

INTERMEDIATE EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - I

Paper-6 : COMMERCIAL AND INDUSTRIAL LAW AND AUDITING

Q1. Comment on the following :

- (i) Proposal + Acceptance + Enforceable by Law = Contract.
- (ii) Minor under Contract Act is always beneficiary.
- (iii) 'A' communicated his decision to revoke his acceptance to B via e-mail. B's computer was sent for repairs, and so he did not check his mail. When is the communication of revocation complete against B?
- (iv) Silence is fraudulent.
- (v) An agreement with insufficiency of consideration is void ab initio.
- (vi) X lent Y Rs. 5000/-. Y signed a post dated cheque in favour of X amounting to Rs.50,000/- erroneously. Can Y plead mistake as defence?
- (vii) There is presumption of undue influence in husband wife relationship.
- (viii) X guarantees all advances made to C within a period of one quarter by YZ bank subject to maximum of Rs 100,000/- . What is the nature of guarantee? If X dies, whether his legal successors will be liable to pay the amount.
- (ix) Sale made by pledgee without reasonable notice is void.
- (x) X consigns a truck of Dussera mangoes to Y at Asansol via Kolkata through A. Sensing that the mangoes may get destroyed, A sells them at Kolkata itself.
- (xi) Some contracts without consideration are valid.
- (xii) Risks follows ownership.
- (xiii) 'A stipulation may be a condition though called warranty in a contract.'
- (xiv) A promissory note is made without specifying the time for payment. The holder added 'on demand' on face of the instrument. Does that amount to changing character of the instrument?
- (xv) A Bill of Exchange is dated 1.6.2009 was made payable 3 months after date. What was the due date of payment?
- (xvi) X has balance of Rs. 3000/- in YZ Bank. He draws a cheque of Rs 10,000/- in favour of C knowing fully that he has no O/D facility. The cheque is dishonoured. Is notice of dishonour to X necessary?
- (xvii) Y has worked for only 32 days in an accounting year. He is not paid bonus and employer is right.
- (xviii) X was on maternity leave for 3 months during the accounting year 2008-09. She availed casual leave of another 8 days. Does this entitle her to full Bonus.

- (xix) A earns a salary of Rs. 10,000 per month. Bonus declared by employer was 10% of salary. Bonus received by A was Rs. 4200.
- (xx) When is a person allowed Gratuity even before completing 5 years of employment?
- (xxi) 'Continuous service' in case of seasonal industries under Payment of Gratuity Act.
- (xxii) An apprentice is entitled to Bonus under Bonus Act, 1972.
- (xxiii) Minimum wage rate may vary.
- (xxiv) Employees are entitled to bonus even if the undertaking falling under Bonus Act suffers loss during a particular accounting year.
- (xxv) An A.C installed in office of ABC & CO stopped working within 2 months of purchase. The proprietor made an complaint with District forum against seller.
- (xxvi) Limited Liability Partnership is distinct from limited partnership.
- (xxvii) D, met an accident in factory premises. He filed a suit against the owner to claim compensation.
- (xxviii) An employer in order to reduce his liability under Workmen Compensation Act entered into a contract with the employees.
- (xxix) Two employees of a factory entered into a fight in the canteen over seat, eventually hurting each other. Whether this is industrial dispute?
- (xxx) How to settle an E.P.F A/c?

Answers 1.

- (i) A proposal when accepted becomes an agreement. An agreement when enforceable by Law becomes a Contract.
- (ii) As per Indian Contract Act, 1872 an agreement with a minor is void abinitio. However there is nothing that debars him from becoming a beneficiary i.e. payee, endorsee or promisee in a contract. The law does not regard him incapable of accepting a benefit. It should be however remembered that his property is liable for meeting the liability arising out contracts to supply him his necessities.
- (iii) As per Indian Contract Act, communication of revocation is complete as against the person to whom it is made when it comes to his notice. So it is complete against B when he checks his e-mail.
- (iv) Mere silence on the part of proposer so as to affect willingness of the acceptor is not fraud as the general rule is buyer beware. However silence is fraudulent in certain cases as follows :
 - a) Where it is duty of the proposer to speak.
 - b) Where silence is equivalent to speech.
- (v) The agreement is neither void nor voidable. The law simply states any contract should be supported by consideration. It does not say that consideration should be of equal value.
- (vi) According to Sec.22 of Indian Contract Act, a contract is not voidable merely because it was caused by one of the parties to the contract being under mistake as to matter of fact. So Y cannot claim mistake as defence.
- (vii) Undue influence is not presumed in husband wife relationship unless the wife is a pardanashin.
- (viii) This is a continuing guarantee. So X's legal successors are liable subject to the amount of property inherited from X.
- (ix) Sale made by pledgee without reasonable notice is not void. But he is liable to the pledgor for damages suffered.

- (x) In this case A is acting as an agent of X out of necessity.
- (xi) A contract without consideration is valid when —
- it is in writing;
 - it is registered;
 - made on account of natural love and affection;
 - the parties stand in near relation to each other.
- xii) As per Sec. 26 of Sale of Goods Act the goods are at buyer's risk when the property in the goods passes to the buyer whether delivery has been made or not. So risk follows ownership unless otherwise agreed.
- xiii) How a contract is constructed decides whether a stipulation is a condition or warranty in a contract.
- For example, when a person buys a particular Pressure Cooker which is warranted to cook rice in just 5 minutes, in case it doesn't the only remedy to the buyer is to claim damages. But if the buyer insists on buying a Pressure Cooker that cooks rice in just 5 minutes, the stipulation is a Condition and the buyer may reject the offer.
- (xiv) A promissory note made without specifying time is payable on demand. So adding "on demand" on face of the instrument does not change the character of the instrument.
- (xv) Due date of payment is 4/9/09 including 3 days of grace.
- (xvi) Notice of dishonour is not necessary when the party charged could not suffer damage for want of notice. As such notice of dishonour to X is not necessary.
- (xvii) An employee is entitled to bonus when he has worked for 30 days at least in an accounting year. So the employer is not right.
- (xviii) An employee is deemed to have worked when on maternity leave or other paid leave. So X is entitled to full bonus.
- (xix) As per Section 12 for calculation of bonus, salary will be taken as Rs. 3500 (Payment of Bonus (Amendment Act), 2007)
- (xx) In case of death of an employee, he is entitled to Gratuity even before completing 5 years of service.
- (xxi) An employee shall be deemed to be in continuous service if he has worked 75% of the number of days the establishment was in operation.
- (xxii) An apprentice is not an employee under Bonus Act, he is therefore not entitled to Bonus.
- (xxiii) Minimum wage rate may vary depending on different :
- scheduled employment
 - classes of work in same scheduled employment
 - locality.
- (xxiv) Even if a employer suffers loss during a accounting year, he is bound to pay minimum bonus as prescribed by Section 10 of Bonus Act.
- (xxv) The proprietor was using the A.C for commercial purpose. Hence, he is not a consumer and not entitled to complain under Consumer Protection Act.

xxvi)	Limited liability partnership is granted to all partners.	Limited partnership is granted to a set of non managing partners only.
	The law relating to partnership is not applicable.	The law relating to partnership is very much applicable.

- (xxvii) D is not entitled to receive compensation under Workmens' Compensation Act, 1923, after filing suit.
 - (xxviii) Employer is not entitled to enter into such a contract with employees and these type of contracts are void.
 - (xxix) Dispute between two Employees/Workmen connected with employment or non employment comes under Industrial Dispute Act. So the above mentioned case is a Industrial Dispute.
 - (xxx) To settle an EPF account one has to resign or retire from establishment and apply for settlement of EPF in Form-19. If the member has not attained 55 years of age at the time of exit, he should not work in any covered establishment for a period of two months from exit date.
- In case of death of a member ,his family members/Nominee have to apply In Form-20 for settlement of PF.

Q2. Akhilesh entered into an agreement with Shekhar to deliver him (Shekhar) 5,000 bags to be manufactured in his factory. The bags could not be manufactured because of strike by the workers and Akhilesh failed to supply the said bags to Shekhar. Decide whether Akhilesh can be exempted from liability under the provisions of the Indian Contract Act, 1872.

Answer 2.

According to Section 56 (Para 2) of Indian Contract Act, 1872 when the performance of a contract becomes impossible or unlawful subsequent to its formation, the contract becomes void, this is termed as 'supervening impossibility' (i.e. impossibility which does not exist at the time of making the contract, but which arises subsequently).

But impossibility of performance is, as a rule, not an excuse from performance. It means that when a person has promised to do something, he must perform his promise unless the performance becomes absolutely impossible. Whether a promise becomes absolutely impossible depends upon the facts of each case.

The performance does not become absolutely impossible on account of strikes, lockout and civil disturbances and the contract in such a case is not discharged unless otherwise agreed by the parties to the contract (*Budget V Bennington; Jacobs V Credit Lyonnais*).

In this case Mr. Akhilesh could not deliver the bags as promised because of strike by the workers. This difficulty in performance cannot be considered as impossible of performance attracting Section 56 (Para 2) and hence Mr. Akhilesh is liable to Mr. Shekhar for non-performance of contract.

Q3. i) Who cannot enter into a contract?

ii) Distinguish between void and illegal agreement

Answer 2.

- i) Section 11, of Contract Act ,1872 lays down the qualifications that make a person competent to contract. Accordingly, the following persons cannot enter into a contract:
 - (a) Minor, who has not attained 18 years of age.
 - (b) A person with unsound mind-lunatics, idiots,drunken or intoxicated persons.
 - (c) A person who is disqualified by law from contracting partially or wholly. Incompetency may arise from political status, corporate status or legal status.
- Contract with a person who is resident of a hostile nation is void. (political status)

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

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

(ii) Distinction between void and illegal agreement

Void agreement	Illegal agreement
An agreement not enforceable by law is void.	An agreement is illegal where either consideration or object is illegal besides being void.
It affects only immediate parties and has no further consequences.	It is void not only between immediate parties has effect of tainting the collateral transactions also.

Q4. i) Does threat to commit suicide amount to coercion?

ii) State the difference between coercion and undue influence.

iii) Is there presumption of undue influence in relationship of husband and wife?

Answer 4.

- (i) As per Section 15 of Indian Contract Act, committing or threatening to commit any act forbidden by Indian Penal Code is coercion. As such 'threat to commit suicide' amounts to coercion as it is forbidden by the Code.

(ii)

Coercion	Undue Influence
(a) It involves the physical force or threat. The aggrieved party is compelled to make the contract against its will.	It involves moral or mental pressure. The aggrieved party believes that he or she would make the contract.
(b) It involves committing or threatening to commit an act forbidden by Indian Penal Code for detaining or threatening to detain property of another person.	No such illegal act is committed or a threat is given.
(c) It is not necessary that there must be some relationship between the parties.	Some sort of relationship between the parties is absolutely necessary.
(d) Coercion need not proceed from the promisor nor need it be directed against the promisor.	Undue influence is always essential between the parties to the contract.
(e) The contract is voidable at the option of the party whose consent has been obtained by the coercion.	Where consent is induced by undue influence, the contract is either voidable or the court may set it aside or enforce it in a modified form.
(f) In case of coercion where the aggrieved party, as per Section 64, rescinds the contract any benefit received has to be restored back to the other party.	The court has the discretion to direct the aggrieved party to return the benefit in whole or in part or not to give any such directions.

- (iii) Undue influence cannot be presumed in husband wife relationship unless the wife is a pardanashin woman (Howes v. Bishop, 1909, 2KB 390). The burden of proving pardanashin rests on the wife.

Q5. i) Discuss the various modes of creating an agency.

ii) When does an agent incur personal liability?

Answer 5.

- (i) Agency may be created in the following ways :
1. By express agreement either oral or in writing. (Sec. 187)
 2. By implied agreement arising out of conduct, situation or relationship of parties. (Sec. 187)
- Implied agency are of three types—
- (a) Agency by Estoppel — (Sec 237) When a person by his conduct or statements creates a situation whereby a certain person is believed to be his agent, he is estopped from denying the fact subsequently.
 - (b) Agency by holding out — An affirmative conduct on part of principal is necessary to create an agency by holding out.
 - (c) Agency of necessity — (Sec 189) In this case there is no express or implied contract between the parties involved, but one is forced to act on behalf of another because of the circumstances.
3. By ratification (Sec 196-200) When an agent acts without the knowledge of his principal or exceeds its authority, the principal, if he so desires, ratify the act of the agent. Such ratification may be express or implied.
- (i) An agent becomes personally liable for his act in the following cases :
- (a) When he represents that he has authority to act on behalf of his principal, but who does not actually possess such authority or who has exceeded that authority and the alleged employer does not ratify his acts. Any loss sustained by a third party by the acts of such a person (agent) and who relies upon the representation is to be made good by such an agent.
 - (b) Where a contract is entered into by a person apparently in the character of agent, but in reality on his own account, he is not entitled to require performance of it.
 - (c) Where the contract expressly provides for the personal liability of the agent.
 - (d) When the agent signs a negotiable instrument in his own name without making it clear that he is signing as an agent.
 - (e) Where the agent acts for a principal who cannot be sued on account of his being a foreign Sovereign, Ambassador, etc.
 - (f) Where the agent works for a foreign principal.
 - (g) Where a Government Servant enters into a contract on behalf of the Union of India in disregard of Article 299 (1) of the Constitution of India, In such a case the suit against the agent can be instituted by the third party only and not by the principal (*Chatturbhuj v. Moheshwar*).
 - (h) Where according to the usage of trade in certain kinds of business, agents are personally liable.

Q6. What is meant by Anticipatory Breach of Contract?

Mr. Dubious textile enters into a contract with Retail Garments Show Room for supply of 1,000 pieces of Cotton Shirts at Rs.300 per shirt to be supplied on or before 31st December, 2004. However, on 1st November, 2004 Dubious Textiles informs the Retail Garments Show Room that he is not willing to supply the goods as the price of Cotton shirts in the meantime has gone upto Rs. 350 per shirt. Examine the rights of the Retail Garments Show Room in this regard.

Answer 6.

Anticipatory breach of contract occurs when the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived. In such a situation the promisee can claim compensation by way of loss or damage caused to him by the refusal of the promisor. For this, the promisee need not wait till the time stipulated in the contract for fulfillment of the promise by the promisor is over.

In the given problem Dubious Textiles has indicated its unwillingness to supply the cotton shirts on 1st November 2004 itself when it has time upto 31st December 2004 for performance of the contract of supply of goods. It is therefore called anticipatory breach of contract. Thus Retail Garments show room can claim damages from Dubious Textiles immediately after 1st November, 2004, without waiting upto 31st December 2004. The damages will be calculated at the rate of Rs. 50 per shirt i.e. the difference between Rs. 350/- (the price prevailing on 1st November) and Rs. 300/- the contracted price.

Q7. Write short notes on :

- (a) Delivery in relation to Sale of Goods Act, 1930.**
- (b) Describe unpaid seller's right of lien on goods.**
- (c) State difference between lien and stoppage in transit.**

Answer 7.

- (a) Delivery is defined under the act as 'a voluntary transfer of possession from one person to another.' (Sec.(2)) As per Section 33, delivery of goods sold may be effected by doing anything which parties agree to be treated as delivery. Thus delivery of goods may be :
 - (i) Actual or physical delivery : Physical possession of goods is handed over to buyer from seller.
 - (ii) Symbolic delivery : In this case delivery involves transfer of some symbol that signifies real possession or control of goods. For example, endorsement of Railway Receipt, delivery of godown key etc.
 - (iii) Constructive delivery : In this case there is only an acknowledgement on the part of the person holding possession of goods that he holds them on behalf of buyer. There are three types of constructive delivery :
 - A) When buyer holding the goods as bailor holds them as his own.
 - B) When seller holding the goods, holds them as bailee of the buyer.
 - C) When third person holding the goods on behalf seller, now agrees to hold them on behalf of buyer.

- (b) The word 'lien' means 'to retain possession of.' According to Section 47 an unpaid seller in possession of the goods has right to retain them in his possession until he receives payment in following circumstances :

- (a) where goods have not been sold on credit;
- (b) where terms of credit has expired for goods sold on credit;
- (c) where buyer becomes insolvent.

It may be noted that lien can be exercised only for nonpayment of price and not for recovering any other dues. Lien can be exercised only by unpaid seller and not by his assignees or creditors. Unpaid seller's right to exercise lien is not affected by his status of holding the goods as agent or bailee of the buyer.

(c)

Lien	Stoppage-in-transit
1. Applicable only when goods are in possession of the seller.	Applicable only after the seller has parted with the goods.
2. Applicable even if the buyer is solvent.	Applicable only when the buyer becomes insolvent.
3. This is a right to retain possession of goods.	This is a right to regain possession of goods.
4. The right can be exercised by seller only.	The right can be exercised by seller through carrier or bailee who is in possession of the goods.

Q8. No one can give a better title than he himself has. State the exceptions to the rule.

Answer 8.

The exceptions to the rule are given vide Sections 27 to 30 of Sale of Goods Act, 1930 These are as follows :

- (a) Sale by a mercantile agent who is in possession of the goods with consent of the seller and sells the goods in ordinary course of business.
- (b) Sale by a joint owner in possession of goods with consent of other joint owners. (Sec 28)
- (c) Sale by a person in possession of goods under a contract which may be voidable on the ground of fraud, misrepresentation, coercion or undue influence provided sale is made before voidable contract is avoided. (Sec 29)
- (d) Sale by seller who is in possession of the goods after sale but not in capacity of buyer's bailee. The subsequent buyer must buy in good faith and for value. (Sec 30)
- (e) Sale by buyer who is in possession of the goods before actual purchase if the subsequent buyer buys bona fide and for value. (Sec 30(2))
- (f) Sale made by unpaid seller exercising his right of lien and stoppage in transit. (Sec 54(3))
- (g) Sale made by finder of lost goods u/s 169 of Indian Contract Act
- (h) Sale by pawnee or pledge u/s 176 of Indian Contract Act
- (i) Sale made by Official Receiver or Official Assignee or Liquidator.

Q9. (i) Ascertain the date of maturity of a bill payable hundred days after sight and which is presented for sight on 4th May, 2000.

(ii) State the difference between :

(a) Negotiation and Assignment.

(b) Holder and Holder in due course.

(iii) What is a 'Sans Recours' indorsement? A bill of exchange is drawn payable to X or order. X indorses it to Y, Y to Z, Z to A. A to B and B to X. State with reasons whether X can recover the amount of the bill from Y, Z, A and B, if he has originally indorsed the bill to Y by adding the words 'Sans Recours'.

Answer 9.

(i) In this case the day of presentment for sight is to be excluded i.e. 4th May, 2000. The period of 100 days ends on 12th August, 2000 (May 27 days + June 30 days + July 31 days + August 12 days). Three days of grace are to be added. It falls due on 15th August, 2000 which happens to be a public holiday. As such it will fall due on 14th August, 2000 i.e. the preceding business day.

(ii) (a)

Negotiation	Assignment
1. Negotiation may be effected by mere delivery if the instrument is bearer one or endorsement and delivery if it is an order instrument.	Assignment should always be on a written document signed by transferor.
2. Transferee gets the title of Holder in due course.	Title of the transferee is always subject to the title of the transferor.
3. Consideration is always presumed.	Consideration must be proved.
4. No information of transfer needs to be given to the debtor in order to bind him.	Notice of assignment is must in order to bind the debtor.

(b)

Holder	Holder in due course
1. Holder is entitled in his own name to possess the instrument and the amount thereon from parties involved.	Holder in due course possesses the instrument for consideration before maturity and in good faith.
2. Title of the holder is subject to title of the transferor.	Holder in due course gets a better title than transferor.
3. Holder may receive the instrument without consideration.	Holder in due course always receives the instrument for consideration.
4. Holder does not get certain privileges available to the holder in due course.	Holder in due course always gets privileges not available to holder.

(iii) Meaning of Sans Recours Endorsement : It is a type of endorsement on a Negotiable Instrument by which the endorser absolves himself or declines to accept any liability on the

instrument of any subsequent party. The endorser signs the endorsement putting his signature along with the words, SANS RECOURS.

In the problem X, the endorser becomes the holder after it is negotiated to several parties. Normally, in such a case, none of the intermediate parties is liable to X. Tills is to prevent 'circuitry of action'. But in this case X's original endorsement is 'without recourse' and therefore, he is not liable co Y, Z, A and B. But the bill is negotiated back to X, all of them are liable to him and he can recover the amount from all or any of them (Section 52 para 2).

Q10. Explain the provisions of the Payment of Bonus Act, 1965 relating to the following:

- (i) **Adjustment of customary bonus against bonus payable under the Act.**
- (ii) **Application of the Act to the establishments in public sector. What is the time limit within which payment of bonus due to an employee under the Act, be paid ?**

Answer 10.

- (i) **Adjustment of customary bonus against bonus payable:** The Payment of Bonus Act, 1965 provides that if in any accounting year, an employer has paid any customary bonus to an employee, then the former shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to employee under the Act in respect of that accounting year. The employee shall be entitled to receive only the balance. The employer can do the same thing even in a case where he has paid off the bonus payable under the Act to an employee before the date on which such bonus payable becomes payable. (Section 17)
- (ii) **Application of the Act to the establishment in public sector:** Section 20 of the Payment of Bonus Act, 1965 provides that if in any accounting year, an establishment in public sector may sell any goods produced or manufactured by it or it may render any services in competition with an establishment in private sector. And if the income from such sale or service or both is not less than 20% of the gross income of establishment in public sector, then the provisions of Bonus Act shall apply in relation to establishment in private Sector (Sub-section 1) save as otherwise provided in Subsection (1), nothing in this Act shall apply to the employees employed by any establishment in the public sector (Sub-section2).

The time limit for payment of bonus: The employer is bound to pay his employee bonus within one month from the date on which the award becomes enforceable or the settlement comes into operation, if a dispute regarding payment of bonus is pending before any authority under Section 22 of the Act. In other cases, however, the payment of the bonus is to be made within a period of 8 months from closing of the accounting year. But this period of 8 months may be extended upto a maximum of 2 years by the appropriate Government or by any authority specified by the appropriate Government. This extension is to be granted on the application of the employer and only for sufficient reasons.

Q11. Explain the following terms in relation to The Payment of Bonus Act, 1965.

- (i) **Allocable surplus vs available surplus.**
- (ii) **Gross Profits.**
- (iii) **Sums deductible from Gross Profits**

Answer 11.

(i)

Allocable surplus (Sec 2(4))	Available surplus (2(6))
1. 67% of available surplus in an accounting year where employer is a company other than a banking company which has not made arrangements for declaration and payment of dividends payable out of profits within India as prescribed under Section 194 of Income Tax Act, 1961	As per Section 5, available surplus comprises of Gross Profit for the accounting year after adjusting there from the sums referred to in Sec. 6, i.e. depreciation, development rebate or allowance, income tax payable during the year, and such further sums as specified in IIIrd schedule. Amount of saving in income tax in preceding accounting year because of payment of bonus should be added back to Gross Profit so derived.
2. In any other case, 60% of available surplus.	

- (ii) Gross Profit implies Gross Profit as calculated under Section 4. According to Section 4 Gross Profit of an establishment shall be calculated :
- in case of banking company in the manner as specified in 1st schedule.
 - in other cases, in the manner as specified in 2nd schedule.
- (iii) Sums to be deductible from Gross Profit are provided vide Sec 6 of the Act.
- Depreciation as admissible u/s 32(1) of I.T Act or under provisions of Agriculture in Income Tax law.
 - Development rebate, investment allowance, or development allowance which the employer is entitled to deduct from his income as per I.T. Act.
 - Any direct tax which the employer is liable to pay subject to section 7 , in respect of his income, profits and gains during the accounting year.
 - Any further sums as specified in the third schedule.

Q12. Distinguish between employee under Bonus Act and under Employees Provident Fund and Miscellaneous Provisions Act.**Answer 12.**

Employee under Bonus Act	Employee under EPF and Misc. Pro. Act.
1. Defined under Section 2(13) of Payment of Bonus Act, 1965.	Defined under Section 2(f) of EPF and Misc. Pro. Act., 1952
2. Any person (other than apprentice) employed with salary or wage not exceeding Rs.10,000/- per month w.e.f 1.4.2006	Any person who is employed and gets his wages directly or indirectly from employer including an apprentice not being an apprentice engaged under Apprentice Act or under standing orders of establishment.

Q13. Who is a 'occupier' under Factories Act, 1948? List the general duties of a occupier.**Answer 13.**

'Occupier' of Factory implies the person who has ultimate control over the affairs of the factory. Provided that:

In case of a firm or AOP any partner or member shall deemed to be occupier.

In case of a company, the directors are occupiers.

In case of a factory owned by Central or State Government or Local Authority, the persons employed to manage the affairs of the factory will be deemed to be the occupiers.

In short, an occupier may be owner, lessee or licensee but he should have the right to occupy the property and dictate terms of management. An employee charged with specific machinery, workers or office is not an occupier.

General duties of an occupier are as follows:

- (i) Every occupier is responsible to ensure so far as practicable, health, safety and welfare of all workers in the factory. (Sec. 7-A(1))
- (ii) Sec 7-A(2) lists the matters in regard to health, safety and welfare of workers that include,
 - (a) ensuring that plant and systems of work are safe and without any risks to health;
 - (b) making arrangements in the factory so that use, handling, storage and transport of articles are safe;
 - (c) providing necessary information, instruction, training and supervision so as to ensure health and safety of workers;
 - (d) ensuring that all places of work in the factory are safe including the entry and exit points from such places;
 - (e) providing, maintaining and monitoring the safety of the working environment and ensuring overall welfare at work places.
- (iii) Except in cases prescribed, the occupier is required to prepare a written statement of his general policy regarding health and safety of the workers and arrangements made in line with that policy. If any changes are made in the policy it should be brought to the notice of all the workers in the manner prescribed.

Q14. Explain the following terms in relation to Payment of Gratuity Act, 1972:

- (i) **Wages**
- (ii) **Rate of Gratuity.**
- (iii) **Continuous service.**
- (iv) **Family in relation to an employee**

Answer 14.

- (i) The term wages as per sec.2 of Payment of Gratuity Act, 1972 includes basic plus D.A but does not include bonus, commission, house rent allowance, overtime wages or any other allowance. The main feature of wages as described aforesaid is that it refers to payment made in cash and not in any other form. Thus supply of food at factory canteen free is not included in wages.
- (ii) **Rate of Gratuity:** Gratuity is payable @ 15 days wages for every year of completed service or part thereof in excess of six months. In case of seasonal industries it is payable @ 7 days wages for each season.

(iii) Continuous Service :

For the purposes of this Act, —

- (1) an employee shall be said to be in continuous service for a period if he has, for that period, been in uninterrupted service, including service which may be interrupted on account of sickness, accident, leave, absence from duty without leave (not being absence in respect of which an order treating the absence as break in service has been passed in accordance with the standing order, rules or regulations governing the employees of the establishment), lay

off, strike or a lock-out or cessation of work not due to any fault of the employee, whether such uninterrupted or interrupted service was rendered before or after the commencement of this Act.

- (2) where an employee (not being an employee employed in a seasonal establishment) is not in continuous service within the meaning of clause (1), for any period of one year or six months, he shall be deemed to be in continuous service under the employer—
- (a) for the said period of one year, if the employee during the period of twelve calendar months preceding the date with reference to which calculation is to be made, has actually worked under the employer for not less than—
- (i) one hundred and ninety days, in the case of an employee employed below the ground in a mine or in an establishment which works for less than six days in a week; and
 - (ii) two hundred and forty days, in any other case;
- (b) for the said period of six months, if the employee during the period of six calendar months preceding the date with reference to which the calculation is to be made, has actually worked under the employer for not less than—
- (i) ninety-five days, in the case of an employee employed below the ground in a mine or in an establishment which works for less than six days in a week; and
 - (ii) one hundred and twenty days, in any other case;

Explanation : For the purpose of clause (2), the number of days on which an employee has actually worked under an employer shall include the days on which—

- (i) he has been laid-off under an agreement or as permitted by standing orders made under the Industrial Employment (Standing Order's) Act, 1946 (20 of 1946), or under the Industrial Disputes Act, 1947 (14 of 1947), or under any other law applicable to the establishment,
 - (ii) he has been on leave with full wages, earned in the previous year;
 - (iii) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment; and
 - (iv) in the case of a female, she has been on maternity leave; so, however, that the total period of such maternity leave does not exceed twelve weeks.
- (3) where an employee employed in a seasonal establishment, is not in continuous service within the meaning of clause (1), for any period of one year or six months, he shall be deemed to be in continuous service under the employer for such period as he has actually worked for not less than seventy-five per cent of the number of days on which the establishment was in operation during such period.

(iv) Family :

In relation to an employee, family shall be deemed to consist of—

- (i) in the case of a male employee, himself, his wife, his children, whether married or unmarried, his dependent parents and the dependent parents of his wife and the widow and children of his predeceased son, if any,
- (ii) in the case of a female employee, herself, her husband, her children, whether married or unmarried, her dependent parents and the dependent parents of her husband and the widow and children of her predeceased son, if any

Q15. Differentiate between :

- (i) Lay off and retrenchment
- (ii) Award and settlement under Industrial Dispute Act.

Answer 15. (i)

Lay off	Retrenchment
(i) Means failure, refusal or inability of an employer to give employment to a workmen whose name appear in muster rolls of his establishment and who has not been retrenched.	It is termination of service of a workman for any reason other than as a punishment by way of disciplinary action but doesnot include: a) VRS b) Retirement on reaching the age of superannuation. c) Termination due to non renewal of contract. d) Termination on the ground of illness.
(ii) U/s 2(kkk) of Industrial Dispute Act	ii) U/s 2(oo) of Industrial Dispute Act
(iii) Worker is entitled to compensation which is 50% of Basic + DA payable to him in case he was not laid off for all days of lay-off excluding weekly holidays.	Compensation is 15 days average pay for each year of completed service or part there of in excess of six months.

(ii)

Award	Settlement
(i) U/s 2(b)	U/s 2(p)
(ii) It means an interim or final determination of any industrial dispute or any question relating thereto by any Labour Court, Industrial Tribunal, or National Tribunal. Also includes arbitration award u/s 10-A.	It is arrived in course of conciliation proceedings and includes written agreement between employer and employee arrived in course of conciliation signed by both parties and copy sent to authorized officer.

Q16. Describe the provisions relating to contribution by the employees and the employer under the Employees Provident Fund and Miscellaneous Provisions Act, 1952.**Answer 16.**

According to section 6 of the EPF & MP Act, 1952, the employees' contribution to the fund shall be 10% of the basic wage, dearness allowance and retaining allowance (if any). An employee can at his will contribute beyond 10 if the scheme makes provision therefore subject to the conditions that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under this Section (i.e. 10%). This rule will prevail irrespective of whether the employer employs the person directly or through contractor. According to the first proviso to the Section 6, the Central Government may, however, raise the aforesaid percentage of contribution from 10% to 12% in respect of any establishments. It may do so after making such enquiries as it deems fit.

The following points are relevant in this regard :

- (i) Where the amount of any contribution involves a fraction of rupee, the scheme may provide for the rounding off of such fraction to the nearest rupee, half rupee or a quarter rupee.
- (ii) Dearness allowance includes cash value of any food concession allowed to the employee.
- (iii) Retaining allowance means an allowance payable for the time being to an employee of any factory or other establishment during any period in which the establishment is not working for retaining his services.

Q17. (a) Define 'consumer' under Consumer Protection Act. (b) Who can file complaint?**Answer 17.**

- (a) "Consumer" means any person who, —
- (i) Buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other

than the person who buys such goods for consideration paid or promised or partly paid or partly promised or under any system of deferred payment when such use is made with the approval of such person but does not include a person who obtains such goods for resale or for any commercial purpose; or

- (ii) [Hires or avails of] any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who [hires or avails of] the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person [but does not include a person who avails of such services for any commercial purpose];

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

- (b) Complaints may be filed with the District Forum/State Commission/National Commission by :

1. The consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided.
2. Any recognised consumer association, whether the consumer to whom goods sold or delivered or agreed to be sold or delivered or service provided or agreed to be provided, is a member of such association or not.
3. one or more consumer, where there are numerous consumers having the same interest with the permission of the District Forum, on behalf of or for the benefit of, all consumers so interested.
4. The Central or the State Government.

Every complaint filed shall be filed along with such amount of fee as may be prescribed.

Q18. Define 'disablement' under The Workmen Compensation Act, 1923.

Answer 18.

Disablement implies loss of capacity to work or move. Disablement leads to loss or reduction in earning capacity of workman. Disablement may be partial or total. Further it may be temporary or permanent.

Partial disablement reduces the earning capacity of workman as a result of some accident. It may be temporary or permanent. Temporary partial disablement reduces the earning capacity of workman in any employment in which he was engaged at the time of employment. Permanent partial disablement reduces the earning capacity in every employment the worker was capable of doing at the time of employment. Total disablement u/s 2(1) (I) means worker becomes incapable in performing any work which he could perform before accident. Total disablement is deemed to result from every injury specified in Part I of Schedule I or combination of injuries specified in Part II resulting in loss of earning capacity to the extent of 100% or more.

Q19. State the objectives of RTI Act, 2004.

Answer 19.

Objectives of the RTI Act :

The objectives of the Act are to—

- (i) Give effect to the Fundamental Right to Information, which will contribute to strengthening democracy, improving governance, increasing public participation, promoting transparency and accountability and reducing corruption.
- (ii) Establish voluntary and mandatory mechanisms or procedures to give effect to right to information in a manner which enables persons to obtain access to records of public authorities in a swift, effective, inexpensive and reasonable manner.

(iii) Promote transparency, accountability and effective governance of all public authorities by, including but not limited to, empowering and educating all persons to :

- Understand their rights in terms of this Act in order to exercise their rights in relation to public authorities;
- Understand the functions and operation of public authorities; and effectively participating in decision making by public authorities that affects their rights.

Q20. State the treatment of Limited Liability Partnership under Income and Corporation Taxes Act, 1988.

Answer 20.

For the purposes of the Tax Acts, a trade, profession or business carried on by a limited liability partnership with a view to profit shall be treated as carried on in partnership by its members (and not by the limited liability partnership as such); and, accordingly, the property of the limited liability partnership shall be treated for those purposes as partnership property.

Q21. (i) In a proceeding before the Competition Commission of India involving two Pharmaceutical companies, the plaintiff requested the presiding officer to call upon the services of experts from the pharmaceutical sector to determine the truth of the allegations leveled by it against the respondent. The respondent opposed the request on the ground that such action cannot be taken by the Competition Commission. You are required to state with reference to the provisions of the Competition Act, 2002, whether the contention of the respondent is tenable.

(ii) The Central Government has formed an opinion that Mr. CBM (a member of the Competition Commission of India) has acquired such financial interest that it may affect prejudicially his functions as a member of the Competition Commission and it wants to remove him from his office. You are required to state with reference to the provisions of the Competition Act, 2002, whether the Central Government can do so and if yes, how?

Answer 21.

(i) As per provisions of Section 36(4) of the Competition Act, 2002 the Competition Commission may call upon such experts from the fields of economics, commerce, accountancy, international trade or other disciplines as it deems necessary, to assist the Commission in the conduct of any enquiry or proceeding before it. As per Regulation 54 of the Competition Commission (General) Regulations, 2004 made by the Commission under Section 64 of the Competition Act, 2002, it may draw up a panel of such experts.

In view of the above stated specific powers given to the Competition Commission, it can call upon the services of an expert from the pharmaceutical sector to determine the truth of the allegations leveled by the plaintiff against the respondent. Hence, the contention of the respondent is not tenable.

(ii) Provisions of Section 11(2) of the Competition Act, 2002 empower the Central Government to remove, by an order, a member of the Competition Commission of India from his office if such member has acquired such financial interest as is likely to affect prejudicially his functions as a Member of the Competition Commission. However, provisions of Section 11(3) of the said Act put some restrictions on such powers of the Central Government. According to this section, in case as stated in the question, the Central Government wants to remove a member of the Competition Commission from his office, it has to make a reference to the Supreme Court. The Supreme Court shall hold an enquiry in accordance with the procedure formulated by it and then report that the member in question ought to be removed from his office.

Thus, the Central Government can remove a member of Competition Commission from his office by following the above procedure.

PART – B (Auditing)

Q1. Comment on the following :

- (i) Auditing, in India can be traced back to the days of Vedas.
- (ii) The concept of evidence is fundamental to auditing.
- (iii) Auditor is entitled to rely on work performed by others.
- (iv) Test check approach and random sampling approach are same.
- (v) US –GAAP and INDIA’S GAAP are not different.
- (vi) Auditor should qualify audit report if any Secret Reserve is created.
- (vii) CAS 3 deals with capacity determination.
- (viii) An Auditor is always appointed by passing a special resolution to this effect.
- (ix) When separate Branch Auditors are appointed, the company auditor may not visit the branches.
- (x) Compliance report is signed by CEO, so auditor need not verify it.
- (xi) Joint auditors are jointly and severally liable for total audit work.
- (xii) Audit Report reflects the work done by the Auditor.
- (xiii) When the auditor doesn’t agree with Financial Statements on certain grounds he gives ‘disclaimer’ of opinion.
- (xiv) The CARO has extended the scope of audit.
- (xv) 100% vouching ensures 100% effectiveness as regards to verification.
- (xvi) Internal Audit is a management tool.
- (xvii) Detection of fraud is duty of statutory auditor only.
- (xviii) Proprietary Audit is essential in Government Companies.
- (xix) Certified statements showing turnover falls under Compliance Audit.
- (xx) Credit Note is issued at the time of giving credit to the purchaser.
- (xxi) Audit committee is only a luxury.
- (xxii) When Information System Audit is an Information Technology, auditor is required to have detailed knowledge of auditing as well as information system.
- (xxiii) Management Audit emphasizes on problem identification rather than problem solving.

Answer1.

- (i) In Ramayana we find Lord Ram asking Bharat about whether his expenditure is more than income. Likewise, in Mahabharata, King Yudhishthira ordered Nakula to verify army’s accounts. The system land revenue, currency, trade and control can be traced even in Manu Smriti. All this indicates that auditing in India rooted long back to the days of Vedas.
- (ii) Auditing involves collection of evidence using various auditing techniques and procedures, evaluation of the validity of the evidence so collected and formation of an opinion based on such evaluation. As per AAS-1, the auditor is required to obtain sufficient appropriate evidence to enable him to draw reasonable conclusions there from on which his opinion on financial statements are based. So evidence forms backbone of auditing function.
- (iii) AAS 1 (SA 200) on, “Basic Principles Governing an Audit” envisages manifold circumstances when an auditor would have to depend upon the work performed by others. Such other parties may be experts, other auditors including branch auditors or his own assistants. AAS 1 (SA 200) while laying down “Work Performed by Others” as one of the basic principle governing an audit makes it clear that in cases where the auditor is required to delegate a

part of his work to his assistants or use the work performed by other auditors/experts, he continues to remain responsible for expressing his opinion on the financial statements. Thus, he can rely on work performed by others provided he exercises reasonable skill and care and he has no reason to believe that he should not have so relied.

The auditor should carefully direct, supervise and review work delegated to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose.

In case of statutory assignments, like relying on audit report of branches conducted by other auditors, he should expressly state the fact of such reliance.

- (iv) Test check approach is different from random sampling approach. Test check is based on intuition while random sampling approach is scientific verification on selective basis. In case of test check samples drawn may be biased but in statistical random sampling samples are based on random number tables, so there will be no element of bias.
- (v) GAAP stands for Generally Accepted Auditing Principles. The features of US-GAAP are clearly different from that of INDIA in respect of preparation of Financial Statements, valuation of fixed assets, depreciation and goodwill, treatment of preoperative expenses, R&D costs, disclosure of assets and liabilities.
- (vi) Auditor should carefully examine the necessity of creating Secret Reserve and need not qualify the audit report if it is found that intention of the company is honest and the amount is reasonable.
- (vii) CAS 3 deals with Overheads and not capacity determination.
- (viii) Normally the 1st Auditor is appointed by the Board of Directors and subsequent Auditors are appointed by shareholders at AGM. Auditors are appointed by Special Resolution only in case of companies in which not less than 25% of subscribed share capital is held either singly or jointly by—
 - (a) Public Financial Institution or Govt. Company or Central Govt. or any State Govt. or any financial institution or other institution in which a State Govt. holds not less than 51% of subscribed share capital.
 - (b) A nationalized bank or an insurance company carrying on general insurance business.
- (ix) It is totally at the discretion of the company auditor as to whether he should visit the branches and to the degree he would rely on branch auditors' report. The company auditor is however not responsible for work done by branch auditor.
- (x) The auditor is required to issue a certificate regarding Compliance of certain conditions of Corporate Governance which is required to be annexed to the director's report and sent to stock exchange. So the auditor has to verify the compliance report.
- (xi) The Institute of Chartered Accountants of India has issued a statement in this regard in absence of any clear provision in Companies Act, 1956. The joint auditors should divide the total audit work amongst themselves and each auditor would be responsible only for the extent of work entrusted to him.
- (xii) An Audit Report is the end product of audit process and gives auditor's opinion on the accounts and records of the company which is used by different people as a reliable document. So it may be said that audit report reflects the work of the auditor.
- (xiii) The statement is not true. When the auditor states that he is unable to form an opinion for want of necessary evidence, then it is 'disclaimer' of opinion.
- (xiv) Under traditional auditing system the auditor was required to comment on certain matters only when he was not satisfied with the final accounts. So the audit report was an exception

report. After CARO the auditor has to make a statement on each of the matters specified whether negative or positive.

He has to comment on internal audit system, records of fixed assets etc. Thus CARO has extended the scope of audit.

- (xv) 100% vouching does not guarantee 100% effectiveness as fatigueness may set in and influence the decision of the auditor. Instead drawing conclusion on basis of scientifically selected samples is more effective. However cash vouchers should be checked in total.
- (xvi) Internal Audit involves systematic and continuous examination and reporting of systems and operations of an organization and helps management in decision making. Thus internal audit is a important tool in hands of management.
- (xvii) The internal auditor is required to ensure the correctness of accounting data and to detect fraud through periodical review of organizational system and procedures. Internal auditor is supposed to complement the work of statutory auditor. So detection of fraud cannot be responsibility of statutory auditor only.
- (xviii) Propriety Audit focuses on whether transactions have been done in conformity with established rules, procedures and standards. It ensures whether funds have been properly used and assets have not been misused. An essential function of the audit is to bring to light transactions which involve improper expenditure or wastage of public money even though not apparent in financial records. So it is essential in Government Companies.
- (xix) Audit in order to certify certain statements required by management on various matters or purpose is known as compliance audit. As such certified statements of turnover is compliance audit.
- (xx) The statement is wrong. Credit note is issued for the following:
 - (a) Return of materials.
 - (b) Excess charge in invoice.
 - (c) Cash discount.
 - (d) Short delivery/delivery of defective materials.
- (xxi) Audit Committee acts as communication link among various interests. It interacts with management, internal auditor, statutory auditor and general public, and thus maintains a fourfold relationship. Hence, audit committee is a necessity and not a luxury.
- (xxii) Information System Audit is examination of control within an IT Infrastructure. It is a process of collecting and evaluating evidence of an organisation's information systems practices and operations.

One of the purpose of IT audit is to review and evaluate an organisation's information systems' availability, confidentiality and integrity. So an auditor needs to have detailed knowledge of information system along with auditing.
- (xxiii) Management audit emphasizes on areas requiring management attention, evaluates the existence of well defined objectives and examines whether policies are consistent with objectives and understood properly at all functional levels. So it tries to identify source of problem rather than solution.

Q2. Discuss the concept of "True and Fair".

Answer 2.

Concept of "True and Fair":

The concept of "true and fair" is a fundamental concept in auditing. The phrase "true and fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the

state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit.

This requires that the auditor should examine the accounts with a view to verifying that all assets and liabilities, incomes and expenses are stated at the amounts which are in accordance with accounting principles and policies, and no material item has been omitted.

What constitutes "true and fair" has not been defined in the legislation. However, section 211(5) of the Companies Act, 1956 states that the balance sheet and profit and loss account of a company shall not be treated as not disclosing a true and fair view of the state of affairs of the company if they do not disclose any matters which are not required to be disclosed by virtue of the provisions of Schedule VI to the Companies Act, 1956, or by virtue of any notification or any order.

Therefore the auditor must see that the accounts are drawn up as per requirements of the provisions of Schedule VI, and whether they contain all matters required to be disclosed therein. In case of companies governed by special Acts, say, banking, electricity, etc. the auditor should see, whether the relevant disclosure requirements are complied with.

Thus, what constitutes a true and fair view is a matter of the auditor's judgement in the particular circumstances of the case. In specific terms to ensure truth and fairness, an auditor has to see:

- (i) that the assets are neither undervalued or overvalued;
- (ii) no material asset is omitted;
- (iii) the charge on assets, if any, is disclosed;
- (iv) material liabilities should not be omitted, and liabilities are neither undervalued or overvalued;
- (v) accounting policies have been followed consistently;
- (vi) all unusual, exceptional, non recurring items have been disclosed separately;
- (vii) accounts have been drawn as per requirement of Schedule VI to the Companies Act; and
- (viii) the accounts have been drawn in compliance to the relevant accounting standards. In case of deviation from accounting standards, disclosure should be made of the reasons for such deviation and financial effects, if any arising due to such deviation

Q3. (i) What is an "Audit Evidence"?

- (ii) What are the various methods of obtaining audit evidence? Mention the same in brief.**
- (iii) Discuss the principles, which are useful in assessing the reliability of audit evidence.**

Answer 3.

- (i) **Audit Evidence:** Audit evidence refers to any information, verbal or written, obtained by the auditor on which he bases his opinion on financial statements.

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

Generally audit evidence depending on its source may be classified as internal evidence or external evidence. Internal evidence is one that has been created within the client's organisation and without its ever going to outside party. Examples are duplicate sales invoices, employee's time reports, etc. External evidence on the other hand is the evidence that originates outside the client's organisation; for example, purchase invoice, supplier's challan and forwarding note, debit notes and credit notes coming from parties, quotations, confirmations, etc.

Sometimes in certain transactions, external evidence is obtained, directly by the auditor, e.g., certificates as regards bank balance, confirmation of balances of debtors and creditors, etc.

The auditor also obtains evidence by performing various analytical procedures. The auditor should evaluate whether he has obtained sufficient appropriate audit evidence before he draws his conclusions therefrom.

The reliability of audit evidence depends on its source – internal or external, and on its nature-visual, documentary or oral. The auditor may gain increased assurance when audit evidence obtained from different sources or of different nature is consistent. In these circumstances, he may obtain a cumulative degree of assurance higher than that which he attaches to the individual items of evidence by themselves.

Conversely, when audit evidence obtained from one source is inconsistent with that obtained from another, further procedures may have to be performed to resolve the inconsistency. Audit evidence should, in totality enable the auditor to form an opinion on the financial information.

(ii) **Methods of Obtaining Audit Evidence:** The auditor obtains evidence by one or more of the following methods:

1. **Inspection:** Inspection consists of examining records documents, or tangible assets. Inspection of tangible assets is one of the methods to obtain reliable evidence with respect of their existence but not necessarily as to their ownership or value. Four major categories of documentary evidence, which provide different degrees of reliability to the auditor, are:

- (a) documentary evidence originating from and held by third parties;
- (b) documentary evidence originating from third parties and held by the entity;
- (c) documentary evidence originating from the entity and held by third parties; and
- (d) documentary evidence originating from and held by the entity.

2. **Observation:** Observation consists of witnessing a process or procedure being performed by others. For example, the auditor may observe the counting of inventories by client's personnel.

3. **Inquiry and Confirmation:** Inquiry consists of seeking appropriate information from knowledgeable persons inside or outside the entity. Inquiries may range from formal written inquiries addressed to third parties to informal oral inquiries addressed to persons inside the entity. Responses to inquiries may provide the auditor with information which he did not previously possess or may provide him with corroborative evidence. Confirmation consists of the response to an inquiry to corroborate information contained in the accounting records. For example, the auditor requests confirmation of receivables by direct communication with debtors.

4. **Computation:** Computation consists of checking the arithmetical accuracy of source documents and accounting records or performing independent calculations.

5. **Analytical Review:** Analytical review consists of studying significant ratios and trends and investigating unusual fluctuations and items.

(iii) **Reliability of Audit Evidence:** The reliability of audit evidence depends on its source-internal or external, and on its nature-visual, documentary, or oral. While the reliability of audit evidence is dependent on the circumstances under which it is obtained, the following generalisations may be useful in assessing the reliability of audit evidence:

- (i) External evidence (e.g. confirmation received from third party) is usually more reliable than internal evidence.

- (ii) Internal evidence is more reliable when related internal control is satisfactory.
- (iii) Evidence in the form of documents and written representations is usually more reliable than oral representations.
- (iv) Evidence obtained by the auditor himself is more reliable than that obtained.

Q4. (a) Define audit risk. Discuss the relation between materiality and audit risk.

(b) (i) What are Contingent Liabilities? Where do they appear in Balance Sheet ?

(ii) What points the Auditor should keep in mind while verifying Contingent Liabilities?

Answer 4.

(a) According to AAS 6 'audit risk' means , the risk that the auditor gives an inappropriate opinion when the financial statements are materially misstated. According to International Federation of Accountants audit risks include :

- (i) Internal risk- risk that a material error will remain.
- (ii) Control risk- risk that client's internal control system cannot prevent or make up for such error.
- (iii) Detection risk-risk that material errors though they are there, will not be detected.

Since the entire process of auditing is based on the assessment of judgements made by the management of the entity as well as evaluation of internal controls, the audit suffers certain inherent risks. Factors which can lead to such risk in conducting an audit are discussed below :

- (i) **Exercising judgement on the part of the auditor:** The auditor's work involves exercise of judgement, for example, in deciding the extent of audit procedures and in assessing the reasonableness of judgements and estimates made by management in preparation of financial statements.
- (ii) **Nature of audit evidence:** The auditor normally relies upon persuasive evidence rather than conclusive evidence. Even in circumstances where conclusive evidence is available, the cost of obtaining such an evidence may far exceed the benefits.
- (iii) **Inherent limitations of internal control:** Internal control can provide only reasonable, but not absolute, assurance on account of several inherent limitations such as potential for human error, possibility of circumstances of control through collusion, etc.

According to AAS 13 , there is an inverse relationship between materiality and degree of audit risk. i.e. higher the materiality level, the lower the audit risk and vice versa. For example, risk that a particular account balance or class of transactions will be misstated by an extremely large amount might be very less, but risk that it could be misstated by extremely small amount is very high. The auditor takes this inverse relationship into consideration while determining the nature, timing, and extent of audit procedure. The auditor reduces the degree of risk by reducing (a) the control risk through carrying out extended or additional test of control (b) detection risk by modifying the nature, timing and extent of planned substantive procedures.

- (b) (i) Liabilities which depend on happening or not happening of something are known as contingent liabilities. These liabilities may involve payment of revenue nature incurring losses or involve acquisition of some assets.

Examples:

- (A) Payment of Gratuity under Industrial Dispute Act.
- (B) Amount of incomplected contracts.

- (C) Calls unpaid on partly paid shares.
- (D) Preference dividend in arrears.

Contingent liabilities appear as a footnote to the Balance Sheet. Contingent liabilities are not actual liabilities, so do not form part of Balance Sheet.

- (ii) The points to be kept in mind while verifying contingent liabilities are as follows:
 - (A) A certificate to be obtained from management regarding contingent liabilities disclosed in Balance Sheet.
 - (B) Relevant documents to be checked to confirm the existence of such liabilities.
 - (C) Possibility of a contingent liability turning into actual liability to be examined.
 - (D) The management should make proper provision for contingent liabilities turning into actual ones. The auditor is to verify whether the management has made necessary provision.
 - (E) The bill discounting register, investment register, minute book and other relevant records should be verified to confirm the amount of contingent liabilities.
 - (F) Whether contingent liabilities have been properly disclosed should be verified.

Q5. (a) Discuss the importance of Audit Working Papers.

(b) State the factors to be considered while drafting an Audit Report.

Answer 5.

- (a) Audit working papers constitute the basic records for the auditor in respect of the audit carried out by him. They constitute the link between the auditor's report and clients' record. These include retention of permanent record in the nature of a document to show the actual audit work executed, the nature of the work, the extent of the work and important points, facts, dates and decisions having bearing on the audit of the accounts audited. The working papers, if properly maintained, can be used as defence in case of need. The audit working papers are found very useful in the following aspects as they:
 - (i) aid in the planning and performance of the audit;
 - (ii) aid in the supervision and review of the audit work;
 - (iii) provide evidence of the audit work performed to support the auditor's opinion; and
 - (iv) act as an evidence in the Court of law when a charge of negligence is brought against the auditor.
- (b) The audit report generally shows the nature and scope of audit conducted by the auditor and his opinion on final accounts of the company. The Companies Act, 1956 and Internal Auditing Guideline has laid down the factors to be considered while drafting an Audit Report :
 - (A) Title- The Report should have a proper 'title' so that it can be distinguished from other reports.
 - (B) Address: The report should be appropriately addressed, e.g. in case of company audit it should be addressed to shareholders.
 - (C) Observations :
 - (i) The auditor should mention whether he has obtained required information necessary to conduct the audit.
 - (ii) He should state whether proper books of accounts as per law have been maintained.

- (iii) He should state whether P/L A/c and B/S are in agreement with books of accounts and indicate true and fair view of the state of affairs of the company.
- (iv) He should mention whether P/L A/c and B/S along with notes give information in manner as required by Companies Act. 1956
- (v) He should also mention whether or not the provisions of section 227(1A) and 227(4A) of the Companies Act, and CARO are complied with and give a separate statement on that to form part of audit report.
- (D) Auditing Standards: The auditor should make a reference to the Standard AAS to ensure that audit has been carried out as per established standards.
- (E) Opinion: The auditor's opinion based on his observations on company's operational results and financial statements. The opinion may be either clean or qualified or disclaimer.
- (F) Signature: The audit report should be signed by auditor on behalf of the firm he represents or in his own name or both as per terms of appointment.
- (G) Address: The report should contain auditor's postal official address.
- (H) Date of report: The report should mention the date of submission of audit report.

Q6. (a) What is Joint Audit? How is it different from Branch Audit?

(b) Discuss the advantages and disadvantages of Joint Audit

Answer 6.

- (a) When two or more auditors/audit firms are appointed together to conduct audit operations it is Joint Audit. This happens specially in case of banking or insurance companies or where regulations of the company require such appointment. The Joint Auditors normally share the total audit work amongst themselves and are responsible for the work allotted to them only.

Joint Audit	Branch Audit
(i) Joint audit involves audit of the company as a whole.	Branch audit is the audit work carried out in respect of branch office in relation to a company.
(ii) Joint auditors are appointed under section 224	The branch auditor may be the company auditor appointed u/s 224 or another auditor appointed u/s 226.
(iii) The total audit work is divided amongst the joint auditors as per statement issued by the Institute of Chartered Accountants of India.	It is upto the company auditor to decide the amount of importance to be given to branch audit reports and its impact on total company accounts.
(iv) The auditors are responsible for the extent of work allotted to them.	The company auditor is not responsible for work of branch auditors but the extent to which he can rely on them is totally his own judgement.

- (b) Advantages of Joint Audit are as follows:
- (i) Sharing of expertise.
 - (ii) Advantage of mutual consultation.

- (iii) Lower workload
- (iv) Better quality of performance.
- (v) Improved quality of performance.
- (vi) Displacement of auditor of the company often obviated.
- (vii) In case of MNCs work can be spread using expertise of local firms who are more conversant with local laws and regulations.
- (viii) Total staff requirement is less.
- (ix) Lower cost to carry out work.
- (x) A sense of healthy competition towards better performance.

Disadvantages of Joint Audit:

- (i) Sharing of fees.
- (ii) Superiority complex of some auditors may effect the work of co-auditors.
- iii) Areas of common concern being neglected.
- (iv) The firms may have different standing on a particular issue relating to Joint Audit.
- (v) Problem arises in coordinating the total work.
- (vi) Uncertainty about liability for total work done.

Q7. Comment on the following:

- (a) In case the existing auditor(s) appointed at the Annual General Meeting refused to accept the appointment, whether the Board of Directors could fill up the vacancy.
- (b) X and Co., Chartered Accountants, who were appointed as the first auditors of the company, were removed without the prior approval of the Central Government, before the expiry of their term, by calling an Extraordinary General Meeting
- (c) Due to the resignation of the existing auditor(s), the Board of directors of X Ltd appointed Mr. Hari as the auditor. Is the appointment of Hari as auditor valid?
- (d) At the Annual General Meeting of the Company, a resolution was passed by the entire body of shareholders restricting some of the powers of the Statutory Auditors. Whether powers of the Statutory Auditors can be restricted?

Answer 7.

- (a) **Board's Powers to Appoint an Auditor :** The appointment of an auditor is complete only on the acceptance of the offer by the auditor. The non-acceptance of appointment by the auditor does not result in any casual vacancy. Moreover, even if the auditor is existing one, the matter would not make any difference since the appointment has to be made at each AGM and the auditor must accept the same. The casual vacancy is said to arise only in case of death, resignation, etc. Therefore, the Board is empowered to fill such a vacancy. Section 224(3) of the Companies Act, 1956, empowers the Central Government to fill up a vacancy in case no auditors are appointed or re-appointed at an annual general meeting (AGM). (It is also opined that the appointment of an auditor having been made by shareholders, sub-section (3) cannot be invoked Thus the auditor could only be appointed by shareholders at general meeting). Thus, the Board of Directors are not authorised to fill up the vacancy in case the existing auditor (s) appointed at the Annual General Meeting refuse to accept the appointment.
- (b) **Removal of First Auditors :** With a view to safeguarding the auditor's independence, the law provides very stringent provisions so far as removal of an auditor before the expiry of the

term is concerned. Section 224(7) of the Companies Act, 1956 provides that an auditor may be removed before the expiry of his term by the company in a general meeting only after obtaining the prior approval of the Central Government. An exception to this rule is that no such approval is required for the removal of the first auditor appointed by the Board of Directors under Section 224(5) of the Companies Act, 1956. Accordingly, X & Co., Chartered Accountants, being the first auditor of the company can be removed without the approval of the Central Government by the company by passing a general resolution to that effect in the extra-ordinary general meeting called for the purpose.

- (c) **Board's Powers to Appoint Auditor(s)** : The resignation of the existing auditor(s) would give rise to a casual vacancy. As per Section 224(6) (a) of the Act, casual vacancy can be filled by the Board of Directors, provided such vacancy has not been caused by the resignation of the auditor. The rationale behind such a provision is to ensure that resignation is a matter of great concern and, thus, it is necessary that all shareholders must be apprised of reasons connected with resignation in case of a casual vacancy arising on account of resignation. The vacancy shall only be filled by the company in general meeting. Thus the appointment of Mr. Hari as the auditor of the company is not valid.
- (d) **Restrictions on Powers of Statutory Auditors** : Section 227(1) of the Companies Act, 1956 provides that an auditor of a company shall have right of access at all times to the books and accounts and vouchers of the company whether kept at the Head Office or other places and shall be entitled to require from the offices of the company such information and explanations as the auditor may think necessary for the purpose of his audit. These specific rights have been conferred by the statute on the auditor to enable him to carry out his duties and responsibilities prescribed under the Act, which cannot be restricted or abridged in any manner. Hence 'any such resolution even if passed by entire body of shareholders is ultra vires and therefore void. In the case of *Newton vs. Birmingham Small Arms Co.*, it was held that any regulations which preclude the auditors from availing themselves of all the information to which they are entitled under the Companies Act, are inconsistent with the Act.

Q8. (a) Write a short note on - Independence of Internal Auditor.

(b) Efficiency Audit.

Answer 8.

- (a) **Independence of Internal Auditor**: The concept of independence is equally relevant for internal auditor also. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. Internal auditor is part of the management but he evaluates the functioning of the management at different levels. Therefore, to be efficient and effective, the internal auditor must have adequate independence. It may be noted that by its very nature, the internal audit function cannot be expected to have the same degree of independence as is essential when the external auditor expresses his opinion on the financial information. To ensure his independence he is made responsible directly to the Board of Directors through audit committee. Such a channel of communication provides an independent mode whereby an internal auditor can communicate and share his views on the scope of internal audit, findings, etc. If internal auditor is made subordinate to lower level, his independence will be effected which will affect his functioning and effectiveness. An outsider, like a firm of chartered accountants, if acting as internal auditor, is likely to be more independent than an employee of the organization.
- (b) The term efficiency audit means studying competence in achieving goals. The objective of efficiency audit is to ensure that management controls are functioning efficiently and effectively. Review under efficiency audit may be divided into two segments:

- (i) Effectiveness of tools and techniques applied in achieving goals.
- (ii) Efficiency and adequacy in quality of staff to attain objective.

Efficiency audit helps to –

- (i) reduce uncertainty in business;
- (ii) remove bottlenecks in achieving business objectives and goals;
- (iii) safeguard against business failures;
- (iv) remove inefficiency and ineffectiveness of operations which result in cash drainage;
- (v) Strengthen the factors of survival and prosperity of business.

The effectiveness and efficiency of an executive in discharging his functions in attainment of organizations objectives also falls under efficiency audit.

Q9. (a) Write a short note on - Examination in Depth.

(b) Inherent limitations of Internal Control system?

Answer 9.

- (a) **Examination in Depth:** It implies examination of a few selected transactions from the beginning to the end 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. This examination consists of studying the recording of transactions at the various stages through which they have passed. At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so in terms of the prescribed procedure.
- (b) Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. This is because it suffers from some inherent limitations, such as:-
 - (i) Management's consideration that cost of an internal control does not exceed the expected benefits.
 - (ii) Most controls do not tend to be directed at unusual transactions.
 - (iii) The potential of human error due to carelessness, misjudgement and misunderstanding of instructions.
 - (iv) The possibility that control may be circumvented through collusion with employees or outsiders.
 - (v) The possibility that a person responsible for exercising control may abuse that authority.
 - (vi) Compliance with procedures may deteriorate because the procedures becoming inadequate due to change in condition.
 - (vii) Manipulation by management with respect to transactions or estimates and judgements required in the preparation of financial statements.
 - (viii) Inherent limitations of Audit.

Q10. Explain how the following are dealt with under CARO:

- (a) Loans
- (b) Deposit of Statutory Dues
- (c) Public deposits
- (d) Inventory

Answer:**(a) Loans:**

In case of loans covered under Section 301 of Companies Act , the auditor has to comment on the following:

- (i) Whether the company has granted or taken any loans ,secured or unsecured to/from companies, firms or other parties covered u/s 301 of Company's Act. If so ,name of the parties and amount involved should be stated.
- (ii) Whether terms and conditions of loans taken/given are prejudicial to interest of the company.
- (iii) Whether payment of principal amount and interest are regular.
- (iv) If overdue is over one lakh, whether reasonable steps have been taken to recover the principal/interest amount.

(b) Deposit of Statutory Dues :

The auditor has to report that:

- (i) Whether the company is regular in depositing undisputed statutory dues including P.F, E.S.I, I.T. sales tax, wealth tax, custom, excise, cess and any other statutory dues with appropriate authorities . If not, the statutory payments overdue for more than six months to be reported by the auditor.
- (ii) In case of disputes regarding payment, the sum involved and forum where the dispute is pending should be mentioned. However he should remember that mere representation to the department do not constitute dispute.

(c) Public Deposits :

The auditor should verify whether public deposits if taken have been according to directions issued by Reserve Bank of India and provisions of Sections 58A and 58AA of Companies Act and rules framed thereunder. If not ,the nature of contraventions should be stated. If an order has been passed by Company Law Board , the same has been complied with or not.

(d) Inventory :

The auditor has to make following statements on verification and valuation of inventory:

- (i) Whether physical verification of inventory is conducted at regular intervals.
- (ii) Whether procedures of physical verification followed by management are adequate considering the size and nature of business of the company. If not, the inadequacies to be reported.
- (iii) Whether proper records of inventory are maintained, whether discrepancies have been noted on physical verification and if so, whether the same has been properly dealt with in books of account.

Q11. Write notes on :

- (a) Objectives of operational audit.**
- (b) Advantages and shortcomings of an Audit Programme.**

Answer 11.**(a) Objectives of operational audit:**

Operational audit is systematic evaluation performed by the internal auditor of operational

policies in attainment of organizational objectives. It is a scientific tool in hands of auditor with following objectives:

- (i) To ensure that operational activities are in line with objectives of the organization.
- (ii) To assure management that MIS is functioning properly to attain organizational objectives.
- (iii) To assure management that management control system is functioning efficiently and effectively.

In operational audit the audit functioning and objectives reach out beyond the financial control aspect into the operating areas of business.

(b) Advantages of Audit Programme:

- (i) Audit programme ensures all audit activities are performed in time and there is no omission of any work.
- (ii) Auditor can gauge the progress of work performed by his assistants.
- (iii) Such programme ensures simplification of allocation of work among assistants.
- (iv) Audit programme acts as a guide in performance of audit work.
- (v) Audit programme helps in final review of work before submission of report.
- (vi) It acts as a guide in preparation of future audit programme in case of similar type of audit.

Disadvantages of the use of an Audit Programme

- (i) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.
- (ii) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on.
- (iii) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
- (iv) A hard and fast programme may kill the initiative and innovation of efficient and enterprising assistants.

Q12. What are the special steps involved in framing a system of Internal Check?

Answer 12.

General Considerations in Framing a System of Internal Check : The term "internal check" is defined as the "checks on day to day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud". The following aspects should be considered in framing a system of internal check :

- (1) No single person should have an independent control over any important aspect of the business. The work done by one person should automatically be checked by another person in routine course.
- (2) The duties/work of members of the staff should be changed from time to time without any previous notice so that the same officer or subordinate does not, without a break, perform the same function for a considerable length of time.
- (3) Every member of the staff should be encouraged to go on leave at least once in a year so that frauds successfully concealed by such a person can be detected in his absence.

- (4) Persons having physical custody of assets must not be permitted to have access to the books of account.
- (5) There should be an accounting control in respect of each important class of assets, in addition, these should be periodically inspected so as to establish their physical condition.
- (6) The system of Budgetary Control should be introduced.
- (7) For stock-taking, at the close of the year, trading activities should, if possible, be suspended. The task of stock-taking, and evaluation should be done by staff belonging to other than stock section.
- (8) The financial and administrative powers should be sub divided very judiciously and the effect of such division should be reviewed periodically.
- (9) Finally, the system must be capable of being expanded or contracted to correspond to the size of the concern.

Q13. Why are Computer Aided Audit Techniques (CAAT) required in EDP audit? What are the advantages of CAATs?

Answer 13.

Computer Aided Audit Techniques (CAATs): The use of computers may result in the design of systems that provide less visible evidence than those using manual procedures. CAATs are such techniques applied through the computer which are used in verifying the data being processed by it. System characteristics resulting from the nature of EDP processing that demand the use of Computer Aided Audit Techniques (CAAT) are:

- (i) **Absence of input documents:** Data may be entered directly into the computer systems without supporting documents. In on-line transaction systems, written evidence of individual data entry authorization, e.g., credit limit approval may not be available.
- (ii) **Lack of visible transaction trail:** Certain data may be maintained on computer files only. In a manual system, it is normally possible to follow a transaction through the system by examining source documents, books of account, records, files and reports. In an EDP environment, however, the transaction trail may be partly in machine-readable form, and it may exist only for a limited period of time.
- (iii) **Lack of visible output:** In a manual system, it is normally possible to examine visually the results of processing. In EDP systems, the results of processing may not be printed or only a summary data may be printed. Thus, the lack of visible output may result in the need to access data retained on machine readable files.
- (iv) **Ease of Access to data and computer programmes:** Data and computer programmes may be altered at the computer or through the use of computer equipment at remote locations. Therefore, in the absence of appropriate controls, there is an increased potential for unauthorized access to, and allocation of, data and programmes by persons inside or outside the entity.

Advantages of CAAT

- (i) **Audit effectiveness:** The effectiveness and efficiency of auditing procedures will be improved through the use of CAAT in obtaining and evaluating audit evidence, for example –
 - (a) Some transactions may be tested more effectively for a similar level of cost by using the computer.

- (b) In applying analytical review procedures, transactions or balance details of unusual items may be reviewed and reports got printed more efficiently by using the computer.
- (ii) **Savings in time:** The auditor can save time by reviewing the EDP controls using CAAT than through other audit procedures.
- (iii) **Effective test checking and examination in depth:** CAAT permits effective examination in depth of selected transactions since the auditor constructs the lost audit trail.

Q14. (a) Write a short notes on - Audit Trail.

(b) Audit Risk in Information System Audit.

Answer 14

- (a) Audit Trail :** An audit trail refers to a situation where it is possible to relate 'one-to-one' basis, the original input along with the final output. The work of an auditor would be hardly affected if "Audit Trail" is maintained i.e. if it were still possible to relate, on a 'one-to-one' basis, the original input with the final output. A simplified representation of the documentation is a manually created audit trail.

For example, the particular credit notes may be located by the auditor at any time he may wish to examine them, even months after the balance sheet date. He also has the means, should he so wish, of directly verifying the accuracy of the totals and sub-totals that feature in the control listing, by reference to individual credit notes. He can, of course, check all detailed calculations, casts and postings in the accounting records, at any time.

In first and early second-generation computer systems, such a complete audit trail was generally available, no doubt, to management's own healthy scepticism of what the new machine could be relied upon to achieve – an attitude obviously shared by the auditor. The documentation in such a trail might again be portrayed, in over simplified way.

It is once again clear that there is an abundance of documentation upon which the auditor can use his traditional symbols of scrutiny, in the form of coloured ticks and rubber stamps. Specifically:

- (i) The output itself is as complete and as detailed as in any manual system.
- (ii) The trail, from beginning to end, is complete, so that all documents may be identified by location for purposes of vouching, totalling and cross-referencing.

Any form of audit checking is possible, including depth testing in either direction.

- (b) Audit Risk :** Audit risk is the risk that an auditor may give an inappropriate opinion on financial information which is materially misstated. An auditor may give an unqualified opinion on financial statements without knowing that they are materially misstated. Such risk may exist at overall level, while verifying various transactions and balance sheets items. There are three components of audit risk:

- (i) **Inherent Risk:** is a risk that material errors will occur. Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material, individually or when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.
- (ii) **Control Risk:** is the risk that the client's system internal control will not prevent or correct such errors, to assess control risk, the auditor should consider the adequacy of control design as well as test adherence to control procedure.

- (iii) **Detection Risk:** is the risk that an auditor's procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material, individually or when aggregated with misstatements in other balances or classes. The level of detection risk relates directly to the auditor's procedures, Some detection risk would always be present.

The inherent and control risks are functions of the entity's business and its environment and the nature of the account balances or classes of transactions, regardless of whether an audit is conducted. Even though inherent and control risks cannot be controlled by the auditor, the auditor can assess them and design his substantive procedures to produce on acceptable level of detection risk, thereby reducing audit risk to an acceptable low level.

Q15. State the advantages and limitations of Management Audit.

Answer 15.

Management Audit is the audit to review ,examine and appraise the different policies of management on the basis of certain prescribed standards. The advantages of Management

Audit are as follows :

- (i) The company's personnel know the organizational policies , plans, operations, personnel , working environment , functional importance and problem themselves.
- (ii) The audit team need not spend an unduly long time for familiarizing themselves with the background information for study.
- (iii) It may be easier to get top management's support as this self appraisal involves no extra cost.
- (iv) The acceptance to the audit findings may be easier as it is conducted by internal management (consisting of co-workers) and not external management workers.
- (v) The implementation of suggested method of operation or organizational arrangement may be easier because the advisers , as they are internal, are present in the premises at the time of implementation.
- (vi) The experience and expertise gained during such management appraisal can be gainfully utilized for subsequent audit.

However there are certain limitations of management audit :

- (i) The experience and expertise of company personnel are limited to their organization only. This may create constraint for the company due to limited experience of the personnel.
- (ii) The company personnel may take facts for granted and not probe details to unearth problems.
- (iii) There may be tendency to suppress unfavourable facts relating to some of their fellow personnel.
- (iv) Necessary personnel may not be present within the organization to conduct audit involving complicated issues.
- (v) It may not be possible for company to spare personnel for studies as these may take long time.
- (vi) Due to conflicting interests the audit work may get prolonged and implementation of findings may get delayed.
- (vii) The vested interest of operational executives may prevent management audit team from being objective.
- (viii) In a management audit scheme require studies to be completed within a time constraint- which may result in some of the areas remaining uncovered.