financial statements with reference to relevant documentary evidence.. Vouching is the substantive testing/examination of transaction at their *point of origin*. On other hand, verification process encompasses the inquiry into the ownership/ title, existence, valuation, completeness and presentation of assets and liabilities in the balance sheet. Verification usually deals with the *final balance* in the Final Accounts viz the balance sheet and profit and loss account.

E) The auditor can rely on work of an expert of valuation of assets.

Ans: The statement is true. Valuation is the duty of management and the auditor can rely of certificate issued by an authorized valuer as to valuation of assets in the balance sheet.

F) As per Indian GAAP, where the company has obtained credit limits from a bank but has not availed them, the details of unused credit lines need not be disclosed in the financial statements.

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Ans: The statement is true. Only the current portion of the debt or whatever is the amount which is outstanding on the date of the preparation of the financial statement, is to be disclosed. There is no requirement as to disclosure of unused limits.

G) The Cost Auditor of a company cannot function as an internal auditor of the same company.

Ans: The statement is true. The Cost Auditor is required to comment on the scope and performance of the internal audit as per the provisions of the Cost Audit (Report) Rules, 2011. If the Cost Auditor also functions as internal auditor, he will not be able to discharge his duties in proper and dispassionate manner.

H) The system of propriety audit is applied in respect of all public limited companies.

Ans: The statement is false. The term 'propriety' has been defined by Kholer as "that which meets the tests of public interest, commonly accepted customs and standards of conduct and particularly as applied to professional performance, requirements of Government regulations, and professional codes." The system of propriety audit is applied in respect to Government companies and Government departments because public money and public interest are involved therein.

In case of non-government companies, the auditor has to comment upon some of the propriety aspects in the transactions of the companies, for example under CARO 2003 pursuant to section 227 of Companies Act. Otherwise, nongovernment company auditors do not conduct propriety audit unlike in case of Government Companies.

I) The Directors of KBK Ltd. proposes to transfer unclaimed dividend to Profit and Loss Account. The auditor can agree with management over this as dividend is declared out of profit.

Ans: The statement is false. If any amount of dividend is not claimed within a period of 30 days from the date of declaration of dividend, the company is required to transfer the total amount of unclaimed dividend to a special account in a scheduled bank called "Unpaid dividend Account of --- Company Ltd or Pvt Ltd." within seven days from the date of expiry of thirty days.

If any amount remains unclaimed for a period of seven years from the date of such transfer, then amount shall be transferred to the Investor Education and Protection Fund.

The Ministry of Corporate Affairs has issued a Circular, notified in the Gazette of India G.S.R. 352(E) dated May 10, 2012, notifying the Rule "Investor Education and Protection Fund (Uploading of information regarding unpaid and unclaimed amounts lying with Companies) Rules, 2012". As per this Rule, companies have to identify and upload details of unclaimed dividend on their website.

17 A) Discuss the principles, which are useful in assessing the reliability of audit evidence.

Ans: Audit evidence refers to any information, verbal or written, obtained by the auditor on which he bases his opinion on financial statements.

The audit evidence may be of varied nature and can assume various forms. For example, a signature on the voucher of a designated official, the payee's receipt, etc. Even the information obtained by the auditor by discussing with the officials of the company also constitutes audit evidence.

The reliability of audit evidence depends on its source-internal or external, and on its nature-visual, documentary, or oral. While the reliability of audit evidence is dependent on the circumstances under

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which it is obtained, the following generalisations may be useful in assessing the reliability of audit evidence:

- (i) External evidence (e.g. confirmation received from third party) is usually more reliable than internal evidence.
- (ii) Internal evidence is more reliable when related internal control is satisfactory.
- (iii) Evidence in the form of documents and written representations is usually more reliable than oral representations.
- (iv) Evidence obtained by the auditor himself is more reliable than that obtained through the entity.

B) What are the risks associated with going concern assumptions which the auditor should consider judging appropriateness underlying the preparation of financial statements?

Ans: An auditor's report helps to establish the credibility of financial statements, it does not a guarantee as to the future viability of the entity.

An entity's continuance as a going concern for the near future, generally around one year after the balance sheet date is assumed in the preparation of financial statement in the absence of any information to the contrary.

However, the auditor should consider the risk that the going concern assumption may no longer be appropriate. Examples of indications of risks that the continuance as a going concern may be questionable are:

Financial Indications:

- (i) Negative net worth or negative working capital.
- (ii) Substantial operating losses, and negative cash flows from operations.
- (iii) Adverse key financial ratios.
- (iv) Excess short-term borrowings to finance long-term assets.
- (v) Arrears of dividend.
- (vi) Increase of creditors, and inability to pay them on due dates.
- (vii) Inability to repay the long-term loans on maturity.
- (viii) Entering into a scheme of arrangement with creditors for reduction of liability.

Operating Indications:

- (i) Loss of key management personnel without replacement.
- (ii) Shortage of important supplies.
- (iii) Loss of major market.
- (iv) Industrial unrest.

Other Indications:

- (i) Non compliance with statutory requirements.
- (ii) Sickness of entity under any statutory definition.
- (iii) Changes in laws or any government policy, adversely affecting the working of the entity.
- (iv) Pending legal proceedings against the entity, which will adversely affect the entity.

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18) As an auditor, how will you vouch and/or verify the following?

A) Research and Development expenses

B) Goodwill

C) Sale proceeds of Scrap Material.

D) Balance with excise authority.

E) Receipt of special backward area subsidy from Government.

Ans: A) **Research and Development Expenses**

- (i) Ascertain the nature of research and development work at the outset and enquire whether separate Research and Development Department exists.
- (ii) See allocation of expenses under revenue and deferred revenue. Ensure that expenses which are routine development expenses are charged to Profit and Loss Account.
- (iii) Check whether the concerned research activity is authorised by the Board and has relevance to the objectives of the company.
- (iv) Examine that generally research expenses for developing products or for inventing a new product are treated as deferred revenue expenditure to be written off over a period of three to five years, if successful. In case it is established that the research effort is not going to succeed, the entire expenses incurred should be written off to the profit and loss account.
- (v) Ensure that if any machinery and equipment have been bought specially for the purpose of research activity, the cost thereof, less the residual value should be appropriately debited to the Research and Development Account over the years of research.

B) Goodwill:

- (i) Ensure that as required by AS 10 on "Accounting for Fixed Assets", goodwill has been recorded in the books only when some consideration in money or money's worth has been paid for. Goodwill arises from business connections, trade name or reputation of an enterprise or from other intangible benefits enjoyed by an enterprise.
- (ii) Check the vendor's agreement on the basis of which assets of the running business have been acquired by the company at a price existing in the book value of the assets or where a specific sum has been paid for the goodwill.
- (iii) See that only the amount paid to the vendors not represented by tangible assets has been debited to the goodwill account. Therefore, it is not prudent that goodwill should be shown in the company's accounts by way of writing up the value of its assets on revaluation or writing back the amount of goodwill earlier written off by the company.
- (iv) See whether goodwill has been written off as a matter of financial prudence.

C) Sale Proceeds of Scrap Material

- (i) Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.
- (ii) Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of scrap materials.
- (iii) Review the production and cost records for determination of the extent of scrap materials that may arise in a given period.

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- (iv) Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years.
- (v) Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.
- (vi) See that scrap materials sold have been billed and check the calculations on the invoices.
- (vii) Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it.
- (viii) Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness.

D) Balance with excise authority

- i. The balance with excise authority in PLA account should be checked with the statements of accounts/records kept with excise section of the unit.
- ii. The remittance into the account, the utilization out of it etc should be cross checked with bank book, clearance forms etc.
- iii. The balance confirmation may be checked.
- iv. The balance should be shown under current assets and advances in balance sheet.
- v. It is to be ensured that the balances in PLA is used only to the extent of liability after adjusting cenvat credit where available.

E) Receipt of special backward area subsidy from Government:

- i. The claim for backward area subsidy submitted to the authorities should be studied.
- ii. It should be ascertained whether the grant is of a capital nature for funding assets or of a revenue nature. Mere computation formula of quantum of grant with reference to the cost of project of itself will not make the grant a capital nature is to facto.
- iii. The accounting of grant should be in accordance with AS 12 "Accounting for Government Grants". The revenue grant can be taken to income statement, with appropriate disclosure.
- iv. The capital grant may be adjusted against cost of asset or may be kept in a capital reserve to be transferred to profit and loss account each year in proportion to depreciation of that asset charged in profit and loss account.
- v. The receipt of the grant should be checked with bank statement, remittance challan etc.
- vi. The conditions attached to grant should be fulfilled by the company. The auditor should check whether any liability or refund of grant for breach of conditions could arise.

19) As an auditor, comment on the following situations:

A) The method of depreciation on plant and machinery is to be changed from SLM basis to WDV basis from the current year.

Ans: Normally speaking, the method of depreciation is applied consistently to provide comparability of the results of the operations of the enterprise from period to period. A change from one method of providing depreciation to another is made only if :

- (i) The adoption of the new method is required by statute ;(or)

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(ii) For compliance with an accounting standard ;(or)

(iii) It is considered that the change would result in a more appropriate presentation or presentation of financial statements of the enterprise.

Therefore, the auditor must ensure that the change in method of depreciation on plant and machinery from SLM to WDV basis from the current year is made in accordance therewith. When such a change in the method of depreciation is made, depreciation is recalculated in accordance with the new method from the date of the asset coming into use. Further, it should be ensured that the deficiency (since change is from SLM to WDV) arising to be adjusted in the year of change by way of a charge to the profit and loss account. He may also ascertain that the change in the method and the effect thereof on the profits of the entity is quantified and disclosed. If it is not done by the management, the auditor has to bring it to the notice of the shareholders through qualification in the audit report.

B) The management tells you that WIP is not valued since it is difficult to know the same in view of multiple processes involved and in any case opening and closing WIP would be more or less the same.

Ans: AS 2 deals with the principles and methods for determining the value at which inventories should be carried in the financial statements. Thus, items hold in the process of production is included in the definition of inventory.

In the given case, the management should have determined the stage of completion of the production and valued the work in process accordingly.

Work in Process (WIP) is normally, valued by taking the basic cost of materials, labour and proportionate factory overhead incurred upto the stage of completion. In view of the above, the argument that the value of opening and closing WIP is more or less same is not tenable as the cost of material, labour and overhead might be different and accordingly, arriving at the different valuation of opening and closing WIP is possible.

Moreover, WIP being a part of opening and closing stock, it needs to be shown in Profit and Loss A/c and carried as current assets in the balance sheet as per valuation.

Thus, if WIP is not valued, the auditor should qualify the report.

20) Give your comments and observations on the following:

A) Assets purchased under hire-purchase system were reflected at their full value and the outstanding installments payable have been included under Sundry Creditors.

Ans: AS 10 on "Accounting for Fixed Assets" requires that assets acquired under Hire Purchase System should be recorded at the cash value. In case cash value is not readily available it should be calculated with reference to hire-purchase payments and an appropriate rate of interest. , The penal interest, if any, should be charged off to revenue. Accordingly, the treatment; followed by the company is correct.

B) PQR Ltd. is a holding company of ABC Ltd. ABC Ltd. is going to start a new project estimated to cost Rs. 50 crores. For this PQR Ltd. made an investment of Rs. 25 crores in the shares of ABC Ltd. by borrowing the same from financial institution @10% p.a. As on 31st March, 2013 the project was not completed. The Directors of PQR Ltd. want to capitalize the interest upto 31st March, 2013 on borrowings amounting to Rs. 5 crores and add it to the cost of investments.

Ans: AS 16 states that borrowing cost that are directly attributable to the acquisition, construction or production of a qualifying asset, should be capitalized as a part of the cost of that asset. Qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or

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sale, e.g. manufacturing plants, power generation facilities etc. that require a substantial period of time to bring them to a saleable condition.

In the given case interest of Rs.1 crore should not be capitalized because as per AS 16

- (a) Investment of Rs. 25 crores in the shares of ABC Ltd. by PQR Ltd. is not a qualifying asset.
- (b) Only borrowing cost incurred upto acquisition is allowed to be capitalized which would be nil in the case of investments.

Therefore the intention of company is wrong. As an auditor it should be brought to the knowledge of management and interest of Rs. 5 crores should be shown as an expenditure in Profit & Loss a/c.

21) As an auditor, how will you verify the following?

A) Deferred Tax Liability.

B) Amount due to subsidiary companies .

C) Stock lying with Third Party.

D) Preliminary expenses.

Ans: A) Deferred Tax Liability:

- (i) The deferred tax liability is created when there is timing difference which result in deferred tax payable with reduction in current tax to the same extent. For example, when more depreciation amount is claimed in Income tax profits than in accounting profits, the current tax payable will be less with an liability to pay more tax in future. This is called Deferred Tax Liability.
- (ii) Check the creation of Deferred Tax Liability and its actual working.
- (iii) Check how much Deferred Tax Liability is reversed during the year.
- (iv) Check that Deferred Tax Liability is disclosed as relating to depreciation and as relating to others.

B) Amounts due to Subsidiary Companies:

- (i) Examine whether the subsidiary company is authorized by its Memorandum of Association to advance the loan to the holding company.
- (ii) Verify the interest rate at which the loan has been obtained and particulars of the security that has been furnished for confirming the amount of interest and disclosure of the charge in the Balance Sheet.
- (iii) 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.

C) Stock lying with third party :

- (i) Obtain confirmations from the third party including the time period and reasons thereof.
- (ii) Evaluate condition of goods and see whether adequate provision has been made.
- (iii) Check whether subsequently the goods lying with third party were sold or received back after the expiry of stipulated time period.
- (iv) Ensure that the goods have been included in the closing stock though lying with third party.

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- D) **Preliminary Expenses:** It is the expenditure incurred incidental to the creation, formation and floating of a company. It consists of stamp duties, registration fees, legal costs, consultants fees, expenses of printing of memorandum and articles, etc. The following should be checked:
- (i) Check Board's minutes book containing the resolution approving the expenses claimed by promoters as having been spent in formation of the company.
 - (ii) Examine supporting papers and vouchers, contracts, agreements, etc. to support the promoters' claims. Also check bills and receipts issued by the printer of the memorandum and articles of association, share certificates, etc.
 - (iii) Check receipt for the registration fee paid for registration of the company.
 - (iv) Verify rates of stamp required to be affixed on the memorandum and articles of association.
 - (v) Ascertain Boards' minutes book for the decision to write off the preliminary expenses over a period. The quantum thereof which has not yet been written off for these expenses should be carried forward in the balance sheet under the head miscellaneous expenditure (to the extent not written off or adjusted) over a period of years.
 - (vi) Check that no expenses other than those what constitutes preliminary expenses are booked under this head, e.g. underwriting commission and brokerage paid.

22) Comment on the following situations:

A) A company had a branch office, which recorded a turnover of Rs.1,89,800 in the earlier year. The auditor's report of the earlier year had no reference regarding the branch although, the branch audit had not been carried out by the statutory auditor.

Ans: Under Section 228(4) of the Companies Act, 1956, the Central Government has formulated Companies (Branch Audit Exemption) Rules, 1961 to exempt any branch office of a company from being audited having regard to quantum of activity.

These Rules require that, if during the said financial year, the average quantum of activity of the branch does not exceed Rs.2 lakhs or 2% of the average of total turnover and the earnings from other sources of the company as a whole, whichever is higher, the said branch is exempted.

In the case under review, the turnover is below Rs. 2 lakhs and other information has not been furnished. Accordingly, it may be presumed, exemption may have been granted but still it is necessary that the fact must be mentioned in the audit report.

Since, reference to branch is called for in the auditor's report even if the same has been exempted by the Central Government, the auditor remains responsible. The auditor has, however, no responsibility in respect of the audit of earlier period accounts.

B) 'At the AGM of ABC Ltd., Mr Y was appointed as the statutory auditor. He, however, resigned after 3 months since he wanted to give up practice and join industry.

State, how the new auditor will be appointed by ABC Ltd.

Ans: Section 224(6) of the Companies Act, 1956 deal with provisions relating to appointment of auditor caused due to casual vacancy. A casual vacancy normally arises when an auditor ceases to act as such after he has been validly appointed, e.g., death, disqualification, resignation, etc. In the instance case, Mr Y has been validly appointed and thereafter he had resigned.

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Thus a casual vacancy had been created on account of resignation. The law provides that in case a casual vacancy has been created by the resignation of the auditor (as in this case), the Board cannot fill in that vacancy. The company in a general meeting can only fill the same.

Thus, in this case ABC Ltd will have to call an extra-ordinary general meeting (EGM) and appoint another auditor. The new auditor so appointed shall hold office only till the conclusion of the next annual general meeting.

The provisions of the Companies Act, 1956 applicable for the appointment of an auditor in place of a retiring auditor would equally applicable in the instant case are given below:

- (i) *Section 225(1)*: Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor.
- (ii) *Section 190(2)*: Special notice is to be sent to all members of the company at least 7 days before the date of the AGM.
- (iii) *Section 225(2)*: On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
- (iv) *Section 225(3)*: Representation if any, received from the retiring auditor should be sent to the members of the company.
- (v) *Section 224A*: Special resolution as required under this section should be duly passed.
- (vi) *Section 224(1B)*: Before any appointment or reappointment of auditors is made at an annual general meeting, a written certificate is to be obtained from the auditor proposed to be appointed that his appointment will be in accordance with the limits specified in Section 224(1B).
- (vii) The incoming auditor should also satisfy himself that the notice provided for under Sections 224 and 225 has been effectively served on the outgoing auditor.

C) H was appointed as auditor of PQR Ltd. In the 18th Annual General Meeting of the company in April, 2012. In October 2012 the company removed him through a resolution in the general meeting and appointed R as its auditor.

Ans: The removal of auditor H, before the expiry of the term of an auditor's appointment by M/s PQR Limited is invalid. Sub-section (7) of Section 224 of the Companies Act, 1956 provides that an auditor may be removed from office before the expiry of his term, by the company only in a general meeting after obtaining the prior approval of the Central Government in that behalf.

However such approval is not required for the removal of the first auditor appointed by the Board of Directors under the proviso to sub-section (5) of Section 224. Since prior approval of the Central Government has not been obtained, the removal of H is not valid and, therefore, H continues to be the auditor. The appointment of R in his place is void.

D) The members of ABC Ltd. preferred a complaint against the auditor stating that he has failed to send the auditors report to them.

Ans: Section 227 of the Companies Act, 1956 lays down the powers and duties of auditor. As per provisions of the law, it is no part of the auditor's duty to send a copy of his report to members of the company. The auditor's duty concludes once he forwards his report to the company. It is the responsibility of company to send the report to every member of the company. It will be for the secretary or the director to convene a general meeting and send the balance sheet and report to the members (or other

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person) entitled to receive it. Hence in the given case, the auditor cannot be held liable for the failure to send the report to the shareholders.

23) As a Company Auditor, how would you deal with the following situations?

A) The Financial Controller of PQR Limited refuses to provide for proposed dividend in books of accounts for the year ended 31.3.2013 on the ground that it is pending approval of shareholders in Annual General Meeting to be held on 18th September 2013.

Ans: Normally, the dividend is proposed first by Board before adoption of the accounts in AGM. It is the shareholders in AGM who may approve the dividend proposed by BOD. It is also correct that as on the date of balance sheet or subsequent to it, but before approval of the financial statements in AGM, the dividend declaration is a contingent one.

But according to AS 4, Contingencies and Events occurring after the Balance Sheet date, even though certain events occur after balance sheet date, they are included/provided in the accounts because of their special nature or statutory requirement. Schedule VI to the Indian Companies Act, 1956 requires disclosure of proposed dividend specifically.

According to AS 4, the proposed dividend pertaining to the period covered by the financial statements, should be included in the financial statements although they are declared after the approval of the accounts.

In the circumstances, applying the above provisions, the contention of the Financial controller of PQR Ltd. is wrong. Hence proposed dividend should be provided in the books of accounts for the year ended 31-03-2013, as the same is a statutory requirement of the law.

B) Other liabilities in Balance Sheet of DEF Limited include Rs. 15.6 lakhs being the amount of excise duty payable since 1.5.2012 remaining unpaid till 31.3.13. However, the same had been paid by the company on 15.4.2013 upon getting clarification from its advocates that the liability is actually payable by it.

Ans: According to CARO 2003, if any undisputed statutory due like excise duty, income tax etc, is not remitted within due date and is outstanding for more than six months, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

In the present case, the statutory liability has crystallized and is outstanding for more than six months. It is not a disputed liability. It is an undisputed liability about which the company had some doubts.

The fact that it had been since remitted before finalization of accounts would not render the requirement of disclosure in CARO 2003 report. The fact of subsequent remittance may be added after the disclosure of non-remittance in the CARO 2003 report.

C) A company, whose accounting year ends on 31st March, 2012 has placed an order with GM Limited, Chennai for a machinery costing Rs.40 lakhs against cash payment during the month of June, 2012. The company has added a foot-note to the Balance Sheet as at 31st March, 2012 showing separately that a capital contract has been entered into which requires the payment of Rs.40 lakhs in cash.

Ans: The placement of an order for the purchase of a machinery against cash, to be delivered in the next year is a capital commitment and, thus, as such there is no necessity for making a provision in the year of order.

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However, the capital commitment for which no provision is made, the company will have to comply with the disclosure requirements and, thus, a note is to be added to the Notes to the Accounts stating that a capital contract has been entered into which would require the payment of Rs.40 lakhs in cash. It is just nothing but a contingent liability on capital account. Therefore, the treatment accorded by the company is correct.

D) XYZ Ltd. has not deposited provident fund contributions of Rs.45 lakhs to the authorities, but accounted in the books.

Ans: The auditor's report under CARO, 2003 has to specifically state whether the company is regular in depositing provident fund dues with the appropriate authority and, if not, the extent of arrears of provident fund shall be indicated by the auditor. The auditor may also ascertain the period since which dues have not been paid. In this case, the failure of XYZ Ltd. to deposit provident fund of Rs. 45 lakhs will be reported by the auditor in CARO, 2003 issued u/s 227(4A) of the Companies Act, 1956. In indicating the arrears, the period to which the arrears relate should preferably be also given.

24 A) Draft a 'checklist' for carrying out the 'Issue of shares for consideration other than cash.'

Ans: The auditor should ensure the following while auditing 'Issue of shares for consideration other than cash.'

- (i) Study of the contract pursuant to which the issue is made to determine how many shares are agreed to be issued and for what value and the nature and other details of the consideration.
- (ii) Examination of the prospectus to see the substance of the contract and the relevant terms of the issue including the mode of payment of the purchase consideration in case of an issue to a vendor of the business or pay ability of commission to the underwriters or pay ability of the preliminary expenses.
- (iii) Examination of the Board's minutes to see the adoption of the relevant contract, the decision to issue shares for a consideration other than cash and the actual allotment of shares.
- (iv) Verification of the filing of the copy of the contract or the relevant terms of the contract where the contracts is not in writing with the Registrar of Companies within a period of 30 days after the date of the allotment. [as per section 75(1B) of the Companies Act, 1956.]
- (v) Ensuring that proper accounting entry has been passed to record the acquisition of the assets or the business or payment of the expenses (any of these may constitute the consideration) on the one hand and the issue of shares on the other. Incidentally, if any premium or discount is involved, seeing that appropriate adjustment entry has been passed therefor.

Sometimes, in view of the nature of transaction, it may be difficult to know whether an allotment is for cash or for a consideration other than cash, for instance, allotment of shares in adjustment of a debt owed by the company. In such a case, if the allotment is made in adjustment of a bonafide debt payable in money at once, the allotment should be considered as against cash.

This position should be kept in view when inquiring into matters stated in section 227(1A). Again if the shares are allotted on a cash basis, though the amount is actually paid later, it should constitute an allotment against cash.

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B) Draft a comprehensive Audit Programme for auditing the receipt of fees from the students of Professional Institute.

Ans: Audit Programme for Auditing Receipts of Fees from students in a Professional Institute.

- i. Check names entered in the Students Fee Receipts for each term with the respective Registration Register and ensure that all fees have been collected and there is no bogus students.
- ii. Verify that there operates a system of internal check which ensures that demands against the students are properly raised regarding different types of fees.
- iii. Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collection in the Fee Register to confirm that revenue from this source has been duly accounted for.
- iv. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance or in arrears is accounted for accordingly.
- v. Check admission fees with admission slips signed by the head of the institution and confirm that admission fees is credited to Capital Fund.
- vi. Verify free studentships and concessions and ensure that a proper system and authorization exists for such cases.
- vii. Confirm that fines if any have been either collected or remitted under proper authority.
- viii. Ensure that caution money if any is shown as liability.
- ix. Verify the cases of refund of fees.
- x. Verify the cases of very old caution money refunds.
- xi. If fees are increased during the year ensure such increase is properly collected and accounted for.
- xii. Compare broadly the trend of fees receipts of last three years with reference to number of students of respective years.
- xiii. Scrutinise Bank Reconciliation Statement to find out cheques received for fees are not dishonoured.
- xiv. See that the investment representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
- xv. Verify any Government grant with the memo of grant.

25) State the reporting requirements of Company Auditor in respect of the following under CARO-2003?

A) Compliance with special terms.

B) Guarantees for loan taken by others.

C) Financial Management.

D) Sickness.

Ans: A) **Compliance with special terms:**

Whether the provisions of any special statute applicable to chit fund have been complied with, in respect of nidhi, mutual benefit fund or societies –

- (i) Whether the net owned fund to deposit liability ratio is more than 1 : 20 as on the date of Balance Sheet.
- (ii) Whether the company has complied with the prudential norms on income recognition and provisioning against sub-standard, doubtful or lost assets.

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(iii) Whether the company has adequate procedures for appraisal of credit proposals/requests, assessment of credit needs and repayment capacity of the borrower.

(iv) Whether the repayment schedule of various loans granted by the nidhi is based on the payment capacity of the borrower and would be conducive to recovery of the loan amount.

B) Guarantees for loan taken by others:

Whether the company has given any guarantee for loans taken by other from bank, or financial institutions, the terms and conditions where of are prejudicial to the interest of the company.

C) Financial Management:

Whether the funds raised on short term basis have been used for long term investment and vice-versa, if yes, the nature and amount is to be indicated.

D) Sickness :

Where in case of a company which has been registered for a period not less than 5 years, its accumulated losses at the end of the financial year not less than 50% of its net worth and whether it has incurred cash losses in such financial year and in the financial year immediately proceeding such financial year also.

26 A) As an internal auditor for a large manufacturing concern, you are asked to verify whether there are adequate records for salary and wage administration.

Ans: The points to be considered while conducting internal audit in connection with Salary and Wage administration may be as follows:

- (i) Check the records, appointment letters, personal files etc. for examining authorization for employment and rates of pay dearness and other allowances should also be checked as to whether revision in rates of pay or increments are properly authorised. In case the dearness allowance is based on cost of living index, examine whether such DA has been calculated correctly.
- (ii) Check whether deductions from pay roll are properly authorized.
- (iii) Check the correctness in recording attendance and time shown as spent on jobs whether some production bonus etc. might have been billed for.
- (iv) Examine the accuracy of records starting with engagement of workers and ending with disbursements of salaries etc.
- (v) Examine whether the employment, rates of pay, promotions and increment are in agreement with the policy declared by the company.
- (vi) Check the clock-cards with the total number of workers on the pay roll.
- (vii) Check the hours shown in the clock-cards with the hours as per timecards or job cards.
- (viii) As a test-check, physically verify the number of workers when they are at work in a department and see whether the same tallies with the pay roll and the employments records.
- (ix) In case there is an incentive scheme, examine the procedure and control thereof. Check the incentive payments with production/sales figures.
- (x) Examine the leave records and see whether the leave has been duly sanctioned.
- (xi) Examine the authority and responsibility in sanctioning overtime, study whether the overtime payment is

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justified. Examine whether overtime has been properly accounted for. See, whether the overtime expenditure has remained within the budget provision.

- (xii) See, whether there is compliance with the provisions of the statutory laws and rules like Factory's Act, Minimum Wages Act, Industrial Disputes Act, Payment of Wages Act, Payment of Bonus Act, Workmen's Compensation Act etc.
- (xiii) Is the payroll prepared well in time? Is their proper coordination between the accounts department, pay roll section, personnel section and production department ?
- (xiv) Check whether proper record is kept with regard to unpaid wages. See whether the subsequent payments are properly controlled and accounted for.
- (xv) Find out the reasons for significant variation between actual cost and budgeted cost.
- (xvi) Examine the procedure for termination of employment either by resignation, discharge, retirement etc. See whether the names of such employees are eliminated from the records to avoid their inclusion in the pay roll, examine also the final settlement made in such cases.
- (xv) Study (if desired by management) the extent of mechanization of accounting possible, in case of pay roll. In case there is the existence of mechanization, study its correctness. The Internal Audit may also conduct " O & M" study if so desired by the management provided it is equipped for the purpose. The study may include the improvement of the following by changing work flow, mechanization etc. Pay roll form, recording by production department, time-office etc., collection of data for management from primary records etc.

B) What do you understand by Internal checks?

Ans: Internal check means checks on day-to-day transactions which operate continuously as part of the routine system whereby work of one person is proved independently or is complimentary to the work of another person. The object of internal check is prevention or early detection of fraud or error. Internal check is the part of internal control system and operates as a built-in device as far as the staff organization and job allocation aspects of the control system are concerned. The system in accounting implies organization of system of book keeping and arrangement of staff in such a manner that no one person can completely carry through a transaction and record every aspect thereof. Essential elements of a good internal check systems are:

- (i) Existence of checks on the day-to-day transaction.
- (ii) System operates continuously as a part of the routine system.
- (iii) Work of each person is either proved independently or is made complementary to the work of another.

The objective of internal checks is to prevent and speedy detection of frauds, wastes and errors.

27A)What are the main points involved in 'Performance Audit' under Government Accounting system?

Ans: Performance audit refers to an examination of a program, function, operation or the management systems and procedures of a governmental or non-profit entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources. The examination is objective and systematic, generally using structured and professionally adopted methodologies.

The scope of audit has been extended to cover efficient, economy and effectiveness audit or performance audit.

Efficiency audit look into whether various schemes/projects are executed and their operations conducts economically & see that amount spent gives expected result & projects carried out in an economical manner.

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Economy aspect looks whether government has acquired financial, human and physical resources in an economical manner and that sanctioning and spending authority have observed economy.

Effectiveness looks into appraisal of performance of programmes, schemes, projects with overall targeted objectives.

Efficiency cum performance audit is examination of Financial & operational aspect of performance.

The performance audit involves preliminary study, planning & execution of audit & reporting.

B) Write a short note on- Permanent Audit File.

Ans: In the case of recurring audits, some working paper files may be classified as permanent audit files. Normally, auditor may consider classifying such papers as permanent which are required in case of recurring audit assignments. This file contains paper of continuing importance to succeeding audits. A permanent audit file normally includes :

- ◆ Information concerning the legal and organisational structure of the entity. In the case of a company, this includes the Memorandum and Articles of Association. In the case of a statutory corporation, this includes the Act and Regulations under which the corporation functions.
- ◆ Extracts or copies of important legal documents, agreements and minutes relevant to the audit.
- ◆ A record of the study and the evaluation of the internal controls related to the accounting system. This might be in the form of narrative descriptions, questionnaires or flow charts, or some combination thereof.
- ◆ Copies of audited financial statements for previous years.
- ◆ Analysis of significant ratios and trends.
- ◆ Copies of management letters issued by the auditor, if any.
- ◆ Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.
- ◆ Notes regarding significant accounting policies.
- ◆ Significant audit observations of earlier years.

28 A) In determining whether to use Computer Assisted Auditing Techniques (CAATs), what are the factors that an auditor has to consider?

Ans: In determining whether to use CAATs, the auditor should consider the following factors:

- (i) *Availability of sufficient IT knowledge and expertise:* It is essential that members of the audit team should possess sufficient knowledge and experience to plan, execute and use the results of CAAT. The audit team should have sufficient knowledge to plan, execute and use the results of the particular CAAT adopted.
- (ii) *Availability of CAATs and suitable computer facilities and data in suitable format:* The auditor may plan to use other computer facilities when the use of CAATs on an entity's computer is uneconomical or impractical, for example, because of an incompatibility between the auditor's package programme and entity's computer.
- (iii) *Impracticability of manual tests due to lack of evidence:* Some audit procedures may not be possible to perform manually because they rely on complex processing (for example, advanced statistical analysis) or involve, amounts of data that would overwhelm any manual procedure.

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- (iv) *Impact on effectiveness and efficiency in extracting a data:* It includes selection of samples, applying analytical procedures, time involved in application of CAAT, etc.
- (v) Time constraints in certain data, such as transaction details, are often kept for a short time and may not be available in machine-readable form by the time auditor wants them. Thus, the auditor will need to make arrangements for the retention of data required, or may need to alter the timing of the work that requires such data.

B) Briefly discuss the framework on which the auditor should work for the audit of Computer Security.

Ans: A framework on which the auditor should work for the audit of computer security is given below:

(i) Types of Errors and Fraud

- Theft of or accidental or intentional damage to hardware and files.
- Loss or theft of or unauthorized access to programs, data files, and other system resources.
- Loss or theft of or unauthorized disclosure of confidential data.
- Unauthorized modification or use of programs and data files.
- Interruption of crucial business activities.

(ii) Control Procedures

- Information security/protection plan.
- Restrictions on physical access to computer equipment.
- Logical access controls based on password protection and other authentication procedures.
- Data storage and transmission controls such as encryption.
- Virus protection procedures.
- File backup and recovery procedures.
- Fault-tolerant systems design.
- Disaster recovery plan.
- Preventive maintenance.
- Firewalls.
- Information systems insurance.

(iii) Audit Procedures : System Review

- Inspect computer sites.
- Interview IS personnel about security procedures
- Review written documentation about physical access policies and procedures
- Review logical access policies and procedures.
- Review file backup and recovery policies and procedures
- Examine data storage and transmission policies and procedures.
- Review procedures employed to minimize system downtime.

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- Examine system access logs.
- Examine disaster recovery plan.
- Examine casualty insurance policies.

(iv) Audit Procedures : Tests of Controls

- Observe computer site access procedures.
- Observe the preparation and off-site storage of backup files.
- Review records of password assignment and modification.
- Investigate how unauthorized access attempts were dealt with.
- Verify the extent of data encryption use.
- Verify the effective use of data transmission controls.
- Verify the effective use of firewalls.
- Verify the effective use of virus protection procedures.
- Verify the use of preventive maintenance and uninterruptible power.
- Verify amounts and limitations on insurance coverage.
- Examine the results of test simulations of disaster recovery plan.

(v) Compensating Controls

- Sound personnel policies.
- Effective user controls.
- Segregation of incompatible duties.

29 A) Distinguish between qualified opinion and disclaimer of opinion with regard to audit report.

Ans: Qualified reports is issued by an auditor when the auditor is not satisfied as to the truth and fairness of the accounts in certain respects which are reserved and so indicated in his report. Such reservations or exceptions are called qualifications. The auditors reports that the accounts do exhibit true and fair view of the affairs and financial status subject to or except the matters of reservations. Such type of reporting is called qualified report. In majority of cases, items which are the subject matter of qualification, are not so material as to affect the truth and fairness of the whole of the accounts but merely create uncertainty about a particular item. In case of companies , this is a legal requirement under section 227(4) of the Companies Act which provides that where the auditors answer any of the statutory affirmations in the negative or with a qualification, their report shall state the reasons for such answers.

The auditor while performing his work may come across several instances where he fails to obtain sufficient information to warrant an expression of opinion, and, thus, is unable to form an opinion, he issues a disclaimer of opinion.

Accordingly, the auditor may state that he is unable to express an opinion because he has not been able to obtain sufficient and appropriate audit evidence to form an opinion.

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The necessity of a disclaimer of opinion may arise due to many reasons such as the scope of examination is restricted or in certain circumstances the auditor may not have access to all the books of account for certain reasons, e.g., books are seized by excise authorities or destroyed in fire, etc.

Another instance may be that an auditor is not permitted to verify inventory at location outside the city in which the company's office is located, it amounts to restriction on the scope of the duties of an auditor.

In both the types of cases the auditor may state that he is unable to express an opinion because he has not been able to obtain sufficient audit evidences to form an opinion.

It is but natural that the auditor must make all efforts to verify and substantiate the events. In case he is unable to obtain audit evidence even from alternative sources, then the auditor can only state that he is unable to form an opinion.

B) What do you understand by - the Cut-off Transactions relating to Inventories?

Ans: Cut-off transactions imply a set of procedures applied to ensure separation of one year's transaction from those of the following year. An auditor is expected to devote his attention to the procedures followed by the management regarding cut-off. The auditor should satisfy himself that these procedures adequately ensure that (i) goods purchased for which properly has passed to the client have in fact been included in the inventories and that the liability has been provided for; and (ii) goods sold have been excluded from the inventories and credit has been taken for the sales.

30 A) Write short note on Management Audit process.

Ans: The management audit process may be summed up as follows:

i).Agreeing the parameters:

In consultation with the client, a format is designed which will meet the specific objectives of the Business , and this will cover who should be included in the audit, and the information which will help the business understand the management resource, and manage any potential risk to the business.

ii).Management assessment:

Using management auditor's expertise as business psychologists, and understanding of the qualities needed to make an impact at top management level, the auditor will interview and psychometrically profile designated members of the management team. The assessment process will explore issues in relation to judgment and problem-solving, team leadership, impact and influence, delivery and execution, and capacity to provide strategic leadership.

iii.)Internal Management Audits :

For certain assignments, which involve an internal management audit, the management auditor might also include feedback to collate the perceptions of colleagues on some of the key issues which he believes will impact on the success of the organisation.

iv.)Reporting the conclusions:

The auditor will produce individual management assessment capability profiles, consolidating the information gained from the various sources of information. The profiles will include summaries of the 'pros' and 'cons' in relation to the organisation and its needs. Where requested, auditor will provide strategic recommendations on the deployment of the talent and experience available, and will also provide 'signposts' on how each individual can optimise their contribution to the business and stretch their performance.

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B) What are the obvious assertions in the following items appearing in the Financial Statements?

- (i) Profit and Loss Statement: Travelling Expenditure Rs.75,000
- (ii) Balance Sheet - Debtors Rs.5,00,000

Ans: (i) Travelling Expenditure: Rs.75,000

- ◆ Expenditure has been actually incurred for the purpose of travelling.
- ◆ Travelling has been undertaken during the year under consideration.
- ◆ Total amount of expenditure incurred is Rs.50,000 during the year.
- ◆ It has been treated as revenue expenditure and charged to profit and loss account.

(ii) Debtors: Rs.5,00,000

- ◆ These include all sales transaction occurred during the year.
- ◆ These have been recorded properly and occurred during the year
- ◆ These constitute assets of the entity.
- ◆ These have been shown at proper value, i.e. after showing the deduction on account of provision for bad and doubtful debts.

