

INTERMEDIATE EXAMINATION

GROUP I

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2012

Paper- 6 : COMMERCIAL AND INDUSTRIAL LAWS AND AUDITING

Time Allowed : 3 Hours

Full Marks : 100

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

- Please (1) Answer all bits of a question at one place.
(2) Open a new page for answer to a new question.
(3) Attempt the required number of question only.

Answer **Question No. 1** and **Question No. 5**, which are compulsory and attempt **any two** from the rest in **Section I** and **any two** from the rest in **Section II**.

SECTION - I (50 Marks)

(Commercial and Industrial Laws)

Q. 1. Comment on the following based on legal provisions (no marks for wrong reasons or justification) :
[2×7]

- (a) Mr. A. Bose contracts with Mr. B. Ghosh to deliver to him 300 kgs Rice before 31.05.2012. Mr. Bose delivered 200 kgs by 31.05.2012. Mr. Ghosh refused to pay due to non-performance.
- (b) Remaining silent with respect to the known defects is fraudulent.
- (c) There are in total two parties to a Promissory Note.
- (d) Any child can be employed in a factory.
- (e) ABC Ltd. who incurred heavy loss during 2011-12 has not paid Bonus to any of its employees.
- (f) Works Manager has deducted INR 500 from wages towards the cost of tools and raw materials supplied to workers for purpose of employment (Payment of Wages Act).
- (g) Mr. A being an agent of Mr. P (who is owner of land) agrees for money to obtain for Mr. B a lease of P's land but without the knowledge of 'P'. Discuss the validity of this agreement.

Answer 1. (a)

As per Sec 37(1) of Sale of Goods Act, 1930, where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them, but if the buyer accepts the goods so delivered he shall pay for them at the contract rate. In this case as Mr. B. Ghosh has accepted the short delivery, he is bound to pay the value of 200 kg. rice to Mr. A. Bose.

Answer 1. (b)

The statement is False. "Silence is not fraud". However, where the parties stand in a fiduciary relation to each other, remaining silent shall be fraudulent. Like wise silence shall be fraudulent where it is equivalent to speech or where contract requires utmost good faith. [Section 17, The Indian Contract Act, 1872].

Answer 1. (c)

The statement is False. There are Five Parties to a promissory note viz.

- (1) **The maker** — The person who makes the "Note" promising to pay the amount stated therein.
- (2) **The Payee** — The person to whom the amount of the "Note" is payable.
- (3) **The Holder** — i.e. either the original payee or any other persons in whose favour the "Note" has been endorsed.
- (4) **The Indorser** — The person who endorses the "Note" in favour of another person.
- (5) **The Indorsee** — The person in whose favour the "Note" is negotiated by endorsement.

Answer 1. (d)

The statement is false. According to Section 67 of The Factories Act, 1948, no child who has not completed his fourteenth year shall be required or allowed to work in any factory. As per Sec, 68 of The Factories Act, 1948, a child who has completed his fourteenth year or an adolescent shall not be required or allowed to work in any factory unless—

- (a) a certificate of fitness granted with reference to him under section 69 is in the custody of the manager of the factory; and
- (b) such child or adolescent carries while he is at work a token giving a reference to such certificate.

Answer 1. (e)

As per Sec. 10 of the Payment of Bonus Act, 1965, subject to the other provisions of this Act, every employer shall be bound to pay to every employee in respect of the accounting year commencing on any day in the year 1979 and in respect of every subsequent accounting year, a minimum bonus which shall be 8.33 per cent of the salary or wage earned by the employee during the accounting year or one hundred rupees, whichever is higher, whether or not the employer has any allocable surplus in the accounting year :

Provided that where an employee has not completed fifteen years of age at the beginning of the accounting year, the provision of this section shall have effect in relation to such employee as if for the words "one hundred rupees", the words "sixty rupees" were substituted.

Answer 1. (f)

Deduction from wages shall be made only in accordance with the provisions of Sec 7 The payment of Wages Act, 1936.

There is a provision that deduction may be made for “such amenities” services supplied by the Employer. The words “amenities” or “Services” in this clause does not include supply of tools or raw materials. Hence Work Manager cannot deduct ₹ 500.

Answer 1. (g)

When an act is done by one person on behalf of another but without his knowledge or authority, the later may elect either to ratify or disown such Act (sec 196 of The Indian Contract Act, 1872).

In the instant case if a lease is granted by “A” in favour of B on the fact coming to the knowledge of the P, he may either decide to ratify the lease agreement or to disown it.

If the P decides to ratify the lease, then it would be a valid contract.

Q. 2. (a) Orders once passed by the Competition Commission of India cannot be reviewed. Do you agree? [2]

(b) Saxena lets to Mr. Menon for hire a horse for his own riding but Mr. Menon drives the horse in his carriage. What action saxena can take? [2]

(c) Mr. Malhotra aged 50 years joined the P.F. Scheme on 01.01.2003. He decided to leave the service w.e.f 01.07.2012 provided he gets Pension under E.P.F. Scheme. Advice based on Rules. [2]

(d) Arun entered into a contract with Barun to let out the house under construction and received advance of INR 2 lakhs. The house was, however, requisitioned by Government and, therefore, Arun failed to honour the contract. Can Barun recover damages for breach of contract? Advice. [2]

(e) As per order, Mr. Malhotra sent some goods to Mr. Paul at Kolkata through Rail. The Station Superintendent of Howrah Station informed Mr. Paul that goods are held at the Station at Paul's risk and cost. In the mean time, Mr. Paul became insolvent. Mr. Malhotra wants to enforce right as an unpaid seller. Advice. [2]

(f) Ashim sells 1600 kgs of wheat out of large quantity lying in his godown forwarded to Bablu. Out of these, Bablu sells 600 kgs to Chandan (wheat yet to be ascertained). Then Chandan forwarded the delivery order signed by Bablu to Ashim who confirmed that wheat would be despatched in due course. Bablu then becomes insolvent. Ashim refused to deliver to Chandan. Advice Chandan based on rules. [3]

(g) Under Rights to Information Act if life or liberty of any person is involved, the Public Information Officer expected to reply within one month. Give correct period if this is wrong. [2]

(h) Mr. Batliboi bought 50 kgs of potato against cash payment from Mr. Joshi under a Contract of Sale but half of consignment was rotten and Mr. Joshi refused to change the rotten potato nor refunded the value. Advice Mr. Batliboi. [3]

Answer 2. (a)

Any person aggrieved by an order of the commission for which an appeal is allowed but no appeal has been preferred may within 30 days from the date of the order apply to the commission for review of its order. Time limit of 30 days can also be extended considering the circumstances. [Section 37, The Competition Act, 2002]

Answer 2. (b)

If the bailee does any act with regard to the Goods bailed inconsistent with the conditions of bailment, the bailor may terminate the bailment [Sec 153 of the Indian Contract Act, 1872].

This is a voidable at the option of Saxena, since Menon has violated the conditions.

Answer 2. (c)

Pension is allowed when

- (i) an employee attained the age of 50 Years or more and
- (ii) when he has completed a total service of, 10 years or more and
- (iii) When he is not receiving any other EPF Pension from any other Employer.

It is presumed he is not receiving any other EPF Pension.

He has attained the minimum age of 50 years but he has not completed minimum 10 years of service.

Hence he will not be entitled to pension if he leaves w.e.f. 1.7.12. He will however be entitled for pension if he leave the Employment after 1.1.2013.

Answer 2. (d)

Mr. Bartin can not recover damages for breach of contract. According to sec 56 of The Indian Contract Act, 1872, a contract becomes void in the event of supervening/subsequent impossibility as to its performance. As the house is requisitioned by the Government, Arun shall be excused of his obligations. The contract becomes void u/s 56, of the Indian Contract Act, 1872.

Answer 2. (e)

Mr. Malhotra has lost his right of stoppage in transit, as the intimation sent by Station Supdt. that the goods are held at Paul's risk and cost has changed the position of Station Supdt. into a bailee of Mr. Paul instead of Mr. Malhotra. The transit has thus come to an end. [Sec 51, The Indian Contract Act, 1872]

The transit being over, Mr. Malhotra's right is thus lost. He can not enforce his right as unpaid seller.

Answer 2. (f)

Ashim can not refuse to deliver 600 kgs of wheat to Chandan. Sec. 53 of The Sale of Goods Act, 1930 provided that seller (i.e. Ashim) loses his right of lien, if he has assented to the sale to a subsequent buyer. By giving assent to Chandan, Ashim has lost his right of lien.

Answer 2. (g)

The statement is not correct. If the life or liberty of any person is involved, the public information officer is expected to reply within 48 hours. [Sec 3, Right to Information Act, 2005]

Answer 2. (h)

As per Section 16(2) of the Sale of Goods Act, 1930, where goods are bought by description from a seller who deals in goods of that description, there is implied condition that goods shall be of merchantable quality. In case of eatables and provisions, in addition to implied condition as to merchantability, there is another implied condition as to wholesomeness in case of foodstuffs and other goods meant for human consumption. Potato is not a manufactured item like biscuits for example which can be labeled with date of manufacture, date of packaging, batch number, best before date etc. Food items like potatoes if packed are only for the convenience of handling. So it may not be possible for the buyer to check the quality. So the doctrine of Caveat Emptor cannot be applied.

So Mr. Batliboi should claim damages for rotten potatoes.

- Q. 3. (a)** Fill in the blanks : [1×4]
- (i) Drinking water shall be provided at suitable points which shall not be situated within _____ metres of any washing place/urinal.
 - (ii) In every factory wherein more than _____ workers are ordinarily employed, cooling drinking water during hot weather shall be provided.
 - (iii) No person shall spit except in the spittons provided for in factory and whoever spits in contravention shall be punishable with fine of INR _____ .
 - (iv) In every factory wherein _____ workers are ordinarily employed, Welfare Officer as may be prescribed shall be employed.
- (b)** A seller may deliver goods to a carrier with a right of disposal. Comment. [2]
- (c)** Jayanta, the owner of a car hand overs the car with key to Partha (the mercantile agent) to sell the car at a price not below INR 1,00,000. Partha (the agent) sold at INR 90,000 to Amitava, who buys in good faith and without notice of reserve price/or any fraud. Partha misappropriated the money also. Jayanta filed a suit against Amitava to recover the car. Advice with reasons whether Jayanta can succeed. [3]
- (d)** Arun seeing a watch in Barun's shop marked for sale for INR 1000 entered the shop, places INR 1000 on the counter and asks for the watch. Barun refused. Can Barun refuse to sell the watch? Give reasons. [2]
- (e)** State the essentials of a valid contract. [5]
- (f)** "Young persons" means a person who has completed 18 years of age (Factories Act, 1948). Do you agree? [2]

Answer 3. (a)

- (i) 6 [Section 18, The Factories Act, 1948]
- (ii) 250 [Section 18, The Factories Act, 1948]
- (iii) ₹ 5/- Rupees five [Section 20, The Factories Act, 1948]
- (iv) 500 [Section 49, The Factories Act, 1948]

Answer 3. (b)

Yes, the seller may do so. In such case, he does not loose the right of lien u/s 46(1)(a) of The Sale of Goods Act 1930, even though the seller has parted with the possession of goods.

Answer 3. (c)

Jayanta can not recover the car from Amitava, as sale by Partha, (the mercantile agent) is a valid sale and confers good title on Amitava. (sec 27 of Sales of Goods Act).

Where mercantile agent is with the consent of the owner, in possession of the goods or of a document of title to the goods, any sale made by him when acting in the ordinary course of business of a mercantile agent shall be valid as if he were expressly authorized by the owner of the goods to make the same provided that the buyer act in good faith and has not at the time of contract of sale notice that the seller has not authority to sell.

Answer 3. (d)

No. Barun is not bound to sell the watch. Price label on article only amount to an invitation to offer and not an offer.

Placing of ₹ 1000 by Arun amounts to an offer which may or may not be accepted by Barun. [Ref. Pharmaceutical Society of Great Britain-Vs-Boots Cash Chemists Ltd, (1953) 1 Q. B. 401].

Answer 3. (e)

Section 10 of Contract Act, 1872 state the elements which are essential in order to constitute a valid contract. They are :

- (i) **Agreement** — In order to constitute a contract, there must be an agreement in first place. An agreement in turn is composed of two elements-offer and acceptance. Thus there must be atleast two parties one making the offer and another accepting it. The terms of offer must be definite and the acceptance must be absolute and unconditional.
- (ii) The parties must intend to create a legal relationship. Agreements of social or domestic nature do not contemplate legal relationship, so they are not contracts.
- (iii) **Lawful consideration** — The agreement must be supported by a lawful consideration. Consideration means 'something in return'. 'Something in return' may be an act or abstinence. But it must be real and lawful.
- (iv) The parties to an agreement must be capable of entering into a contract. A person is considered competent if he is (a) eighteen years of age (b) of sound mind (c) not disqualified from contracting by any law to which he is subject.
- (v) The object of agreement must be lawful.
- (vi) The consent of the parties must be free and genuine i.e. not induced by coercion, undue influence, fraud or misrepresentation.
- (vii) The agreement not expressly declared void or illegal by law.
- (viii) The terms of agreement must be certain and capable of performance.
- (ix) **Legal formalities** — Where nature of agreement is such that it requires compliance of certain formalities, such requirements should be fulfilled. A contract may require registration in addition of being in writing.

However as regards to legal effects, an oral contract has same weightage as a contract in writing.

Answer 3. (f)

The statement is not correct. Young persons means a person who is either a child or an adolescent. [Sec 2(d), The Factories Act, 1948]

A child means a person who has not completed his 15th year of age. [Sec 2(c), The Factories Act, 1948] An adolescent means a person who has completed his 15th year of age but not completed his 18th year. [Sec 2(b), The Factories Act, 1948]

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

[4×4]

- (i) Future Goods;
- (ii) Counter Offer;
- (iii) Protection of Gratuity;
- (iv) Limited Liability Partnership;
- (v) Industrial Disputes (I.D. Act, 1947).

- (b) In the event of principal debtor being a minor, creditor cannot recover his money, from the surety-offer you views. [2]

Answer 4. (a)

- (i) **Future Goods** — These are the goods which a seller does not possess at the time of the contract but which will be manufactured or produced or acquired by him after the making of the contract of sale [Sec.2(6), The Sale of Goods Act, 1930] A contract of present sale of future goods, purports to operate as an agreement to sell and not sale [Sec. 6(3)] This is because the ownership of a thing cannot be transferred before the thing comes into existence.

A railway administration entered into a contract for sale of coal-ash that might accumulate during the period of contract. [Union of India v. Tara Chand, A. I. R.(1976) M.P. 101]

- (ii) **Counter offer**

Where the offeree instead of unconditionally asserting to the terms of the offer accepts subject to certain conditions, he is said to have made a counter offer.

The counter offer has the effect of determining the original offer since it shall amount to a fresh offer by the offeree which the offerer may or may not agree to accept.

Where an offeree agreed to accept half of the quantity of goods offered by the offerer without changing the other terms and conditions of the offer, it was held that there was no contract as there was a counter offer to the original offer.

- (iii) **Protection of Gratuity**

No gratuity payable under the Payment of Gratuity Act, 1972 and no gratuity payable to an employee employed in any establishment, factory mines, oil field, plantation, port, Railway company or shop exempted u/s 5 shall be liable to attachment in execution of any decree or order of any civil, revenue or criminal court. [Sec 13, The Payment of Gratuity Act, 1972]

- (iv) **Limited Liability Partnership (LLP)**

Limited Liability Partnership is formed under Limited Liability Partnership Act, 2008. Its essential features are :

- (1) A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners and liability of partners are limited.
- (2) A limited liability partnership shall have perpetual succession.
- (3) Any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.
- (4) The provisions of the Indian Partnership Act, 1932 shall not apply to a limited liability partnership.
- (5) Any individual or body corporate may be partner of LLP.
- (6) Every limited liability partnership shall have at least two partners.
- (7) Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.
- (8) Every limited liability partnership shall have a registered office to which all communications and notices may be addressed and where they shall be received.
- (9) Every limited liability partnership shall have either the words “limited liability partnership” or the acronym “LLP” as the last words of its name.

(v) **Industrial Disputes**

As per Section 2(k) of the Industrial Dispute Act, 1947, “industrial dispute” means any dispute or difference between employers and employers, or between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment or the terms of employment or with the conditions of labour, of any persons;

The definition of ‘**industrial dispute**’ in Sec 2(k) of The Industrial Dispute Act, 1947 has three ingredients and if all these are satisfied, the dispute raised is an industrial dispute. These ingredients are :

- there should be real and substantial dispute or difference;
- the dispute or difference should be between employer and his workmen; and
- the dispute or difference must be connected with the employment or non-employment or the terms of employment or with the conditions of labour, of any persons.

Answer 4. (b)

Surety is the person who gives guarantee to perform the promise or discharge the liability of a third person in case of his default. The person in respect of whom guarantee is given is called the principal debtor. Sec 128 of the Indian Contract Act, 1872 deals with the nature of surety’s liability. It provides that ‘the liability of the surety is co-extensive with that of the principle debtor, unless it is otherwise provided by the contract.’

However there are contrary judgments in this regard pending apex courts decisions. In *Kashhiba vs Shripat* (1895) 19 ILR Bom. 697, the Bombay High Court held that contract of surety is not a collateral contract but a principal contract. So the surety is held liable to repay the loan as principal debtor is a minor, hence not liable.

In *Dane vs Mortgage Insurance Corpn. Ltd.*, (1894) 1 Q B 54, it was held that the discharge of principal debtor by operation of law does not discharge the surety. There are judgments in accordance with Section 128.

In view of the fact that the liability of the minor to repay the debt is nil, so is the liability of the surety, too [*Manju Mahadeo vs Shivappa Manju*, as also *Pestonji Mody vs Meherbai*].

The logic is simple enough. That is, if the minor cannot be held to have defaulted, and that the liability of the surety, being secondary and contingent thereto, can arise only thereafter, this liability as well cannot be said to be there at all. The Madras High Court has also held similar views in the case of *Edavan Nambiar vs Moolaki Raman* [AIR 1957 Mad. 164]. It has, however, been further observed that **unless otherwise specifically provided to the contrary, the surety cannot be held liable for having guaranteed a minor’s debt**. Alternatively speaking, the surety can be held liable for having guaranteed a minor debt, if it has been so specially provided to this effect in the guarantee document.

SECTION - II (50 Marks)
(Auditing)

Q. 5. Comment on the following statements based on legal provisions (no mark for wrong reasons or justification) :

- (a) Development of the audit evidence is the basic to the understanding of the audit process.
- (b) Verification of assets and liabilities is very important function.
- (c) EDP audit has not changed the fundamental nature of auditing.
- (d) Year end stock ready for exports are proposed to be valued at realisable value.
- (e) Practising Cost Accountant cannot be Internal Auditor as Internal Audit is related to financial accounting.
- (f) Test checks may be applied to all transactions.
- (g) Dividend has been declared out of profit on re-issue of forfeited shares. [2×7]

Answer 5. (a)

The concept of evidence is fundamental to Auditing. All auditing techniques and procedures are derived from it. It helps the Auditor in perceiving the types of evidence available in a audit situation, collecting it through the various audit techniques and evaluating its efficiency and completely to support accounting data.

Hence, Development of this concept is the basic to the understanding of the Audit process.

Answer 5. (b)

Verification is a function of examining assets & liabilities to check value, ownership, title; existence, possession & to see whether the assets are free from any charge or encumbrances etc.

Verification is very important function from view point of both the auditor and the client as it gives clear idea as to true & fair view of Balance Sheet.

Answer 5. (c)

The statement is true. EDP Audit is the process of Auditing in a computerized environment. Although the overall objectives, scope and fundamental nature of Audit have not changed but it has definitely caused substantial changes in the methods of evidence collection & evaluation, the prime objectives of EDP. Audit are to determine whether computer system safe-guard assets maintain data integrity, achieve organizational goals, effectively and consume resources efficiently. Proper systems of internal control can not be avoided.

Answer 5. (d)

As per AS 2 closing stock is to be valued at cost or market price whichever is lower, the stock shall not be valued at realizable value.

Answer 5. (e)

The statement is false. Practising Cost Accountant can also be the internal auditor provided, he is not the Cost Auditor of the same company.

Answer 5. (f)

The statement is false. Only some transactions are subject to Test Check. Cash/Bank Book and Pass Book should be thoroughly checked.

Answer 5. (g)

Profit on re-issue of forfeited shares are not freely available for distribution as dividend because Profit on reissue of forfeited shares are transferred to capital reserve. Hence Auditor shall advice the management for rectification otherwise to report to the shareholders through his Audit Report.

- Q. 6. (a)** Newly formed ABC & Associates, Chartered Accountants have received offer from 25 Public Ltd. Companies having a Paid-up Capital of INR 10 lakh and 5 Private Companies with Paid-up Capital of INR 15 lakh each. All the offers have been accepted. Comment on validity. [4]
- (b)** Accounts of Mumbai Branch was audited by a firm of Chartered Accountants of Mumbai. Even then the Company Auditor demanded to visit Mumbai Branch, Director (Finance) could not agree. Offer views. [2]
- (c)** Internal Control and Internal Check are same.-Comment. [4]
- (d)** What are the points an Auditor shall consider in I.T. Audit in respect of “Information Processing Facilities”? [2]
- (e)** Managing Director of the Vintex Co. Ltd. opined that Management Audit is not useful and, therefore, there is no need of Management Audit. —State the circumstances if Management Audit is useful to the management. [2]
- (f)** Explain what are expected under CARO regarding—
- (i) Maintenance of Cost Records;
 - (ii) Financial Management. [2+2]

Answer 6. (a)

Sec 224 (1B) of Companies Act 1956 provides that a person or a firm can accept the appointment.

- (i) As Auditor of 20 Companies in case of Companies having a paid up share capital of less than ₹ 25 lakhs.
- OR
- (ii) 20 Companies out of which not more than 10 (ten) shall be companies each of which has a paid up share capital of ₹ 25 lakhs or more

The ceiling of 20 companies does not apply to the Private Companies.

In view of the above, and since the paid up capital of all the public companies is less than ₹ 25 lakhs. Auditor can accept appointment of maximum 20 Public companies. They are to surrender the appointment of any 5 public companies.

Besides they can accept appointment of all the 5 (five) private companies.

Answer 6. (b)

The Company auditor is entitled to visit the Branch office and has right to access all books and accounts records etc of the branch. The Director (Finance) cannot disallow the company auditor the right to visit Branches.

Answer 6. (c)

Internal control	Internal Check
<p>In accounting and auditing, internal control is defined as a process effected by an organization's structure, work and authority flows, people and management information systems, designed to help the organization accomplish specific goals or objectives. It is a means by which an organization's resources are directed, monitored, and measured. It plays an important role in preventing and detecting fraud and protecting the organization's resources, both physical (e.g., machinery and property) and intangible (e.g., reputation or intellectual property such as trademarks).</p>	<p>Internal check means checks on day-to-day transactions which operate continuously as part of the routine system whereby work of one person is proved independently or is complimentary to the work of another person. The object of internal check is prevention or early detection of fraud or error. Internal check is the part of internal control system and operates as a built-in device as far as the staff organization and job allocation aspects of the control system are concerned. The system in accounting implies organization of system of book keeping and arrangement of staff in such a manner that no one person can completely carry through a transaction and record every aspect thereof. Essential elements of a good internal check systems are :</p> <ul style="list-style-type: none"> (i) Existence of checks on the day-to-day transaction. (ii) System operates continuously as a part of the routine system. (iii) Work of each person is either proved independently or is made complementary to the work of another. <p>The objective of internal checks is to prevent and speedy detection of frauds, wastes and errors.</p>
<p>Internal control thus refers to a process that is designed for helping the organization to accomplish goals and objectives through people of the organization.</p>	<p>Whereas Internal Check is a part of Internal Control. Internal check is subsystem of internal control.</p>

Answer 6. (d)

An auditor to verify that this processing facilities is controlled to ensure timely, accurate and efficient processing of applications under normal and potentially disruptive conditions.

Answer 6. (e)

The statement is not true. Following are the circumstances where in Management Audit is useful to the management. Company itself feels the need of management audit to assess its managers' performance and link an incentive system to the results of such assessment.

There are of other factors :

- (i) To overcome the human limitations of Top Management.
- (ii) To improve the Management's production.
- (iii) Circumstances of corporate planning deficiencies, organisations structural defects, in effective management control system etc. warrant the necessity of management.
- (iv) In connection with acquisition of another entity, merger etc.

Answer 6. (f)

Audit under CARO is to report as follows :

- (i) Where maintenance of cost records has been prescribed by the Central Government u/s 209 (1) (a) of Companies Act, 1956 whether such accounts and records have been made and maintained.
- (ii) Whether the funds raised on short-term basis have been used for long-term investment and vice-versa. If yes, the nature and amount is to be indicated.

Q. 7. (a) What are expected under CARO in respect of—

- (i) Fraud; [2+2]
- (ii) Internal control on purchase of assets. [2+2]
- (b)** Proposed dividend was not adjusted in the financial statement. Offer your views. [2]
- (c)** How you will verify the machinery imported from Germany? [4]
- (d)** In course of verification of production equipment, how you will verify the idle facilities? [4]
- (e)** Auditor is concerned with "Desired Audit Risk" under computer information system, as such risk also help him in making a decision. Name with short description of such "Desired Audit Risk". [4]

Answer 7. (a)

The following matters are required to be dealt with in CARO—

- (i) Whether any fraud has been noticed or reported during the year, if yes, 'the nature and the amount involved is to be indicated.
- (ii) Is there an adequate Internal control procedure commensurate with the size of the company and the- nature- of its business for the purpose of inventory and fixed assets and sale of goods. Whether there is a continuing failure to correct major weakness- in internal control?

Answer 7. (b)

Proposed dividend by Directors should be disclosed in the financial statements as per the requirement of schedule VI to Companies Act. Though the dividend proposed is subject to approval of the shareholders in the AGM, dividend proposal is one of the appropriation of Profits and as such it should be taken in the preparation of the financial statement as per schedule VI.

Answer 7. (c)

Checklists for verification of imported machinery :

- (i) To check and verify the Authority for purchase viz. Boards Resolution, shareholder's approval where Board has no power.
- (ii) To verify the RBI's Permission/approval and the import license where necessary.
- (iii) To verify the agreement terms & conditions, interest rates, basis of installment payment if any, guarantee erection, trial run etc.
- (iv) To vouch the bill & receipts, customs papers, certificates necessary for purchase from outside India, clearing and shipping charges, insurance premium etc.
- (v) To check the entries in the books of accounts.
- (vi) To check whether all expenditures even revenue type expenses spent for this specific items have been capitalised.
- (vii) Whether such machine has been recorded in the Asset Register & whether machine has been numbered.

Answer 7. (d)

Checklists for verification of idle facilities :

- (i) To find out the reasons for idle facilities.
- (ii) To check the total idle facilities during the year. Steps taken to reduce the same, specially for controllable reasons.
- (iii) Review the plans, procedures for control of the idle facilities, value of idle facilities in terms of money.
- (iv) Examine the scope for utilization of idle facilities, can the facility be leased out?
- (v) See whether any review report is made periodically.

Answer 7. (e)

Desired Audit Risk are :

- (i) Internal risk - which represent the material loss or errors existing in some segments of the Audit before the reliability of internal controls is considered.
- (ii) Control risk - which means the likelihood of internal controls in some part of Audit cannot present, detect or correct the material losses or errors.
- (iii) Detection risk - which means the audit procedures used in some part of audit will fail to detect the material losses or errors.

Q. 8. (a) After understanding the importance of system to reduce complexity, the nature of audit risk, the types of audit procedures etc. under computer information system, Auditor is to take steps for carrying out Audit. —Indicate the 'steps'. [4]

(b) Following figures are given in respect of ABC Ltd. :

	Gross Profit	Sales
2010-11	12800	60000
2011-12	15200	74800

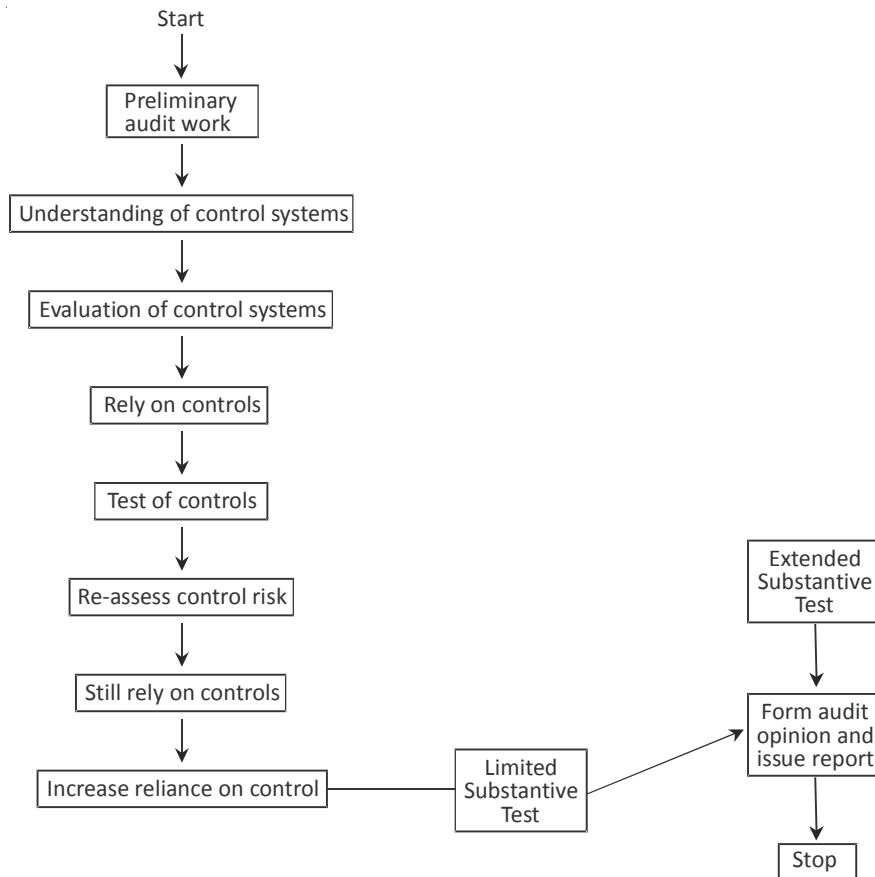
- (i) Is there fall or rise in gross profit ratio?
- (ii) What can cause if rise or fall in the gross profit ratio? [1+1]

14 ♦ Suggested Answers to Question — CIA

- (c) One electric bill for INR 20000 for the month of March, 2011 was paid in the month of October, 2011 for which no provision was made in the Accounts for 2010-11. How you will solve this item in the Accounts of 2011-12? [2]
- (d) CMA Ltd. want to treat the heavy advertisement expense incurred for launching a new product as revenue expenditure. The product did not pick up and the sales were negligible. It is anticipated that no material benefit would accrue in future. —Offer your views. [2]
- (e) As an auditor of a company, how you will vouch the sales tax/VAT? [4]
- (f) Explain what is expected under CARO regarding “Disclosure of end use of money raised from Public Issue”. [2]
- (g) Find out the difference between India GAAP and US GAAP in respect of “Investment in own shares”. [2]

Answer 8. (a)

Steps in an audit under Computer Information System :



Answer 8. (b)

$$\begin{aligned} \text{(i) G.P. Ratio for 2010-11} &= \frac{12800}{60000} = 21.33\% \\ \text{2011-12} &= \frac{15400}{74800} = 20.58\% \end{aligned}$$

There is fall in G.P. ratio.

(ii) Effect/Cause :

A low gross profit ratio may indicate unfavourable purchasing policies, inability of management to develop sales-volume, over investment in plant facilities, too much staff as compared to production facilities etc.

Answer 8. (c)

This relates to previous year, the provisions of AS 5 shall be observed.

Previous years item i.e. INR 20000 may be included in the determination of net profit/loss for the current year by opening a separate account named "Prior Period Adjustment A/c".

Alternatively,

Show such amount in the statement of Profit & Loss after determination of current years net profit or loss.

In either case the objective is to indicate the effect of such item on the current year's profit or loss.

Answer 8. (d)

An expenditure is treated as revenue expenditure if benefits are not likely to extend for more than one year. In the present case the sales of product are negligible. Besides no materials benefits will accrue in future. Therefore, this amount be treated as revenue expense even if the amount is heavy.

Answer 8. (e)

Checklist to Vouch Sales Tax/VAT :

- (i) To compare the current year's ratio of Sales Tax/Vat to sales effected with that of the previous year.
- (ii) Vouch the payment of Central Sales Tax/Vat with challans & return of payment.
- (iii) To ensure whether VAT Audit is applicable, if so whether audit completed within prescribed time by the authorized person.
- (iv) To see that the Accounting of set-off if any of payment of tax is properly made and shown properly in final accounts.
- (v) Verify the assessment order to calculate the short or excess payment & accounting done.
- (vi) Check the assessment year in regard to payment of tax etc.

Answer 8. (f)

Whether the management has disclosed on the end use of money raised by public issue and the same has been verified.

Answer 8. (g)

India GAAP : Expressly prohibited except in case of buy back of own securities.

US GAAP : Permitted and is shown as a reduction from share-holder's equity