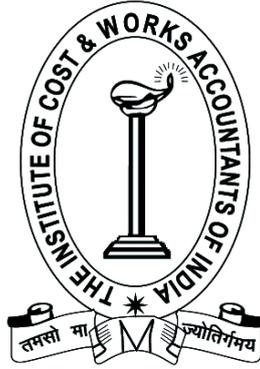


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DECEMBER 2010

GROUP I



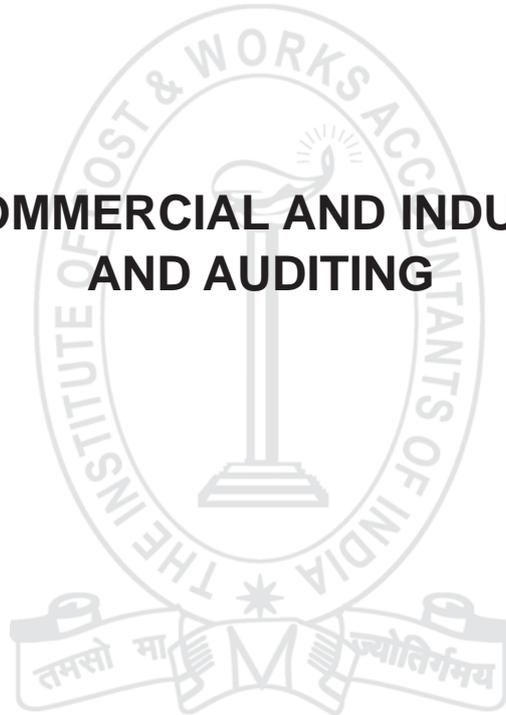
DIRECTORATE OF STUDIES

THE INSTITUTE OF
COST AND WORKS ACCOUNTANTS OF INDIA

12, SUDDER STREET, KOLKATA-700 016

GROUP - I

Paper-6 : COMMERCIAL AND INDUSTRIAL LAW AND AUDITING



INTERMEDIATE EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - I

Paper-6 : COMMERCIAL AND INDUSTRIAL LAW AND AUDITING

SECTION - I

(Commercial and Industrial Law)

Q. 1. Comment on the following statements based on legal provisions :

- (a) A lost his dog. He sent his servant to search the dog. When he did not hear about the lost dog, he advertised a reward of ₹ 500 to any person who found the lost dog and returned it to A. The servant found the lost dog and returned the dog to A. When the servant came to know about the reward, he claimed the reward from A. Can he claim the reward? Give reasons.
- (b) A is sixteen years of age. He lends ₹ 1 lac to B on the strength of a mortgage executed in his favour. Is the borrower liable to repay the money? Give reasons.
- (c) Can a minor appoint an agent?
- (d) Does the endorsement of a Railway Receipt amount to Transfer of Ownership?
- (e) What is 'Caveat Emptor'?
- (f) Gratuity can be attached by an order of the court.
- (g) Eligibility to Bonus depends on the period of actual service.
- (h) It is illegal to pay gratuity in excess of the limits prescribed in the Payment of Gratuity Act.
- (i) As per Industrial Disputes Act, 1947, the Charitable Institutions are not industry.
- (j) Bonus is payable only if there is profit.
- (k) A drew cheques in favour of B. A's clerk forged B's endorsement and negotiated the cheques to C who took them in good faith and for value. C received payment of the cheques. A claims to recover the amount from C. will he succeed?

Answers 1.

- (a) No, the servant cannot claim the money. He acted without any information as to the offer. A person cannot 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 Dutt.
- (b) Yes, A can recover the money from B. Though a contract with a minor is *void ab initio*, he is allowed to be a beneficiary in a transaction and enforce his claim. The basic logic is that a contract with a minor has been kept void only to protect his interest and not to prejudice his interest.
- (c) Section 183 of the Indian Contract Act permits only persons of the age of majority to employ an agent. Thus, a minor cannot appoint an agent.

- (d) The question was raised in a Bombay case of *Shamji v. N . W. Rly.*. The High Court, in the case, ruled that endorsing a railway receipt in favour of another does not by itself, pass property in the goods to the endorsee. It merely constitutes the endorsee the agent of the consignor, to receive the goods. Such an endorsement by itself, does not constitute the endorsee either a bona fide pledge or transferee for value of the goods represented by the railway receipt.
- (e) Caveat Emptor is the fundamental principle of the law of sale of goods. It means 'buyers beware' or 'caution buyer' (i.e. let the buyer beware). In the other words, it is no part of the seller's duty to point out defects of his own goods. The buyer must inspect the goods to find out if they will suit his purpose. He must buy goods after satisfying himself about quality, suitability etc. If he makes a bad choice, he cannot blame the seller.
- (f) No gratuity payable under the Act and no gratuity payable to an employee in any establishment, factory, mine, oilfield, plantation, port, railway company or shop exempted under Section 5 shall be liable to attachment in execution of any decree or order of any Civil, Revenue or Criminal Court.
- (g) Eligibility to Bonus amount depends on the actual period of service of an employee provided he has worked for a minimum number of 30 days in a year. Sanctioned leave is treated as actual service.
- (h) False, The Payment of Gratuity Act specifies the minimum amount of gratuity payable but the right of an employee to receive better terms of gratuity under any award, or agreement or contract with the employer is protected.
- (i) As per Industrial Disputes Act institutions owned or managed by organisations wholly or substantially engaged in any charitable, social or philanthropic service are not covered in the definitions of "Industry".
- (j) False- The Payment of Bonus Act, 1965 provides for minimum bonus of 8.33% even if a unit makes loss.
- (k) In his claim to recover the amount from C, A will succeed if the cheque was an order cheque, but fail if the cheque was payable to bearer.

Indian Contract Act, 1872 :

- Q. 2. (a) An employee agrees not to institute any legal proceedings against his employer. Can the agreement be enforced by the employer?**
- (b) "A mere mental acceptance not evidenced by words or conduct is, in the eyes of the law, no acceptance." Comment.**
- (c) Write a note on 'Counter Offer'.**
- (d) Distinguish between an 'agent' and a 'servant'.**

Answer 2.

- (a) No, such an agreement is *void ab initio* since it constitutes restraint of legal proceedings. Section 28 of the Indian Contract Act, in this regard, provides that every agreement by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals or which limits the time within which he may thus enforce his rights, is void to that extent.
- Thus, the agreement is question shall be void as per Section 28 and hence the employer will not be in a position to enforce the agreement.
- (b) One of the rules of valid acceptance is that it must be communicated to the offeror. The communication may, however, be express or implied. A mere, mental acceptance is no acceptance. A mere mental acceptance means that the offeree is assenting to an offer in his mind only and has not communicated it to the offeror.

- (c) Where the offeree, instead of unconditionally assenting to the terms of the offer, accepts subject to certain conditions, he is said to have made a counteroffer.

Thus, where A offers his car to B for ₹ 1,00,000 and B accepts to buy A's car for ₹ 80,000, B has made a counter offer.

A counter offer has the effect of terminating the original offer. If in the aforesaid illustration, B later accepts to pay ₹ 1,00,000 for the car, it shall amount to a fresh offer by B which A may or may not accept.

Similarly, where an offeree agreed to accept half the quantity of goods offered by the offeror on the same terms and conditions as would have applied to the full contract, it was held that there was no contract as there was a counter offer to the original offer.

- (d) There is too much of similarity between an agent and a servant as both are employed to act for and on behalf of principal. However, there is a lot of difference between the two. An agent has the authority to create contractual relationship between the principal and a third party, but a servant ordinarily has no such authority. A servant usually serves only one master but an agent may work for several principals at the same time. A servant is generally paid salary or wages, whereas an agent may be paid on commission basis. Thus, we find that an agent is not a servant though a servant may be authorized to serve as an agent.

Q. 3. Write short notes on :

- (a) Bailee's Lien
- (b) Essentials of a valid acceptance.
- (c) Position of the finder of lost goods.
- (d) Personal liability of agent.

Answer 3. (a)

Bailee's right of lien is particular in certain cases whereas general in other cases.

Particular Lien is conferred upon a bailee by virtue of the provision of Section 170. It reads :

'Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the service he has rendered in respect of them.'

General Lien : The provisions of Section 171 empower certain categories of bailees to exercise a general lien. These include : bankers, factors, wharfingers, attorneys of High Court and policy brokers. These bailees can retain all goods of the bailor so long as anything is due to them, unless there is a contract to the contrary.

Answer 3. (b)

Essentials of a valid acceptance :

- (i) Acceptance must be absolute and unqualified.
- (ii) It must be communicated.
- (iii) It must be according to the mode prescribed.
- (iv) It must be given within the time prescribed or within reasonable time.
- (v) It must be in response to offer.
- (vi) It must be made before the offer lapses.
- (vii) It must be given by the person to whom the offer is made.

Answer 3. (c)

Finding is not keeping. A finder of lost goods is treated as the bailee of the goods found and is, therefore, charged with the responsibilities of a bailee, besides the responsibility of exercising reasonable efforts in finding the real owner. However, he enjoys certain rights also. His rights may be summed up hereunder :

1. *Right to retain the goods* (Section 168). A finder of lost goods may retain the goods until he receives the compensation for money spent in preserving the goods and/or amount spent in finding the true owner. A finder, however, cannot sue for such compensation. But, where a specific reward has been offered by the owner for the return of lost goods, the finder may sue for such reward, and may retain the goods until he receives it.
2. *Right to sell* (Section 169). When a thing which is commonly the subject of sale is lost, if the owner cannot, with reasonable diligence, be found or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it :
 - (a) When the thing is in danger of perishing or of losing the greater part of the value; and
 - (b) When the lawful charges of the finder in respect of the thing found, amount to 2/3 of its value.

Answer 3. (d)

The general rule is that only the principal can enforce, and can be held liable on a contract entered into by the agent except when there is a contract to the contrary. Sec. 230 of the Contract Act clearly lays down this rule: "In the absence of any contract to that effect, an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them."

An agent is, however, personally liable in the following cases :

1. **When the contract expressly provides.** A person while entering into a contract with an agent may expressly stipulate that he would hold the agent personally liable in case of breach of contract, and if the agent agrees to it, he is personally liable.
2. **When the agent acts for a foreign principal** (Sec. 230, para 2). When the contract is made by an agent for the sale or purchase of goods for a merchant residing abroad, the agent is personally liable. He can exclude his personal liability by express provision to this effect in the contract. If he does so, he cannot be sued on the contract.
3. **When he acts for an undisclosed principal** (Sec. 230, para 2). Where an agent acts for an undisclosed principal, he is personally liable though the principal, on being discovered by the third party, is also liable.
4. **When he acts for a principal who cannot be sued** (Sec. 230, para 2). Where the principal is incompetent to enter into a contract, e.g., where he is a minor or an idiot, the agent is personally liable as the credit is presumed to have been given to the agent and not to the principal.
5. **Where he signs a contract in his own name.** An agent who signs a contract in his own name without qualification (i.e., without disclosing that he is acting as an agent), though known to be an agent, is understood to have contracted personally, unless a contrary intention appears from the body of the instrument.
6. **Where he acts for a principal not in existence.** This is a rather peculiar case. The promoters of a company, yet to be incorporated, sometimes enter into contracts on behalf of the company, though in such a case the alleged principal (i.e., the company) has no legal existence till the time of incorporation. In such a case the promoters are held to have contracted on their own account and are personally liable.
7. **Where he is liable for breach of warranty of authority.** Where a person professes to act as an agent but has no authority from the alleged principal or exceeds his authority, he is personally liable for breach of warranty of authority in a suit by the third party with whom he professed to make the contract [*Cohen v. Wright*, (1857) 7 E. & B. 301].

8. **Where he receives or pays money by mistake or fraud.** Where an agent receives money from a third party by mistake or fraud, he is personally liable to the third party. Likewise, he has the right to sue the third party for the recovery of the money where he has paid it by by mistake or under fraud of the third party.
9. **Where his authority is coupled with interest.** When an agent has an interest in the subject matter of the contract entered into by him with a third party, his authority is coupled with interest. He has, in such a case, the right to sue, or be sued, but only to the extent of his interest in the subject-matter.
10. **Where the trade usage or custom makes him personally liable.** Where there is a trade usage or a custom making the agent personally liable, he is liable unless there is a contract to the contrary.
- Q. 4. (a) A's wife B paid ₹ 500 to C to be given as a bribe to a jailor for procuring release for her husband from jail. The Jailor failed to procure the release. Can B recover the amount ?**
- (b) Mr. Pal of his own promised to subscribe to Indira Gandhi Memorial Fund by 30.04.2010, but did not pay. Under the circumstances, he can be enforced – Comment.**
- (c) Mr. X forced Mr. Y to sale Y's house to Mr. Ex at ₹ 5 lakhs, the market price of which was ₹ 15 lakhs.**
- (d) Distinguish between Indemnity and Guarantee.**

Answer 4. (a)

An agreement will not be enforceable if its object or the consideration is unlawful. According to Section 23 of the Act, the consideration and the object of an agreement are unlawful if the court regards it as immoral or opposed to public policy, an agreement whose object or consideration is immoral or is opposed to the public policy, is void.

In the given case, as the agreement is unlawful, being opposed to public policy, is void. So, B cannot recover the amount.

Answer 4. (b)

False. Consideration is essential element of contract without which no promise can be enforced. Therefore a gratuitous promise to contribute to Indira Gandhi Memorial Fund can not be enforced. However if the promisor knew the purpose and also knew that on the faith of such promise, certain obligations are incurred, the promisor would be bound by the promise.

Answer 4. (c)

It is a case of voidable contract. In this case Mr. Y at his option can avoid the contract. However if 'Y' wants he can enforce it against Mr. 'X'.

Answer 4. (d)

A contract by which one party promises to another to compensate him for loss is a contract of Indemnity. A contract to perform the promises or discharge the liability is a contract of Guarantee.

Basic points of differences are

Indemnity	Guarantee
There are two parties viz. the indemnifier and the indemnified.	There are three parties viz. the creditor, the principal debtor and the surety (or Guarantor)
Indemnifier's liability is primary and independent.	Surety's liability is secondary i.e. it arises only on default of principal debtor.
Indemnifier's right is contingent.	Surety's liability is subsisting.
It is a simple contract i.e. one contract.	It is composite in nature i.e. 3 contracts.

Indemnity	Guarantee
It is for the reimbursement of the loss if any on the happening of a contingency.	It is for the security of the creditor, Guaranteed by the surety of an existing debt.
The indemnifier cannot sue the third party in his own name unless there is an assignment in indemnifier's favour. If there is no such assignment, the indemnifier must bring the suit in the name of indemnified.	The surety can proceed against the principal debtor in his own right.

- Q. 5. (a)** A sells his grocery business, including goodwill, to B for a sum of ₹ 50,000. It is agreed that A is not to open another grocery store in the whole of India for the next ten years. A opens another store in the same city two months later. What are the rights of A?
- (b)** A made a contract with B supplying to him certain goods at a place outside the State when there was no prohibition against sending the goods outside the State. Subsequently prohibition was imposed on the sending on those goods to that place and the railway booking was consequently closed. A failed to supply the goods. B sued A for damages for non-supply of goods. A, inter alia, pleaded that the contract becomes impossible of performance and so he was absolved from performing it. Will A succeed in his said defense?
- (c)** A, B and C jointly promise to pay D ₹ 5,000. A and B are untraceable. Can D compel C to pay him in full?
- (d)** A promises to sell and deliver on the 5th of January a lorry to B. The parties have stipulated that time should be the essence of the contract. A delivers the lorry only on the 5th of February. Explain what are the rights of B against A in this case. Suppose B desires to accept the belated delivery and also to claim compensation for loss occasioned by the non-performance of promise at the time agreed. Advise B as to whether he can achieve these two objectives.

Answer 5. (a)

As per Section 27 of The Indian Contract Act, every agreement, by which anyone is retained from exercising a lawful profession, trade or business of any kind, is to that extent void. Exception to Section 27 provides that the seller of the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within local limits, so long as the buyer or any one deriving title to the goodwill from him carries on alike business, provided that such limits are reasonable.

In the given case, as the limits agreed regarding place as well as time is not reasonable, the agreement is void. So, B cannot take any legal action against A.

Answer 5. (b)

According to Section 56, impossibility of performance may fall into either at the time of agreement or arising subsequent to the formation of contract. Impossibility which arises subsequent to the formation of a contract (which could be performed at the time when the contract was entered into) is called post-contractual or supervening impossibility. In such a case, the contract becomes void when the act becomes impossible or unlawful. Impossibility of performance of a contract, as a general rule, is no excuse for the non-performance of the contract, but where this impossibility is caused by the circumstances beyond the control of the parties, the parties are discharged from further performance of the obligation under the contract.

In the given case, the contract is void and A is absolved from performing it.

Answer 5. (c)

As per Section 43 of The Indian Contract Act when two or more persons make a joint promise and there is no express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise. This means the liability of joint promisors is joint and several.

So, in the given case, D can compel C to pay him in full.

Answer 5. (d)

In a contract, in which time is of the essence of the contract, if there is a failure on the part of the promisor to perform his obligation within the fixed time, the contract (or so much of it as remains unperformed) becomes voidable at the option of the promisee (Sec. 55, para 1). If, in such a case, the promisee accepts performance of the promise after the fixed time, he cannot claim compensation for any loss occasioned by the non-performance of the promise at the agreed time. But if at the time of accepting the delayed performance, he gives notice to the promisor of his intention to claim compensation, he can do so (Sec. 55, para 3).

In the given case B can repudiate the contract. In the latter case, B may accept the delivery and also claim compensation if he gives notice of his intention to do so.

Q. 6. (a) A agrees to sell to B a horse for ₹ 20,000 if it wins a race and for ₹ 500 if it does not. The horse wins the race. Advise the parties if —

- i. B refuses to pay ₹ 20,000 and buy the horse
- ii. A refuses to sell the horse to B
- iii. B agrees to buy the horse for ₹ 10,000

(b) A sold some land to B. At the time of sale both parties believed in good faith that the area of the land sold was 10 hectares. It, however, turned out that the area was 7 hectares only. How is the contract of sale affected? Given reasons.

(c) H who was badly in need of money offered to sell his piano worth ₹ 5,000 to C for ₹ 4,000. C refused to buy. H gradually lowered his price until ₹ 1,000 was reached, which C accepted. Before the piano was delivered, H received an offer of a larger sum from T, and he refused to carry out the contract with C, claiming that the consideration was inadequate. Is H liable to pay damages to C for failure to carry out his part of the contract?

(d) A offers, by a letter, to sell a certain articles to B who receives the letter the next day. B immediately posts his letter of acceptance. The same evening A posts a letter revoking the offer. A's letter of revocation and B's letter of acceptance cross in the post. Is there a contract between A and B?

Answer 6. (a)

A wager is an agreement between two parties by which one promises to pay money or money's worth on the happening of some uncertain event in consideration of the other party's promise to pay if the event does not happen. As per Section 30 no suit can be brought for recovering anything alleged to be won or any wager, or entrusted to any person to abide by the result of any game or other uncertain event on which any wager is made.

In the given case, as the agreement is a wager, the effect will be as follows :

- i. A cannot compel B to buy the horse and pay ₹ 20,000
- ii. B cannot compel A to sell the horse
- iii. A is not bound to sell the horse.

Answer 6. (b)

Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, there is a bilateral mistake. In such a case, the agreement is void (Sec. 20). The following two conditions have to be fulfilled for the application of Sec 20.

- i. The mistake must be mutual
- ii. The mistake must relate to a matter of fact essential to the agreement.

As Sec 20 is applicable on the given case, the agreement is void.

Answer 6. (c)

Consideration means “something in return”. This something in return need not necessarily be equal in value to “something given”. So long as consideration exists, the Courts are not concerned as to its adequacy, provided it is of some value. The adequacy of the consideration is for the parties to consider at the time of making the agreement, not for the Court when it is sought to be enforced. Consideration must, however be something to which the law attaches value though it need not be equal in value to the promise made. In the given case, H is liable to pay damages to C for failure to carry out his part of the contract though the consideration is inadequate.

Answer 6. (d)

The communication of a proposal (offer) is complete when it comes to the knowledge of the person to whom it is made (Sec. 4). The communication of an acceptance is complete – as against the proposer when it is put into a course of transmission to him, so as to be out of the power of the acceptor.

In the given case, as B receives the letter sent by A the next day, the offer is complete. And as B posts his letter of acceptance immediately, the acceptance is complete as against A. So, there is contract between A and B.

Sale of Goods Act, 1930 :

Q. 7. (a) Rama bought a refrigerator from M/s. Ananda Enterprises for a sum of ₹ 12,000. The Refrigerator was defective right from the beginning and it did not work inspite of repairs by the expert mechanics. Rama wants to return the refrigerator to M/s. Ananda Enterprises and claim refund. Explain.

(b) A purchased a car from B who had no title to it. A used the car for several months. After that, the true owner spotted the car and demanded it from A – Discuss the remedies available to A.

(c) X of Delhi orders Y of Madras, to deliver certain goods to him at Delhi. While the goods are lying at the Delhi Railway Station, the Station Master informs X that the goods are held at the Station at X's risk. But X has become insolvent. Has Y any right over the goods as an unpaid seller?

(d) What are the exceptions to the doctrine of Caveat Emptor?

Answer 7. (a)

Rama shall be entitled to return the refrigerator and claim refund. According to Section 16(2) of the Sale of Goods Act, unless otherwise agreed upon, every contract of sale of goods is subject to the condition as to merchantability, i.e., the goods must be capable of being used as the goods of that description. Thus, a refrigerator is expected to function as a refrigerator. Where it fails to, as in the present case, there is deemed to be breach of that condition and as such, return of price shall have to be made.

Answer 7. (b)

As per Section 14(a) of The Sale of Goods Act, 1930 in a contract of sale unless the circumstances of the contract are such as to show a different intention is an implied condition on the part of the seller that in the case of a sale, he has a right to sell the goods.

In the given case, A was bound to hand over the car to its true owner and A could successfully sue B, the seller without title, for the recovery of the purchase price even though several months had passed.

Answer 7. (c)

Y, in the given case, has lost his right of stoppage in transit, the intimation by the Station Master that the goods are held at the station at X's risk, has transformed the positions of the Station Master into a bailee of X instead of Y. The transit has thus come to an end [Sec. 51(31)]. An unpaid seller can stop the goods in transit in the event of buyer's insolvency. The transit being over, the right is thus lost.

Answer 7. (d)

The doctrine of "*Caveat Emptor*" is subject to the following exceptions :

1. Where the seller makes a false representation and buyer relies on that representation. The rule of "*Caveat Emptor*" will not apply and the buyer will be entitled to the goods according to that representation.
2. Where the seller actively conceals a defect in the goods, so that on a reasonable examination the same could not be discovered.
3. Where the buyer makes known to the seller the purpose for which he is buying the goods, and the seller happens to be a person whose business is to sell goods of that description, then there is an implied condition that the goods shall be reasonably fit for such purpose. The rule *Caveat Emptor* will not apply.
4. In case of sale by description, there is implied condition as to their being of merchantable quality. However, if the buyer has examined the goods, this condition of "*merchantability*" extends only to hidden or latent defects. The defects which examination ought to have revealed are not covered, i.e., the rule of *Caveat Emptor* will be applicable.

Q. 8. (a) "Only the owner of goods can transfer a good title". What are the exceptions to this rule?

(b) B selects certain furniture in a shop. The price is settled. He arranges to take delivery of the furniture the next day and agrees to pay on the first of the next month. The furniture was destroyed by fire the same evening. Is B liable to pay the price? Give reasons.

(c) A agrees to sell to B his two second-hand cars on the terms that the price was to be fixed by C. B takes delivery of one car immediately. C, however, refuses to fix the price. A asks for the return of the car already delivered whereas B insists on the delivery of the second car to him for a reasonable price of both the cars. Decide.

(d) When an unpaid seller's lien is lost?

Answer 8. (a)

There are several exceptions to the said rule. They are laid down by Sections 27 to 30 and are as follows :

Sale by Mercantile Agent. In case of sale by a mercantile agent who is in possession of either the goods or documents of title to the goods with the consent of the owner and sells the goods in the ordinary course of business as a mercantile agent, the buyer gets a good title to the goods provided he buys them in good faith and for value.

Sale by a Joint-owner. Where one of several joint owners of goods has the sole possession thereof, with the consent of the others, any purchaser from such person, for value without notice at the time, of the seller's want of authority to sell, acquires a good title thereto against the other joint-owners.

Sale by a Person in Possession under a Voidable Contract. A person who has obtained possession of goods under a contract which is voidable on the ground of fraud, misrepresentation, coercion, or under influence, can convey a good title, provided the sale takes place before the voidable contract is avoided (Section 29).

Sale by the Seller in Possession of Goods after Sale. Where a seller having sold goods, continues in possession thereof or of documents or title to the goods, the delivery or transfer by such person or by a mercantile agent acting for such person, of the same, by way of sale, pledge or other disposition, will pass

a good title to the transferee, if such latter person has acted in goods faith and without notice of the previous sale (Section 30).

Sale by buyer in Possession of Goods. Where a person having bought or agreed to buy obtains, with the consent of the seller, possession of the goods or of the documents of title to the goods. The delivery or transfer by such person or by a mercantile agent acting for such person, of the goods or documents, by way of sale, pledge or other disposition thereof will be valid and effective, if the person receiving the same, acted bona fide and without notice of the seller's lien, if any [Section 30 (2)].

Sale by an unpaid seller. According to Section 54 (3), an unpaid seller of goods who has exercised his right of lien or stoppage in transit can, even though the ownership in them has passed to the buyer, resell the goods and convey a valid title to another buyer, though no notice of re-sale has been given to the original buyer.

Sale by a finder of lost goods under section 169 of the Indian Contract Act.

Sale by a pledgee under section 176 of the Indian Contract Act.

Sale by an Official Receiver or Official Assignee or Liquidator.

Answer 8. (b)

Yes, B is liable to pay the price, the contract being an unconditional contract for the sale of specific goods in a deliverable state. In the case of specific goods, in a deliverable state, property in them passes at the time when the contract (unconditional) is made (Section 20). The fact that the time of payment or the delivery of the goods, or both, is postponed does not affect the passing the property.

Answer 8. (c)

As per Section 10 of The Sale of Goods Act, in case price is left to be fixed by the valuer and the valuer fails to fix the price, the agreement becomes void except as to part of goods delivered and accepted regarding which the buyer is bound to pay a reasonable price. If however, one of the parties prevents the 'valuer' from making the valuation, he would be liable to pay damages to the other contracting party.

In the given case, B shall have to pay for the car already delivered a reasonable price. A cannot ask for its return. As regards the second car, B cannot insist on its delivery to him since the contract has become void.

Answer 8. (d)

An unpaid seller loses his lien in the following cases :

- (i) when the seller delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer, without reserving a right of disposal of the goods to himself; e.g., take R/R or Transport Receipt in the name of buyer or his agent;
- (ii) where the buyer or his agent lawfully obtains possession of the goods;
- (iii) by waiving the right of lien;
- (iv) where he assents to a sub-sale by the buyer;
- (v) where he takes a security from the buyer for the payment of the price, in place of his lien.

It should, however, be noted that an unpaid seller does not lose his lien by reason only that he has obtained a decree for the price of the goods.

Q. 9. (a) Write a short note on 'right of re-sale'.

- (b) At an auction sale, A makes the highest bid for a flower vase. Purporting to accept the bid, the auctioneer strikes the vase and breaks it. Who is to bear the loss? Would your decision differ if the auctioneer had struck the table on which the vase was kept with the hammer and the vase fell down and broke to pieces?**

- (c) A to sell a horse to B who tells A that he (B) needs the horse for riding to Mumbai immediately. The horse is ill at the time of agreement. What are the rights of A and B?
- (d) A seller agrees to supply to the buyer timber of $\frac{1}{2}$ " thickness for being made into cement barrels. The timber actually supplied varies in thickness from $\frac{1}{2}$ " to $\frac{5}{8}$ ". The timber is merchantable and commercially fit for the purpose for which it was ordered. The buyer rejects the timber. Is his action justified?

Answer 9. (a)

The unpaid seller, who has retained possession of the goods in exercise of his right of lien or who has resumed possession from the carrier upon insolvency of the buyer, can resell the goods :

- (i) If the goods are of a perishable nature, without any notice to the buyer; and
- (ii) In other cases, after notice to buyer calling upon him to pay or tender the price within reasonable time, and upon failure of the buyer to do so.

The seller is entitled to recover from the original buyer damages caused to him by the resale. But if any profit accrues from the resale, such profit shall go to the unpaid seller and not to the buyer. The seller does not act as the agent of the buyer.

Answer 9. (b)

As per Section 64 of The Sale of Goods Act where goods are destroyed or damaged before the completion of sale, the loss will fall on the seller. The sale is complete when the auctioneer announces its completion by the fall of the hammer or in some other customary manner. Until such announcement any bidder may retract (withdraw, revoke) his bid.

In the given case, as the auctioneer did not announce the completion of sale by the fall of the hammer or any other customary manner, the sale is not complete. So in both the cases the loss is to be borne by the owner of the vase.

Answer 9. (c)

As per Section 8 of the Sale of Goods Act, an agreement to sell specific goods become void if subsequently the goods, without any fault on the part of the seller or buyer, perish or become so damaged as no longer to answer to their description in the agreement before the risk passes to the buyer.

In the given case B needs the horse for riding to Mumbai immediately. But the horse is ill and not able to perform the agreement. As per the above cited explanation the horse being a specific good the agreement becomes void.

Answer 9. (d)

Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description. The rule of law contained in Section 15 of the Sale of Goods Act summarized in the following maxim : "If you contract to sell peas, you cannot oblige a party to take beans. If the description of the article tendered is different in any respect, it is not the article bargained for and the other party is not bound to take it".

In the given case the buyer can reject the timber even if the timber is merchantable and commercially fit for the purpose for which it was ordered.

Industrial Laws :

- Q. 10. (a) A is the owner of a concern manufacturing cigars. 20 persons are employed in the concern. Of these 20 employees, one is a graduate for supervising the work and another an apprentice learning work. The remaining 18 are employed not on the time wage system, but on the piece work system. Is the concern a factory within the meaning of the term under the Factories Act, 1948?**

- (b) The services of a woman worker who had completed 4 months' continuous service in a factory were terminated.**
- i. To what leave is she entitled ?
 - ii. To what leave will she be entitled if she were below 15 years of age?
- (c) What are rules relating to recovery of Gratuity under the Payment of Gratuity Act, 1972?**
- (d) Life Insurance Corporation (LIC) formulated a scheme called 'salary saving scheme' under which employees of an organisation could buy an insurance policy. Premium due on each policy was collected by the employer from the salary of the employees nor did it issue any premium notice. When the widow of the deceased employee made a claim to LIC on the death of her husband, the LIC repudiated the claim on the ground that four instalments of premium had not been paid. The widow was approached the consumer forum for redressal. Is the LIC liable for deficiency in service?**

Answer 10. (a)

As per Section 2 (m) factory means any premises including the precincts thereof -

- i. Whereon 10 or more workers are working or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or
- ii. Whereon 20 or more workers are working or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on.

For computing the number of workers, all the workers in different groups in a day shall be taken into account.

So, in the given case, as per section 2(m) the concern is a factory within the meaning of that term under the Factories Act, 1948.

Answer 10. (b)

As per section 79 every worker who has worked for a period of 240 days or more in a factory during a calendar year shall be allowed during the subsequent calendar year leave with wages for a certain number of days. These days of leave shall be calculated at the rate of -

- i. If an adult, one day for every 20 days of work performed by him during the previous calendar year.
- ii. If a child, one day for every 15 days of work performed by him during the previous calendar year.

So, in the given case, she is entitled to

- i. 6 day's leave, and
- ii. 8 day's leave.

Answer 10. (c)

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

Section 8 deals with the recovery of gratuity. If the employer fails to pay gratuity within the prescribed time to the person entitled thereto, the controlling authorities are authorised to issue a certificate to the Collector to recover the amount. The amount will carry compound interest at such rate as the Central Government may, by notification, specify (Presently 10 per cent) from the date of expiry of the prescribed time. This amount has to be recovered as arrears of land revenue. However, the amount of interest payable shall in no case exceed the amount of the gratuity payable under the Act.

Answer 10. (d)

LIC is liable for deficiency in services. In the instant case the employer had implied authority to collect premium on behalf of the corporation. There is no gainsaying the fact that if the employee had, after deducting the stipulated amount from the employee's salary, failed to remit the premium to the Corporation. It was clearly the fault of the agent of the Corporation. So, LIC has wrongly discharged its liability under the policy.

The present problem is similar to *Delhi Electric Supply Undertaking v. Basanti Devi* 1999(6) SCALE 236 where it was held that since the burden of collecting the premium and remitting it to the corporation was on the employer, it was not the responsibility of the employee to intimate the Corporation about non-remittance of the premium.

Q. 11. (a) A qualified Homeopathic Physician treated a patient with allopathic medicine and the patient died. Can the said physician be guilty of negligence under Consumer Protection Act, 1986?

(b) An individual dispute is not an industrial dispute.

(c) 'Complaint' means any person. (Consumer Protection Act, 1986)

(d) Distinguish between Retrenchment and Lay Off.

Answer 11. (a)

Since a qualified homeopathic physician treated with allopathic medicine which is not his area of specialization/knowledge, this physician would be held guilty of negligence on the death of a patient. This is a fault also on the part of the physician.

Answer 11. (b)

The statement can be said to be correct. However, under certain circumstances, as provided in section 2A of the Industrial Disputes Act, an individual dispute shall be deemed to be an industrial dispute, although no other workmen or any union of workmen is a party to the dispute.

Answer 11. (c)

False, Consumer Protection Act, 1986 defines a Complaint as a consumer, a registered voluntary consumer association, the Central or State Government and one or more Consumers where there are numerous consumers having the same interest.

Answer 11. (d)

Retirement and layoff are differently defined in the Industrial Disputes Act. While retrenchment means termination by the employer of the service of a worker for any reason other than a punishment as a disciplinary action, layoff has been defined as the failure, refusal or inability of an employer to give employment to a workman whose name appears on the master roll and who has not been retrenched due to shortage of coal, power, raw material, accumulation of stocks, breakdown of machinery, natural calamity etc.

Q. 12. (a) A workman under the influence of drink touched a live wire while working at a machine and instantaneously died. His widow claimed compensation but the employer took the plea that he was not liable as the accident arose out of a default by the workman. Decide.

(b) When gratuity payable to an employee can be forfeited?

(c) Is it lawful for an employer to make deductions from bonus payable to an employee?

(d) Twelve employed persons acting in concert absent themselves for 2 days without due notice and without reasonable cause. What is the maximum amount that may be deducted on account of the absence from duty of these persons?

Answer 12. (a)

An employer is not liable to pay compensation for personal injury caused to a workman by accident arising out of and in the course of employment—

- (a) if the injury does not result in the total or partial disablement of the workman for a period exceeding 3 days;
- (b) if the injury, not resulting in death, is caused by an accident which is directly attributable to—
 - (i) the workman having been at the time of the accident under the influence of drink or drugs; or
 - (ii) the wilful disobedience of the workman to an order expressly given, or to a rule expressly framed, for the purpose of securing the safety of workmen; or
 - (iii) the wilful removal or disregard by the workman of any safety guard or other device (which is an offence under the Factories Act, 1948) which he knew to have been provided for the purpose of securing the safety of the workmen [Proviso (a) to Sec. 3 (1)].

The exceptions, namely (i) intoxication by drink or drugs, (ii) wilful disobedience of certain rules and orders, (iii) wilful removal of safety devices, are not applicable in case of a fatal accident [Proviso (b) to Sec. 3 (1)]. The reason is that where a workman has died as a result of personal injury it is extremely difficult for the dependants to rebut evidence that the accident was caused by the deceased's misconduct.

As per the above explanation, in the given case, the employer is liable to give compensation.

Answer 12. (b)

The gratuity payable to an employee may be wholly or partially forfeited if the services of such employee have been terminated for—

- (i) his riotous or disorderly conduct or any other act of violence on his part, or,
- (ii) any act which constitutes an offence involving moral turpitude, provided that such offences are committed by him in the course of his employment [Sec. 4 (6) (b)]. Any decision to forfeit gratuity can however be taken only after affording opportunity of hearing to the employee [*Bharat Gold Mines Ltd. v Regional Labour Commr.* (1986) Lab. I.C. 1976 (Kant). (D.B.)].

Answer 12. (c)

According to Section 18 of the Payment of Bonus Act, 1965, when in any accounting year, an employee is found guilty of misconduct causing financial loss to the employer, then, it shall be lawful for the employer to deduct the amount of loss from the amount of bonus payable by him to the employee under the Act in respect of that accounting year only and the employee shall be entitled to receive the balances, if any. Thus, the provision of Section 18 suggests that there can be no other deductions from the bonus except in respect of a financial loss directly attributable to the employee's misconduct.

Answer 12. (d)

If, 10 or more employed persons, acting in concert, absent themselves without due notice and without reasonable cause, the deduction for absence from duty from any such person may include such amount not exceeding his wages for 8 days as may be due to the employer in lieu of notice [Proviso to Sec. 9 (2)].

So, in the given case, wages for 10 days, i.e. two days' wages for absence plus 8 days' wages for not giving due notice may be deducted.

Q. 13. (a) A, a medical practitioner purchased an ultrasound scanner and the same stopped functioning within a short period of time. A claimed refund of the price from the supplier. The supplier pleaded that the complainant was not a consumer as the scanner was used for the professional purpose and A was making profit out of it. The complainant claimed that it was being run by his personal skill and to earn his livelihood. Decide.

(b) "Deficiency in service is a ground for preferring a complaint to the Consumer Protection Forum".
Comment.

(c) Write short notes on – Rights of a consumer under the Consumer Protection Act, 1986?

(d) A person has worked only for 35 days in an accounting year. Is he eligible or entitled to be paid bonus by his employer for that year?

Answer 13. (a)

As per the definition of the 'Consumer', the goods purchased or services availed should not be meant for re-sale or for a commercial purpose. Commercial purpose does not include use by a consumer of goods bought and used by him and services availed by him exclusively for the purpose of earning his livelihood, by means of self-employment.

In the given case, the question of profit is not relevant. The question to be seen is whether the goods purchased by consumer were being used by himself. From the affidavit of the complainant, it is clear that the scanner was used by him by his skill for earning his livelihood. Hence, he is a consumer. The supplier is bound to refund the price.

Answer 13. (b)

Deficiency in service complained of could be in respect of the service hired or availed or agreed to be hired or availed of by the complainant who suffered from deficiency in any respect. Deficiency must pertain to performance. Whenever there is a deficiency arising out of negligence of a party, the consumer can approach the Forum for redressal. Negligence is sine qua non regarding deficiency of service.

Answer 13. (c)

Section 6 of the Act recognises the following six rights of consumers :

1. **Right to safety**, *i.e.*, the right to be protected against the marketing of goods and services which are hazardous to life and property.
2. **Right to be informed**, *i.e.*, the right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be, so as to protect the consumer against unfair trade practices.
3. **Right to choose**. It means right to be assured, wherever possible, access to a variety of goods and services at competitive prices. In case of monopolies, say, railways, telephones, etc., it means right to be assured of satisfactory quality and service at a fair price.
4. **Right to be heard**, *i.e.*, the consumers' interests will receive due consideration at appropriate forums. It also includes right to be represented in various forums formed to consider the consumers' welfare.
5. **Right to seek redressal**. It means the right to seek redressal against unfair practices or restrictive trade practices or unscrupulous exploitation of consumers. It also includes right to fair settlement of the genuine grievances of the consumers.
6. **Right to consumer education**. It means the right to acquire the knowledge and skill to be an informed consumer.

Answer 13. (d)

Section 8 of the Payment of Bonus Act, 1965 provides that 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 30 working days in the year.

However, since the employee in the given case has not worked for all the working days in an accounting year, the provisions of Section 13 also become relevant which provide for proportionate reduction of bonus in such cases.

Thus, the employee in question shall be entitled to bonus for 35 working days only as ratio of the bonus payable for the total working days.

Q. 14. (a) Is adjustment of a customary or interim bonus paid permissible against bonus payable under the Payment of Bonus Act, 1965?

(b) Describe the events when gratuity becomes payable?

(c) Write a short note on – Reliefs available to consumers under the Consumer Protection Act, 1986.

(d) What is the difference between lock-out and closure?

Answer 14. (a)

Section 17 of the Payment of Bonus Act, 1965 provides that where in any accounting year—

- (a) an employer has paid any Puja Bonus or other customary bonus to an employee, or
- (b) an employer has paid part of the bonus payable under the Act to an employee before the date on which such bonus becomes payable, then, the employer shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under the Act in respect of that accounting year and the employee shall be entitled to receive only the balance.

Answer 14. (b)

According to Section 4(1) gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than 5 years—

- (a) on his superannuation, or
- (b) on his retirement or resignation, or
- (c) on his death or disablement due to accident or disease.

Gratuity cannot be claimed by a workman who has not put in service for the specified minimum period of five years. Where a workman is discharged before he has put in service for the minimum period, no liability attaches to the employer [*May & Baker (India) Ltd. v. Their Workmen*].

However, completion of continuous service of 5 years shall not be necessary where the termination of the employment of any employee is due to death or disablement. In case of his death, gratuity is payable to his nominee, or, if no nomination has been made, to his heirs. Where such nominee or heir is a minor, the share of such minor shall be deposited with the Controlling Authority who shall invest the same for the benefit of such minor in such bank or other financial institution, as may be prescribed, until such minor attains majority.

Answer 14. (c)

Reliefs available to consumers under the Consumer Protection Act, 1986 —

- (a) to remove the defect pointed out by the appropriate laboratory from the goods in question;
- (b) to replace the goods with new goods of similar description which shall be free from defects;
- (c) to return to the complainant the price, or as the case may be, the charges paid by the complainant;
- (d) to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party;
- (e) to remove the defects or deficiencies in the services in question;
- (f) to discontinue the unfair trade practice or the restricted trade practice or not to repeat them;
- (g) not to offer the hazardous goods for sale;
- (h) to withdraw the hazardous goods from being offered for sale;

- (i) to cease manufacture of hazardous goods and to desist from offering, services which are hazardous in nature;
- (j) to pay such sum as may be determined by it if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently;
- (k) to issue corrective advertisement to neutralize the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement;
- (l) to provide for adequate costs to parties.

Answer 14. (d)

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

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

Q. 15. (a) What is the time limit for payment of bonus under the Payment of Bonus Act, 1965?

(b) An employee committed an act in respect of which a fine was imposed. No prior notice specifying this particular act in respect of which fine could be imposed had been exhibited. The employer deducted the fine in 4 installments from the wages of the employee. What provisions of the Act does the employer violates?

(c) A watchman whose duty was to guard the property of the premises of a rest house, had his quarters within the premises of the rest house. His duty ended at 11 p.m. At 2.30 a.m. (i.e. within 3.5 hours of the said 11 p.m.) he was found murdered near his quarters. Is the employer liable to pay compensation?

(d) Who are exempted from the provisions of Employees' Provident Fund Scheme?

Answer 15. (a)

As per Section 19 of the Payment of Bonus Act, 1965, the employer is bound to pay to his employees bonus in cash within a period of 8 months from close of the accounting year. However, this period of 8 months may be extended up to a maximum of 2 years by the appropriate Government or by any authority specified by the appropriate Government. But in case of a dispute regarding payment of bonus, it must be paid within one month from the date on which the award or settlement, effected by the relevant authority, comes into operation.

Answer 15. (b)

An employer can deduct the fine imposed on any employee from the wages of the same. But as per Section 8(2) the notice specifying the acts and omissions for which fines may be imposed shall be exhibited in the prescribed manner on the premises (and in case of persons employed upon a railway, at the prescribed place or places) in which employment is carried on. Similarly section 8(6) provides that such a fine shall not be recovered from the employed person by installments or after expiry of 90 days from the day on which it was imposed.

Answer 15. (c)

Yes, as the accident arise out of and in the course of employment. When a person is employed on a duty of this kind his actual employment does not cease within the specified hours of duty but he is in a way in constant employment since it can by no means be said that if a watchman detected a thief at a time he was not actually on duty, he would not be required to resist and obstruct the thief and that it would be no part of his duty to do so.

Answer 15. (d)

The Employees' Provident Fund Scheme may make provision for exemption of any person or class of persons employed in any establishment to which this Scheme applies from the operation of all or any of the provisions of this Scheme, if

- (i) such person or class of persons is entitled to benefits in the nature of provident fund, gratuity or old-age pension, and
- (ii) such benefits, separately or jointly, are on the whole not less favourable than the benefits provided under the Act or the Employees' Provident Fund Scheme [Sec. 17(2)]. But no such exemption shall be granted in respect of a class of persons unless the appropriate Government is of opinion that the majority of persons constituting such class desire to continue to be entitled to such benefits [Proviso to Sec. 17(2)].

Other Laws :

Q. 16. (a) A bill of exchange is payable to Shyam on order. At maturity another person of the same name wrongfully gets possession of the bill and presents it to the acceptor for payment. After being satisfied that the person presenting is Shyam, the acceptor makes payment on it in due course. Is the acceptor discharged?

(b) Define the followings as per The Competition Act, 2002

- i. Dominant Position
- ii. Predatory Price.

(c) What are the documents required for a limited liability partnership to be incorporated?

(d) A draws for his own accommodation a bill for ₹ 1,000 on B, and after acceptance by B, endorses it to C as security for ₹ 500. B is adjudged insolvent. Discuss the rights of C.

Answer 16. (a)

"Payment in due course" means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof the payment to the person in possession of the instrument must be under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount mentioned in the instrument. If, under suspicious circumstances, the person making the payment does not make the necessary inquiry, the payment is not a payment in due course.

In the given case, if the acceptor does not make the necessary inquiry before making the payment, it is not a payment in due course. So, he is not discharged.

Answer 16. (b)

(i) Dominant Position : It means a position of strength, enjoyed by an enterprise, in the relevant market, whether in India or outside India, which enables it to—

- (a) operate independently of competitive forces prevailing in the relevant market; or
- (b) affect its competitors or consumers or the relevant market in its favour.

(ii) Predatory price : It means the sale of goods or provision of service, at a price which is below the cost, as may be determined by regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors [Sec. 4(2)].

Answer 16. (c)

For a limited liability partnership to be incorporated —

- (a) two or more persons associated for carrying on a lawful business with a view to profit must have subscribed their names to an incorporation document,
- (b) there must have been delivered to the registrar either the incorporation document or a copy authenticated in a manner approved by him, and
- (c) there must have been so delivered a statement in a form approved by the registrar, made by either a solicitor or CS, CA or Cost Accountant engaged in the formation of the limited liability partnership or anyone who subscribed his name to the incorporation document, that the requirement under the act and rules made there under have been complied with.

Answer 16. (d)

When there is a partial absence or failure of money-consideration for which a person signed a promissory note, bill of exchange or cheque, the same rules as apply to total absence or failure of consideration will apply. Thus the parties standing in immediate relation to each other cannot recover more than actual consideration, but this rule does not apply to a holder in due course.

So, C can recover ₹ 500 from A.

Q. 17. (a) Define the following as per the RTI Act, 2004 :

- i. Information
- ii. Right to information

(b) Write short note on 'Bid rigging'.

- (c) A agrees to supply a quantity of paper to B. B accepts a bill for ₹ 1,000 drawn by A being the price of the paper. The paper is delivered to B. But it turns out to be not of the quality stipulated for and is worth ₹ 500 only. B retains the paper. Can A recover from B the full amount of the note?
- (d) A bill of exchange purports to be drawn by A on B and is accepted by B. the bill is payable to C or order. C negotiates it to D who takes it as a holder in due course. In a suit by D on the bill, can B disclaim liability on the ground that A's signature is forged?

Answer 17. (a)

(i) "Information" means any material in any form, including records, documents, file notings, memos, emails, opinions, advices, press releases, circulars, orders, log-books, contracts, reports, papers, samples, models, data, material held in any electronic form and any information relating to a private body which can be accessed by a Public Authority under any law;

(ii) "Right to information" means the right to access information held by, legally accessible by or under the control of any Public Authority and includes :

- (1) Inspection of works, documents, records;
- (2) Taking notes and extracts and obtaining certified copies of documents or records;
- (3) Taking certified samples of material;
- (4) Obtaining information in the form of diskettes, floppies, tapes, video cassettes or in any other electronic mode or through printout where such information is stored in a computer or in any other device;

Answer 17. (b)

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

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

- (i) tie-in arrangement;
- (ii) exclusive supply agreement;
- (iii) exclusive distribution agreement;
- (iv) refusal to deal; and
- (v) resale price maintenance.

Answer 17. (c)

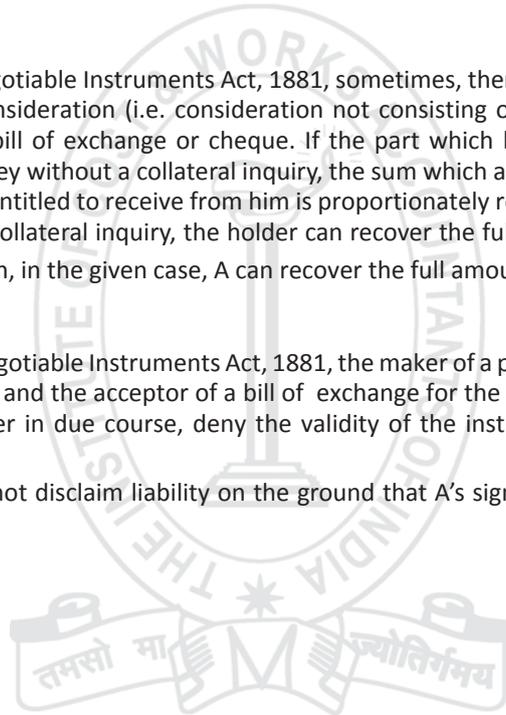
As per Section 45 of The Negotiable Instruments Act, 1881, sometimes, there may be a partial absence or failure of non-monetary consideration (i.e. consideration not consisting of money) for which a person signed a promissory note, bill of exchange or cheque. If the part which has failed is capable of being ascertained in terms of money without a collateral inquiry, the sum which a holder standing in immediate relation with such signor is entitled to receive from him is proportionately reduced. If such ascertainment cannot be made without a collateral inquiry, the holder can recover the full amount.

As per the above explanation, in the given case, A can recover the full amount of the note.

Answer 17. (d)

As per Section 120 of The Negotiable Instruments Act, 1881, the maker of a promissory note, the drawer of a bill of exchange or cheque and the acceptor of a bill of exchange for the honour of the drawer cannot, in a suit thereon by a holder in due course, deny the validity of the instrument as originally made or drawn.

So, in the given case, B cannot disclaim liability on the ground that A's signature is forged.



SECTION - II (Auditing)

Q. 1. Comment on the following statements based on legal provisions :

- (a) Procedural error arises as a result of transactions having been recorded in a fundamentally incorrect manner.
- (b) An auditor requires more reliable evidence to reach the conclusion regarding materiality.
- (c) The auditor examines debit notes to vouch sales return.
- (d) Inventory turnover ratio is calculated by the auditor to obtain evidence concerning management's ascertain about valuation of inventory?
- (e) Year end stock ready for exports are proposed to be valued at realizable value.
- (f) An adverse report is one where an auditor gives an opinion subject to certain reservation.
- (g) Shareholders, by a majority vote, have authorized the Board of Directors to keep the books of accounts of the company in its Administrative Office, as against the earlier practice of keeping them in the Registered Office. No Government authority has been informed about this. Company contends that this practice is in order.
- (h) S Ltd. is the subsidiary of H Ltd. Ram owes S Ltd. ₹ 10,000, Laxman has given guarantee for the same. Can Laxman be appointed as statutory auditor of H Ltd. ? Give reasons for your answer.
- (i) Test checks refers to the out of routine checks that are carried out in the normal course of Audit.
- (j) What do you understand by Computer Information System (CIS) environment?

Answers 1.

- (a) Errors of omission and errors of commission constitute Procedural Errors. If transaction is basically recorded in the books in an incorrect manner, it is an error of principle. These errors do not affect the Trial Balance. Hence, the given statement is incorrect.
- (b) The concept of materiality is fundamental to the process of aggregation, classification and presentation of accounting information. It is an important and relevant consideration for an auditor who has to constantly judge whether a particular item of transaction is material or not. Obviously, an auditor requires more reliable evidence in support of material items.
- (c) False. The auditor examines purchase return transaction with reference to copies of debit notes issued to suppliers and outward return notes to vouch purchase return.
- (d) True. Calculation of inventory turnover ratio and its comparison with those of previous year's ratio will provide an evidence on correct valuation of slow-moving, defective and obsolete items included in inventories.
- (e) As per AS-2, closing stock is to be valued at cost or market price, whichever is lower. The stock is question cannot be valued at realizable value.
- (f) False. A qualified report is one where an auditor gives an opinion to certain reservation. An adverse report is given when the auditor concludes that based on his examination, he does not agree with the affirmation made in the financial statements/ financial report.
- (g) False, as per section 209 of the Companies Act, 1956, the books of accounts can be kept in a place other than its registered office also, but the board of Directors should, within 7 days file a written notice to the Registrar of Companies, the full address of the new place. Here the company has not complied with this mandatory requirement.

- (h) Section 226 of the Companies Act, 1956 speaks of the qualifications and disqualifications of auditors.

As per Section 226(3), a person who has given any guarantee in connection with the indebtedness of any third person to the company for an amount exceeding ₹ 1,000 shall not be qualified to be appointed as auditor of the company. Hence Laxman cannot be appointed as auditor of S Ltd.

Sub-section (4) of section 226 states that where a person is not qualified to be appointed as auditor of a company, the disqualification shall extend to the holding company of the said company also.

Hence Laxman cannot be appointed as statutory auditor of H Ltd. also.

- (i) False. Test checking is an accepted auditing procedure wherein only a part of its transactions is checked to form an opinion instead of checking all the transactions.
- (j) A CIS environment exists when one or more computers of any type or size is involved in the processing of financial information, including quantitative data. Those computers may be operated by the entity or by a third party.

Auditing Basics :

- Q. 2. (a) What are the main sources of GAAP in India?**
(b) How will you verify Development of Property?
(c) Proposed dividend is not adjusted in the financial statements. Decide.
(d) "An auditor must select his sample carefully because the results of a representative and unbiased sample can be mathematically interpreted." – Explain this statement.

Answer 2. (a)

The main sources of GAAP in India are :

- (i) Accounting Standards and Statements issued by the Institute of Chartered Accountants of India.
- (ii) Derived from the Companies Act, 1956.
- (iii) Standards issued under Income Tax Act, 1961.
- (iv) Statement and Regulations issued under SEBI Act and Guidelines issued by SEBI.
- (v) Industry specific Legislations (Insurance, Banking, Financial Institutions, etc.)

Answer 2. (b)

When expense incurred for the development of any property, they cannot be conveniently added to the value of such property. Such expenses should be capitalized under the head "Development of Property" e.g. expenses incurred in grading and preparing the soil for plantations.

Such amount shall be written off over the period during which the benefit from such development will accrue to the business. To verify this the auditor should :

- (i) Verify the amount of budget allocation for such expenditure and note the sanction of the appropriate authority.
- (ii) Examine whether the amount of expenditure is reasonable based on Technical Reports, if applicable.
- (iii) Vouch the payment made and expenditure incurred on the basis of bills enclosed and payments made through the cash/bank book.
- (iv) Verify whether an appropriate amount has been written off, keeping in view the period of benefit or the exploitation, as the case may be.

Answer 2. (c)

Proposed dividend should be disclosed in the financial statements as per the requirements of schedule VI to Companies Act, 1956, though the dividend proposal is subject to the approval of the General Body in the Annual General Meeting. Dividend proposal is one of the appropriations of the profits of the company and as such it should be taken in the preparation of the financial statement as per schedule VI of Companies Act, 1956.

Answer 2. (d)

Sampling is the selection of a part of the population representing the total affairs. At the time of actual start of audit the auditor has to decide whether all transactions be checked or only part of them be examined. If it is practicable to check each and every transaction then there is no need to think about statistical sampling. But in large scale organizations it would be almost difficult to check the huge volume of transactions due to the available limited time, that is why some kind of selective checking becomes inevitable. Effective auditing depends upon the proper selection of transactions. Therefore, the auditor should be very careful at the time of selecting his audit samples and evaluating the results of audit procedure.

Q. 3. (a) Briefly state the basis and types of liability of auditors.

- (b) A company has paid interest on share capital to the shareholders, as there was a long gestation period before the company would start making profits. As the Statutory Auditor of a Public Limited Company, comment on the situation.**
- (c) Write short notes on – Teaming and Lading.**
- (d) How will you verify Goods in Bond ?**

Answer 3. (a)

The liability of professional negligence may arise under the statute or agreement with the client. The liability may be civil or criminal liability; further, the auditor may expose himself to disciplinary action by ICAI under the Chartered Accountants Act, 1949 for professional negligence and for failure to conduct the audit with reasonable care and caution required of him, under the facts and circumstances of the case.

The liability of an auditor may also arise under misfeasance provisions of the Companies Act, for failure to report properly and adequately the mis-statements in the financial statements, in order to hide more than they reveal.

The auditor will also be held criminally liable for negligent performance of his task and for collusion with the company management in the commission of frauds etc.

Answer 3. (b)

Section 208 of the Companies Act, 1956 permits payment of interest to shareholders out of capital, where there is a long gestation period. Payment of interest on capital is, however, capitalized as part of cost of construction of the project. The auditor should ensure that following conditions have been complied whenever such interest has been paid :

- (i) Payment is authorized by the Articles or by special resolution of shareholders in general meeting;
- (ii) Payment is approved by the Central Government;
- (iii) It is paid only for the period determined by the Central Government not exceeding six months after the half year in which the project has been completed.
- (iv) The rate shall not exceed 12% p.a. or such other rate as may be prescribed by the Government;
- (v) The payment of interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid.

Answer 3. (c)

Teaming and Lading – It is an ingenious method of concealing a cash shortage. It involves misappropriation of receipts from one or more customers and covering the shortage with receipts from other customers. This shortage may be made up with receipts from still other customers. Thus, while the shortage will continue to be there, it will never be in the same account. This can be understood with the help of following example. Suppose, a cheque of ₹ 6,000 received in full settlement of debt from Mr. A, is misappropriated.

This means that Mr. A's debt will continue to remain outstanding. Now, suppose at a later date a cheque for same or similar amount is received from Mr. B. With a view not to let Mr. A's debt continue as outstanding for long, which might lead to discovery of misappropriation, the cheque from Mr. B may be shown as having been received from Mr. A, and posted to his account. As a result, now Mr. B's account will appear as outstanding and it will be cleared when another cheque for a similar amount is received from some other customer, and so it may go on. At time, the receipt from one customer may be split over the accounts of many customers, thus concealing several misappropriations at any time and rendering the detection of irregularity still more difficult.

Answer 3. (d)

For goods in bond, the auditor should –

- (I) Ascertain –
 - i. the reason for goods remaining in bonded warehouse
 - ii. period for which it remains there and
 - iii. the date of subsequent removal/ clearance.
- (II) Ensure that there are separate stock sheets for goods in bond
- (III) Examine the bond warrants as acknowledgement of goods lying in the bonded warehouse, and trace the same into bond stock sheet.
- (IV) Obtain bankers' certificate when such goods are pledged with banks.
- (V) Ensure that the bonded goods are valued at the lower of cost or market value.
- (VI) Test check the valuation of goods in bond, based on relevant invoices from foreign suppliers. See whether the principles of translation of foreign currency as per AS-11 are properly followed.

Q. 4. (a) How will you vouch / verify stock lying with job-worker?

- (b) State with reasons whether you, as an auditor, would approve the payment of dividend out of capital?
- (c) State the difference between India's GAAP & US GAAP regarding :
 - i. Related Party Transactions
 - ii. Goodwill.
- (d) How will you verify imported plant & machinery?

Answer 4. (a)

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

Aspect	Matters be verified/Auditor's Duties
Delivery Chalan and Excise Records	Verify the quantity of the goods despatched to the third party to know the value of the goods sent at the time of despatch.
GRN of Contractor	Confirm whether the goods despatched to third parties have been actually received by them, by examining GRN issued by them.
Confirmation from processor	<ul style="list-style-type: none"> • Verify the quantity lying with the processor at the year-end, by obtaining a confirmation showing quantity of materials and date of receipt. • Confirm whether goods sent have been received back within reasonable time and are in accordance with the agreed specifications.
Valuation and Disclosure	<ul style="list-style-type: none"> • Ensure that the goods are valued properly at each stage of completion in respect of WIP, inclusive of expenses incurred in sending the goods for processing. • Where the amount is material, disclose the same separately as "Stock in hands of Processors or Contractors".

Answer 4. (b)

According to the Companies Act, no dividend can be paid out of capital as it expressly provides in Section 205 that the dividend is payable only out of current profit or past undistributed profits, arrived at after providing for depreciation. Therefore, if the memorandum or the articles of association even empower the company to declare dividend out of capital, such power becomes automatically invalid. [Verner vs General and Commercial Investment Trust Ltd. (1894)]

In the following circumstances, payment of dividend may amount to payment of dividend out of capital :

1. If dividend is paid out of the sale proceeds of fixed assets
2. If profits are inflated by the following :
 - Charging revenue expenditure to capital
 - Making lower provisions for depreciation or liabilities
 - Overvaluing closing stock or investments
 - Excluding revenue expenditure from accounts
 - Increasing profit by any other way
3. If a deficiency of capital exists and dividend is paid without making good such deficiency.

Answer 4. (c)**(i) Related Party Transactions :**

India	USA
No specific disclosures required. Auditors have a duty to report certain transactions entered into by related parties as defined under the companies Act, 1956 : AS-18 is issued w.e.f. 01.04.2001	Disclosures are stringent and require descriptions of nature of relations and control, transactions, amounts involved, and amounts due.

(ii) Goodwill :

India	USA
Purchased goodwill is capitalized and amortised over the expected period of benefit or charged against available capital reserves. No standard except for brief references is AS-10, Fixed Assets and AS-14, Accounting for Amalgamations. Goodwill arising from amalgamations can be written off over 5 years.	Treated as any other intangible asset, and is capitalized and amortised. The maximum carry forward period is 40 years.

Answer 4. (d)**Important Plant & Machinery :**

- (i) The Auditor should examine the directors minute Book for the resolution passed authorizing the purchases.
- (ii) The Auditor should check the RBI's permission and the import License.
- (iii) The Auditor should examine the agreement with the foreign supplier, particularly check the terms of payment, interest rates and the basis of deferred Payment.
- (iv) The Auditor should vouch the bills & receipts relating to purchases, customs duty payment, clearing & shipping charge, insurance premium etc.,
- (v) The Auditor should check the entries made in the books of accounts.

Companies Act Provisions Relating to Audit :

- Q. 5. (a) A company running a Departmental Store and having total turnover of ₹ 150 Cr. during the financial year, need not get its branch audited whose turnover is ₹ 2.85 cr. during the same year. Decide.**
- (b) The cost auditor of a company can be its internal auditor, and is to be appointed by the shareholders of the company. Comment on the validity.**
- (c) Distinguish between – Negative Opinion and Disclaimer of Opinion.**
- (d) Subsequent to the issue of audit opinion, the auditor of a company came to know about an important matter about the company. Had he known about this earlier, he would have given a different opinion. How you will as an auditor deal under this situation?**

Answer 5. (a)

A branch office of a company shall be exempted from audit, if the company carrying on any manufacturing, processing or trading activity and the average quantum of activity of the branch does not exceed – i) ₹ 2 lakhs or ii) 2% of the average of the Total Turnover of the Company, whichever is higher.

In the given case, the turnover of the Branch Office of the Trading Company (Departmental Store) is 1.90%, i.e. less than 2% of the average of the total turnover of the company. Hence, the branch office is exempted from audit.

Even if exemption is available, it is necessary that the fact must be mentioned in the Audit Report. The Company Auditor should expressly state in his Audit Report that the Branch Office is exempt from audit, by virtue of quantum of activity.

Answer 5. (b)

The cost auditor of a company cannot be its internal auditor or vice versa.

The disqualifications attracting the (financial) auditor of a company are equally applicable to cost auditor of a company also. [Section 226(3) of the Companies Act, 1956].

Section 226 is made applicable to appointment of cost auditor under section 224 (1B) of Companies Act. Therefore, a qualified person can be appointed as cost auditor of a company but he cannot be at the same time be its internal auditor or financial auditor.

Even a qualified cost accountant who is acting as an internal auditor cannot be appointed as cost auditor of that company in view of the provisions of section 226(3) read with clause (ie) of that section.

The Cost Auditor having the requisite qualification will be appointed by the Board of Directors of the company with the previous approval of the Central Government and submit his report to the Central Government within the time prescribed by it.

The ceiling on the number of audits is also applicable to persons or firms appointed as Cost Auditors.

Answer 5. (c)

When the auditor does not have sufficient information (for example, where books of accounts are with the tax authorities) to serve as the basis of his opinion, he may disclaim an opinion on the accounts and balance sheet and profit and loss account. Accordingly, the auditor may state that he is unable to form an opinion on the financial statements. An example of the disclaimer of the opinion can be s statement by the auditor that “we have been unable to state whether the Balance Sheet shows a ‘true and fair’ view.....” In certain circumstances, the auditor may not get access to all the books of account for certain reasons. There may also exist very material items, the value of which may be totally uncertain. In many cases certain material information or explanations may not be forthcoming. Whenever an auditor disclaims an opinion he should give reasons for the same.

An adverse or negative opinion will be given when there is a sufficient basis for the auditor to form an opinion that the accounts and financial statements, taken as a whole, do not present a true and fair view of the financial statements and the operating results of the enterprise. Thus, the rule is that where the reservations are so material that rendering a qualified opinion would not serve the purpose, the alternative is to make an adverse report.

Answer 5. (d)

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

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

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

Likewise, it may be advisable for the auditor to attend the meeting with a view to bringing to the notice of the shareholders, any matter which came to his knowledge subsequent to his signing the report and if it had been known to him at the time of writing his audit report, he would have drawn up the report differently, or where the accounts have been altered after the report was attached to the accounts.

Q. 6. (a) Discuss the rights and powers of statutory auditor of a public limited company.

(b) Discuss briefly the scope of Audit Committee in a big public limited company.

(c) Before accepting your appointment as auditor of a limited company, what steps will you take to ensure that your appointment is valid?

(d) A company has purchased Plant and Machinery from a foreign supplier on installment payment basis. The liability has been classified as "Secured Loan" by the Company. Give your opinion on the above.

Answer 6. (a)

Rights and Power of Auditor :

- (i) As per section 227(1) of the companies act 1956, every auditor shall have a right of access to the books, accounts and voucher of the company at all time.
- (ii) The auditor is entitled to require from the officers of the company such information and explanations as he may think necessary for the performance of his duties as Auditor. He may also obtain information under section 221 from the officers as he may deem fit.
- (iii) The auditor is required to make a report to the members of the company on the financial statement and relevant annexures which are laid before the shareholders in general meeting.
- (iv) Section 231 of the Companies Act provides that all notices and other communications relating to any general meeting of a company which any member is entitled to have sent to him shall also be forwarded to the auditor of the company.
- (v) The auditor shall be entitled to attend any general meeting and make any statement/explanation with regard to the accounts audited by him.
- (vi) Under Section 228, Power of the auditor wherein accounts of branch are audited by another auditor have been dealt with.

Answer 6. (b)

The scope of audit committee are as follows :

- (i) To review of annual financial statement before submission to the Board of Directos.
- (ii) Selection of statutory auditor.
- (iii) To Act as liaison between the statutory auditor and the Board of Directors.
- (iv) To review of internal control functions.
- (v) To review and approve financial information for publication.
- (vi) To review proposed changes in accounting systems and procedures.
- (vii) To help resolve differences between management, internal and statutory auditor.
- (viii) To report on the audit committee's activities in the corporation's ANNUAL REPORT.
- (ix) To ensure reliability of the organisation's financial statements and operational activities.

Answer 6. (c)

The Incoming Auditor should take the following steps before accepting his appointment —

1. **Ceiling Limit** : Ensure that a certificate has been issued u/s 224 so that total number of Company Audits held by him (including the new appointment) will not exceed the specified number.
2. **Resolution at AGM** : Inspect General Meeting Minutes Book to see that the appointment is duly recorded.
3. **Compliance with law** : Satisfy that the legal procedure contemplated in Sec. 224 and 225 of the Act dealing with removal of existing Auditor, if required, has been followed. Also see whether Sec. 224A (special resolution) and Sec. 619B (C & AG Appointment) are attracted and complied with, if required.
4. **Code of Conduct** : Communicate with the previous Auditor, if any, to ascertain if there are any professional reasons for not accepting the appointment.

Answer 6. (d)

1. **General Principles** : There are no specific disclosure requirements for Deferred Payment Liabilities unde Schedule VI. The same should be disclosed on the basis of sound accounting principles and practices prevailing in the country, considering the general requirements of Sec. 211.
2. **Nature** : Deferred Payment Liability should be diclosed keeping in view the nature of the liability. It is not in the nature of Loan as per common commercial parlance.
3. **Disclosure** : The instalments of Deferred Payment Liabilities payable within 12 months of the Balance Sheet date must be disclosed as "Current Liabilities" while the other instalments i.e. long-term liabilities may be disclosed under "Provisions" in the Balance Sheet.

Q. 7. (a) During the year under audit, one of the joint auditors died. The Board of Directors appointed another auditor in his place. State your views on this.

(b) Retiring auditor is always reappointed automatically.

(c) What are the rights of the Branch Auditor and the Company Auditor, with regard to audit of Branches?

(d) What is the responsibility of joint auditor?

Answer 7. (a)

The appointment of a new auditor by the Board of Directors is perfectly valid. The death of one of the joint auditors causes a casual vacancy in the office of auditor. Under section 224 (6) of the Companies Act, the Board may fill this casual vacancy. The auditor so appointed shall hold office until the conclusion of the next Annual General Meeting. While any such vacancy continues, the remaining Auditor (s), if any, may act.

Answer 7. (b)

Though the retiring auditor is eligible for reappointment, it cannot be said that reappointment is always automatic. The retiring auditor may be removed and some other person is appointed in his place at the AGM after complying with the provisions laid in the Companies Act in this regard.

Answer 7. (c)**1. Rights of Branch Auditor [Sec. 228(3)] :**

- (a) **Audit Powers** : To exercise the same powers and duties in respect of Branch Office Audit as enjoyed by the Company's Statutory Auditor in respect of the Company's Audit.
- (b) **Reporting** : To prepare a Report on the accounts of the Branch Office examined by him and to forward it to the Company's Auditor who shall deal with it in the manner required to prepare/ finalise his Report.
- (c) **Remuneration** : To receive such remuneration as the Company in General Meeting or the Board may fix.

2. Rights of Company Auditor [Sec. 228(2)] : The Company Auditor shall have the following rights when the Branch Accounts are audited by another person —

- (a) To visit Branch Office, if deemed necessary for the performance of his duties, and
- (b) To have access at all times to the books, accounts and vouchers maintained at the Branch Office.

In case of Foreign Branches of Banking Companies, the Company Auditor is allowed access to such copies of and extracts from the books and accounts of the Branch, as have been transmitted to the Head Office in India.

Answer 7. (d)

Responsibility of joint auditor : In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him.

Each auditor should bring to the attention of the other joint auditor matters requiring discussion, disclosure or application of judgment, by submitting a report or a note prior to the finalisation of audit. If any such matter were brought to the attention of the other joint auditors by an auditor after the audit report has been submitted, the other joint auditors would not be responsible in respect of those matters.

It is the responsibility of each joint auditor to determine the nature, timing and extent of audit procedures to be applied in relation to the area of work allocated to him.

Review and Audit of Internal Control System :**Q. 8. (a) How does an audit programme help to plan and perform the audit?**

- (b) **As a protective function, the internal audit department has a big role to play in preventing frauds in any organization. Do you agree?**
- (c) **State the circumstances in which a private limited company is exempt from the applicability of the Companies (Auditor's Report) Order 2003.**
- (d) **List the areas in which internal audit operates.**

Answer 8. (a)

An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions. The auditor should prepare a written audit programme setting

forth the procedures that are needed to be implemented while carrying out the audit plan. The audit programme serves as a ready check list of audit procedures to be performed. So, the audit programme is of immense help to plan and perform the audit.

Answer 8. (b)

The internal audit department has a big role to play in preventing fraud in different organizations, as a part of protective functions. Every big organization has an internal audit manual and such a manual usually outlines the internal audit function in detail in vulnerable areas, where loss through fraudulent means may arise frequently. Example of vulnerable area are stores receipt/ consumption, cash expenditure, sizable receipt of cash, civil maintenance jobs etc. The internal audit manual prescribes in detail the manner and procedure as to how internal audit function would be carried out in these areas. The manual also directs the frequency of such audit. If internal audit of such areas is done accordingly, the possibility of occurrence of both visible and invisible frauds get eroded. However, it needs to be mentioned that the success of internal auditor in preventing fraud is also dependent on the cooperation from other department of the organization.

Answer 8. (c)

The conditions for exempting a private limited company from the operation of CARO, 2003 are as follows :

- (i) The paid up capital and reserve should not exceed ₹ 50 lakhs.
- (ii) No loans should be outstanding from any Bank or Financial Institutions exceeding ₹ 25 lakhs.
- (iii) The turnover should not exceed ₹ 5 cr. at any point of time.

All the above three conditions should be fulfilled to get the exemption.

Answer 8. (d)

Internal Audit covers the following areas :

- (i) Review of accounting system and related internal controls.
- (ii) Examination of financial and operating information, on behalf of management.
- (iii) Examination of economy, efficiency and effectiveness of operations, including non-financial controls of the organization.
- (iv) Physical examination and verification of Tangible Assets.

Q. 9. (a) What are the internal control aspects in relation to Bank Reconciliation Statement?

(b) Write short notes on 'Audit in Depth'.

(c) ABC Ltd. has ₹ 55 lakh Paid Up Capital and ₹ 4.5 Crores average annual turnover of past 3 years preceding the financial year under Audit. The company does not have any Internal Audit System as the Management does not think it mandatory. Comment.

(d) What are the advantages of Working Papers?

Answer 9. (a)

Internal control aspects in relation to bank Reconciliation Statement are as follows :

- (i) **Receipt of Bank Statement** : Decision regarding handing over/ receipt of Bank Statements.
- (ii) **Frequency of reconciliation** : How frequently reconciliation should be performed.
- (iii) **Authoristaion** : By whom and the detailed procedure to be followed for reconciliation. The person responsible for carrying out the bank reconciliation should not normally be concerned with handling cash and cheques received or with arrangements for disbursements.
- (iv) **Attention points** : Special attention to be given for long standing un presented cheques, stop payment notices, examination of the sequence of cheque numbers and comparison of cheque details with details recorded in the Cash Book.

Answer 9. (b)

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

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

Answer 9. (c)

As per clause 4(vii) of CARO, having regard to their size and nature of business, the Auditor should report whether or not the following Companies have an Internal Audit System –

- (i) Listed companies,
- (ii) Companies having paid-up capital and reserves exceeding ₹ 50 lakhs as at the commencement of the financial year concerned,
- (iii) Companies having an Average Annual Turnover exceeding ₹ 5 crores for a period of three consecutive financial years immediately preceding the financial year concerned.

In the given case the paid-up capital is 55 lakhs (exceeding the limit of ₹ 50 lakhs) and the Average Annual Turnover is ₹ 4.5 crores (within the limit of ₹ 5 crores) and hence, the above reporting clause is attracted. CARO does not mandate the above clauses of Companies to compulsorily have an Internal Audit System. Hence, the Management's view that the Internal Audit is not mandatory, is correct. However, the Auditor is required to report the fact that the Company does not have any internal audit system, in view of CARO Reporting requirements.

Answer 9. (d)

Working Papers are necessary to –

- (a) Aid in planning and performance of the audit,
- (b) Aid in the supervision and review of the audit work,
- (c) Provide evidence of the audit work performed to support the Auditor's opinion,
- (d) Record and demonstrate the audit work from one year to another,
- (e) Plan the timing and extent of audit procedures to be performed,
- (f) Draw conclusions from the evidence obtained,
- (g) Standardise the Working Papers and audit procedures to improve the efficiency of the audit,
- (h) Facilitate the delegation of work as a means to control quality of work performed,
- (i) Provide guidance to the audit staff with regard to the manner of checking the schedules,
- (j) Fix responsibility on the staff member who signs each schedule checked by him, and
- (k) Act as evidence in a Court of law when a charge of negligence is brought against the Auditor.

Q. 10. (a) List the factors to be considered for preparing an Audit Programme?

(b) Mention a few items that are not suitable for test checking.

(c) List the situations where statistical sampling methods may not be appropriate.

(d) Moon Ltd. had its Registered Office at Madras. During the current accounting year, it has shifted its Corporate Head Office to Kolkata though it has retained the Registered Office at Madras. The Managing Director of the Company wants to shift its books of account to Kolkata from Madras, as he feels that there is no legal bar in doing so. Comment.

Answer 10. (a)

While constructing an Audit Programme, the Auditor should keep the following points in his mind —

1. To operate within the scope and limitation of the assignment.
2. To determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
3. To apply only those steps and procedures, which are useful in accomplishing the verification purpose in the specific situation.
4. To consider all possibilities of error.
5. To co-ordinate the procedures to be applied to related items.

Answer 10. (b)

The following items are not suitable for test-checking —

1. Opening and Closing Entries.
2. Bank Reconciliation Statement.
3. Balance Sheet Items — Loans, Advances, Other Assets and Liabilities.
4. Matters involving estimation as well as computation, e.g. Depreciation, Royalty, etc.
5. Transaction that may be small in number but important and material.
6. Transactions, which are recognised by law to be looked into by the Auditor carefully, e.g., Managerial Remuneration, Dividends, Shares issued for Cash Consideration, etc.
7. Seasonal industry, where test checking is carried out on annual basis.
8. Transactions of non-recurring nature or exceptional transactions.
9. Transactions involving statutory payments / dues, e.g. ESI, EPF, Tax Deduction at Source, etc.

Answer 10. (c)

The Auditor should not adopt statistical sampling, in the following circumstances —

1. When the population is too small (i.e. all items can be checked in such case),
2. When the population is very diverse and cannot be identified into strata or clusters,
3. When the internal control system is weak and unreliable,
4. When another audit approach is necessary to obtain sufficient evidence,
5. When another audit approach will provide satisfactory information in less time or with less effort,
6. Where the statistical sampling methods are not likely to satisfy the level of assurance required,
7. When exact accuracy is required, and
8. Where legal requirements are involved.

Answer 10. (d)

Sec. 209 Requirements : Sec. 209 provides as under —

- (a) The books of account shall be kept at the Registered Office of the Company.

- (b) All or any of the books of account may be kept at such other place in India as the Board of Directors may decide. The Company shall within 7 days of the decision of the Board, file with the ROC, a notice in writing giving the full address of that other place. The Notice to ROC shall be given in Form 23AA and shall specify the names of the books of account to be kept at other place.

Conclusion : From the above, it is clear that the Board of Directors of the Company may decide to keep the books of accounts of the Company in any other place other than the Registered Office of the Company by fulfilling the requirements specified in the above paragraph.

Q. 11. (a) XYZ Ltd. has not deposited Provident Fund contributions of ₹ 15 lakhs to the authorities but accounted in the books. Comment on the above.

(b) Audit procedures and audit techniques are not the same thing – Discuss.

(c) Financial audit suffers from a number of limitation. Discuss.

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

Answer 11. (a)

CARO Requirements : Under CARO 2003, the Auditor is required to report —

- (a) Whether the Company is regular in depositing undisputed statutory dues, like, Provident Fund, Investor Education & Protection Fund, Employees State Insurance, Income Tax, Sales Tax, Wealth Tax, Service Tax, Customs Duty, Excise Duty, Cess and any other statutory dues with the appropriate authorities.
- (b) If not paid regularly, the extent of arrears of outstanding statutory dues as at the last day of the Financial Year concerned for a period of more than **6 months** from the date they became payable, shall be indicated in the Auditor's Report.

Conclusion : In the instant case, even though accrual principles have been followed, disclosure of non-payment is necessary in view of CARO requirements. The Auditor should disclose the fact of non payment of ₹ 20 lakhs in his Report.

Answer 11. (b)

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

Answer 11. (c)

Financial audit is primarily concerned with verification of accounting data for determining the reliability and accuracy of accounting statements and report upon whether the financial statements reveal the 'true and fair' view of the working results and state of affairs of the enterprise. With this end in view, the financial auditor limits his work to vouching of transactions, reviewing internal controls, assessing the

effectiveness of internal audit to the extent he can plan the audit or simplify audit procedures and verifies the assets and liabilities in order to express his opinion on the financial statements.

In view of time constraints, Financial Auditor performs only Test Checks depending upon his judgement of the controls obtaining in the organisation. He relies mostly on vouchers, minutes of the Board meeting and correspondence with customers/suppliers and that too on test basis and is not concerned about the Quality of transactions.

Since his attention is pre-occupied with books of accounts and records, financial audit does not cover qualitative aspects of business or human resources/factors in the organization.

Financial Auditor does not get time enough to examine supervisory efficiency, propriety of managerial decisions, and contributions of the enterprise to environment and society at large. The scope of Financial Audit does not cover audit efficiency, economy, effectiveness and last but not least, the need for incurring expenses-propriety aspects.

The financial auditor largely relies on Books of accounts; and the controls functioning in the entity and expresses his opinion on the financial statements in respect of the working results and state of affairs as they are, not as they ought to be. Thus the scope of financial audit is very limited.

Answer 11. (d)

The requirements laid down by the CARO, 2003 are in addition to those laid down in the existing provision of section 227 of the Companies Act regarding the auditor's report. Nevertheless, there are certain points of difference between the Order and the requirements of section 227, which are as under :

- (i) While CARO exempts certain classes of companies from its application, the provisions of sub-sections (1A), (2), (3) and (4) of section 227 are applicable to all companies; and
- (ii) The provisions of sub-section (1A) cast an obligation on the auditor to make certain specific enquiries during the course of his audit. There is no requirement to report on any of the matters specified in the sub-section unless he has any special comments to offer in respect of the said matters. If he is content as a result of the enquiries conducted, there is no further obligation to report that he is so satisfied, CARO, 2003, on the other hand, casts an obligation to voice the opinion in respect of each of the matters specified therein even if he has no comments to make on any of the matter(s) contained in Order. In this regard, the provisions of CARO are similar to the provisions of sub-sections (2), (3) and (4) of section 227.

Information System Audit and Management Audit :

Q. 12. (a) "Doing an audit in an EDP environment is simpler since the Trial Balance always tallies." Analyse critically.

(b) What are CAATs ? Why CAATs are used?

(c) Discuss the difference of nature and purpose of cost audit and management audit.

(d) What are the conditions or events peculiar to an EDP environment that increase the risk of fraud and error?

Answer 12. (a)

In an EDP environment, the Trial Balance may always tally, but it does not necessary mean that the job of an auditor becomes simpler.

There is a possibility of -

- i. Errors of complete omission
- ii. Compensating errors
- iii. Duplication of entries
- iv. Errors of principles, and

v. Deliberately concealed frauds even when the Trial Balance tallies.

Tallying of Trial Balance may mean arithmetical accuracy in most cases. But the audit objective is expression of opinion on the true and fair view of the Financial Statements, not just ensuring arithmetical accuracy. Accounting aspects have become multi-faceted due to emergence of concepts like lease finance, options and futures, derivatives, off-balance sheet financing, packaged lending, book building etc.

Besides tallying a Trial Balance, there are other audit issues like estimation of depreciation, valuation of inventories, etc. where the auditor is required to exercise his skill and judgement.

In view of the above, it may be concluded that a tallied Trial Balance in an EDP environment need not necessarily simplify the audit function.

Answer 12. (b)

Due to the special characteristics of an EDP environment, auditors often use the computer for performing several compliance procedures as well as substantive procedures. The techniques, which involve the use of the computer for audit purposes, are known as 'Computer assisted audit technique' (CAATs).

Statement on AAS-16 states that effectiveness and efficiency of audit procedures may be improved through use of CAATs. CAATs may be used in performing various auditing procedures, including the following :

- i. Tests of details of transactions and balances.
- ii. Analytical procedures
- iii. Tests of general controls
- iv. Sampling programmes to extract data for audit testing
- v. Tests of application controls
- vi. Re-performing calculations performed by the entity's accounting system.

Answer 12. (c)

Nature : Management Audit is an independent appraisal activity for the review of managerial functions so as to ensure compliance with organizational objectives policies, procedures and purposes. Management audit covers all aspects or processes of management including planning, organization, control etc. of a business. Management audit is carried out to find out the efficacy of the control systems in operation and in business at any given time.

"Cost audit is a systematic and detailed checking of costing systems, techniques and account to verify their correctness and to ensure adherence to the objective of cost accountancy".

Cost audit is concerned with the review, examination and appraisal of cost accounting records so as to ensure true and correct cost of production.

Purpose : The purpose of management audit is to assess whether the integrated management systems which are required to fulfill the contractual and legal obligations of the company to its customers and community are being effectively implemented. It is to inform the management whether the control systems introduced are functioning properly or need to be strengthened.

The purpose of cost audit is to critically review the cost statements and other information and making recommendations for improvement.

Answer 12. (d)

Conditions or events that are peculiar to an EDP environment that increase the risk of fraud and error concerning the sphere of management, accounting records and routines as underlined by the Institute of Chartered Accountants of India in its statement of auditing practices (SAP4) are as follows :

- (i) Inability to extract information from computer files due to lack of, or non-current documentation of record contents or programmes.

- (ii) Large number of programme change that are not documented, approved or tested.
- (iii) In-adequate over-all balancing of computer transactions and data bases to the financial accounts.
- (iv) Loss of audit trails.

- Q. 13. (a) How will the auditor overcome loss of or changes in audit trail in an EDP environment?**
(b) Write short note on – Qualities of Management Auditor.
(c) Mention briefly the behavioural problems involved in conducting Management Audit.
(d) Enumerate five cases when auditing through the computer must be used.

Answer 13. (a)

The Auditor may use special techniques to overcome the loss or changes in audit trail. Some measures to overcome the loss of audit trail include —

1. Arranging for special printouts containing additional information,
2. Programmed interrogation facilities, e.g. records on magnetic or card files may be printed on a selective basis,
3. Clerical re-creation like re-verification of computer generated totals with manually prepared vouchers,
4. Testing on a total basis and ignoring individual items,
5. Reliance on alternative tests, and
6. Use of Special Audit Techniques, either manual or computer aided.

Answer 13. (b)

Whoever may be appointed as management auditor, should possess the following qualities—

- (i) Ability to understand the problems of the business.
- (ii) General understanding as to nature and objects of the organization.
- (iii) Expert knowledge of the principles of delegation of authority, management by objectives, management by exception, management control, budgetary control, internal control, flow charts, use of computers etc.
- (iv) Sufficient knowledge and experience in preparing different reports for presentation to the different levels of management including top management.
- (v) Background of engineering, costing, statistics, management accounting, financial accounting, industrial psychology, managerial economics etc.
- (vi) General understanding of different laws and regulations like company laws, tax laws, etc.
- (vii) Tactfulness, perseverance, pleasing & dynamic personality.

Answer 13. (c)

Management auditor is viewed as a fault finder or critic and this creates heartburns among the auditees. Management auditors being staff experts came in conflict with line managers. While proposing recommendations, the view points of line manager involving their practical difficulties may be ignored by management auditors resulting in stiffness and conflicts.

The management auditor is expected to evaluate the effectiveness of control systems. Consequently the report may have adverse effect on auditees, leading to hostile relationship on account of :

1. Fear of criticism stemming from adverse audit findings.
2. Action by superiors on the basis of reported defects and deficiencies in audit practices namely :
 In sensitive and highly critical reports
 Reports that focus only on deficiencies.
 Hostile audit style such as when the management auditor is cold in his approach, lack of understanding of the practical problems of auditees and excessive concentration on insignificant errors.

Answer 13. (d)

Auditing through the Computer :

1. The inherent risk associated with the application system is high.
2. The application system processes large volumes of input and produces large volumes of output that makes extensive direct examination of the validity of the input and output difficult to undertake.
3. Significant parts of the internal system are inbuilt in the computer.
4. The processing logic embedded within the application system is complex.
5. Substantial gaps in the visible audit trail are common in the system.

Q. 14. (a) What are the types of internal controls likely to be found in a computer based system?

(b) What are the major phases in the audit of computerized accounts?

(c) The overall objective and scope of audit does not change in computerized environment – Explain.

(d) Write short note on – Types of CAATs.

Answer 14. (a)

Internal Control in Computer based System.

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

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

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

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

Answer 14. (b)

The audit of computerised accounts can be divided into two major phases :

1. Review of internal controls ; and
2. Examination of records produced by the data processing system.

Review of internal controls :

The auditor's review of internal controls involves ascertaining the system, testing compliance through the performance of compliance procedures, and finally, making an evaluation of the system as a basis for ascertaining the degree of reliance which he can place on the system in determining the nature, timing and the extent of his substantive procedure.

The auditor can obtain any document on understanding of the internal controls through the use of organisation charts, internal control questionnaires, inquires, and EDP application controls. It must be recognised that general EDP controls have pervasive effect on all facets of the system. Thus, if these controls are not effective, it is possible that material errors might occur and remain undetected. The auditor should review the various general EDP controls as well as the EDP application controls, i.e. controls over input, processing output, etc.

Examination of records produced by the data processing system :

The next step for auditor is to select and examine the records produced by the data processing system with a view to assessing their accuracy, validity and completeness. In doing so, the auditor has to deal with a problem peculiar to EDP systems, namely, lack of a complete and visible audit trail.

The audit trail refers to the links by which an original transaction can be traced forward to its final output or whereby each item of the output can be traced back to the source documents. The vouchers, journal, ledger, and other books of account provide the links in the audit trail. These are important for an auditor since he can trace the final impact of all transactions on the financial statements only through such links.

Answer 14. (c)

The most important objective of an audit of financial statements, prepared in accordance with recognised accounting policies and practices and within the framework of relevant statutory requirements, if any, is to ensure that the financial statements reflect a true and fair view of the state of affairs of the auditee. The scope of an audit of financial statements is determined by the auditor taking due note of the terms of the audit reference, the requirements of relevant legislation and the pronouncements of the Institute made from time to time. This would involve assessment of reliability and sufficiency of the information contained in the accounting records and other source data; this in turn involves systematic study and evaluation of accounting system and internal controls in place. The overall objective and scope of an audit does not change in an EDP environment; it remains the same. It is the use of the computer which modifies the processing and storage of financial information. This may affect the methods and procedures employed by the entity to ensure presence of adequate internal control system. As a logical consequence, the procedures followed by the auditor in his study and evaluation of the accounting system and related internal controls as well as the nature, timing and extent of his other audit procedures may be significantly influenced by an EDP environment. The computerization of accounts would also have an impact on the increase in fraud and errors. In an EDP environment, empirical studies have revealed that a huge quantum of loss arises on account of errors and omissions and that the greatest threat to the organisation comes from its employees. The auditor should bear these aspects in mind while auditing the computerized system. Further, when auditing in an EDP environment, the auditor should have sufficient understanding of computer hardware, working idea of the software and processing systems to plan the engagement and to understand how EDP affects the study and evaluation of internal control and application of auditing procedures. These would be required to plan usage of generalized audit software and computer-assisted audit techniques.

Thus, it is clear from the above that overall objective and scope of audit does not change irrespective of fact that whether the accounting information is generated manually or through EDP.

Answer 14. (d)

CAATs can be broadly categorised into the following three types :

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

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

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