

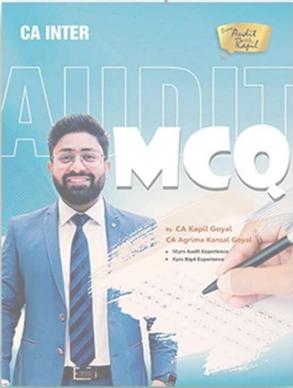
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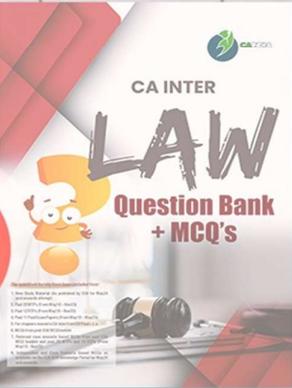
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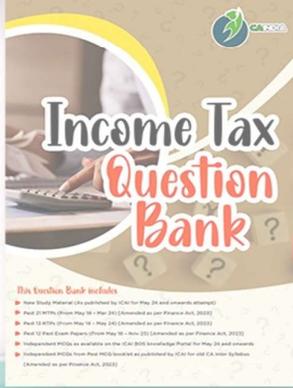


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Chapter 1- Nature, Objective and Scope of Audit

Category A

1. The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain (MTP April 19)

Ans. Responsibilities for the Financial Statements: The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept **responsibility for the preparation of the financial statements**. Management also accepts responsibility for such **internal control** as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

2. The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. Advise about qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (MTP Oct. 19)

Ans. Evaluations by the Auditor: The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.

This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

Qualitative Aspects of the Entity's Accounting Practices

- Management makes a number of judgments about the amounts and disclosures in the financial statements.
- SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.
- In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated.

Indicators of a lack of neutrality include the following:

- The selective correction of misstatements brought to management's attention during the audit
 - Possible management bias in the making of accounting estimates.
- d) SA 540 addresses possible management bias in making accounting estimates.

Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

3. The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. Explain. (SM and RTP May 22)

OR

The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded as being incompatible with integrity and objectivity. Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist requiring the application of different safeguards. Explain stating

clearly the five types of threats as contained in Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC)

OR

Write a note on “Self-review threats”

(RTP Nov. 19)

OR

Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client’s interests. Explain.

(MTP April 19)

Ans. The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded as being incompatible with integrity and objectivity.

Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist requiring the application of different safeguards.

The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are as follows

1. **Self-interest threats:** which occur when an auditing firm, its partner or associate could benefit from a **financial interest in an audit client**. Examples include (i) direct financial interest or materially significant indirect financial interest in a client, (ii) loan or guarantee to or from the concerned client, (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement, (iv) close business relationship with an audit client, (v) potential employment with the client, and (vi) contingent fees for the audit engagement.

2. **Self-review threat:** which occur when during a review of **any judgement or conclusion reached in a previous audit or non-audit engagement** (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are (i) when an auditor having recently been a director or senior officer of the company, and (ii) when auditors perform services that are themselves subject matters of audit.

3. **Advocacy threats:** which occur when the **auditor promotes, or is perceived to promote, a client’s opinion to a point where people may believe that objectivity is getting compromised**, eg. When an auditor deals with shares or securities of the audited company, or becomes the client’s advocate in litigation and third-party disputes.

4. **Familiarity threats:** are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client’s interests. This can occur in many ways:

- (i) Close relative of the audit team working in a senior position in the client company,
- (ii) Former partner of the audit firm being a director or senior employee of the client,
- (iii) Long association between specific auditors and their specific client counterparts, and
- (iv) Acceptance of significant gifts or hospitality from the client company, its directors or employees.

5. **Intimidation threats:** which occur when **auditors are deterred from acting objectively** with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

4. The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organizations where audit is not compulsory. Explain.

(RTP NOV. 18)

OR

PACE is proprietorship firm of Mr. Abhinav engaged in the manufacturing of textile and handloom products. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of Rs. 50 crores. It has also availed cash credit limit of Rs. 5 crores from Axis Bank. In the year 2017-18, proprietor of the firm is worried about the financial

position of the company and is under the impression that since he is out of India, therefore firm might run into losses. He approaches CA Mahesh about advantages of getting his accounts audited throughout the year so that he may not suffer due to accounting weaknesses. Advice regarding advantages of getting accounts audited.

Ans. The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organization's where audit is not compulsory,

These advantages are given below:

- (a) It **safeguards the financial interest** of persons who are not associated with the management of the entity, whether they are partners or shareholders, bankers, FI's, public at large etc.
- (b) It acts as a **moral check** on the employees from committing defalcations or embezzlement.
- (c) Audited statements of account are **helpful in settling liability for taxes**, negotiating loans and for determining the purchase consideration for a business.
- (d) These are also **useful for settling trade disputes** for higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.
- (e) An audit can also help in the **detection of wastages and losses** to show the different ways by which these might be checked, especially those that occur due to the absence of inadequacy of internal checks or internal control measures.
- (f) Audit ascertains whether the necessary **books of account and allied records have been properly kept** and helps the client in making good deficiencies or inadequacies in this respect.
- (g) As an appraisal function, **audit reviews the existence and operations of various controls in the organizations' and reports weaknesses, inadequacies**, etc, in them.
- (h) Audited accounts are of great **help in the settlement of accounts at the time of admission or death of partner**.
- (i) Government may require audited and certified statement before it gives assistance or issues a license for a particular trade.

5. "An auditor who before the completion of the engagement is requested to change the engagement to one which provides a lower level of assurance should consider the appropriateness of doing so." Discuss. (RTP MAY 18 and RTP Nov 23)

OR

An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so. Explain stating the factors based on which client can request the auditor to change the engagement. (RTP Nov. 19 and RTP Nov 2022)

OR

R & Co, a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients for last 5 years despite changes in business and professional environment.

OR

Elucidate the circumstances that may warrant the revision in terms of engagement. (ILLUSTRATION SM and Exam Dec 21)

OR

As an auditor of XYZ Ltd, how would you consider the acceptance of a change in audit engagement? (MTP Mar 22)

Ans. Acceptance of a Change in Engagement: An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should **consider the appropriateness** of doing so.

A request from the client for the auditor to change the engagement may result from

- i) A change in circumstances affecting the need for the service,
- ii) A misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances.

The auditor would consider carefully the reason given for the request, particularly the **implications of a restriction** on the scope of the engagement, especially any legal or contractual implications.

If the auditor **concludes that there is reasonable justification to change the engagement** and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement.

In order to avoid confusion, the report would not include reference to-

- (i) The original engagement; or
- (ii) Any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

The **auditor should not agree to a change of engagement where there is no reasonable justification for doing so**. If the terms of the audit engagement are changed, the auditor and management shall agree on and **record the new terms of the engagement in an engagement letter** or other suitable form of written agreement.

If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management **to continue the original audit engagement**, the auditor shall-

- (a) Withdraw from the audit engagement where possible under applicable law or regulation; and
- (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

6. The firm's system of quality control should include policies and procedures addressing each and every element of system of quality control. State those elements. (MTP Oct. 19)

OR

How does SQC 1 ensure that independence in engagements is not breached by an audit firm? [New SM Question]

Ans. The firm's system of quality control should include policies and procedures addressing each of the following elements:

- a) Leadership responsibilities for quality within the firm.
- b) Ethical requirements.
- c) Acceptance and continuance of client relationships and specific engagements.
- d) Human resources.
- e) Engagement performance.
- f) Monitoring

7. As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. Explain

(RTP MAY 18 and MTP Nov 21)

OR

CA Raj, an engagement partner wants to take decision, regarding acceptance and continuance of an audit engagement. Which in formations he should obtain before accepting an engagement?

(Exam May 19)

Ans. Information which assist the Auditor in accepting and continuing of relationship with Client:

As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client.

The following information would assist the auditor in accepting and continuing of relationship with the client:

- (i) The **integrity** of the principal owners, key management and those charged with governance of the entity;
- (ii) Whether the **engagement team is competent** to perform the audit engagement and has the necessary capabilities, including time and resources;
- (iii) Whether the **firm and the engagement team can comply** with **relevant ethical requirements**; and
- (iv) **Significant matters** that have **arisen** during the current or previous audit engagement, and **their implications** for continuing the relationship.

8. As per SA 220, the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. While taking responsibility for the overall quality on each audit engagement, analyze and explain the emphasis of the actions of the engagement partner and appropriate messages to the other members of the engagement team. Also define engagement partner. [RTP Nov 2020 and RTP May 23]

Ans. As per SA 220 “Quality Control for an Audit of Financial Statements”, the **engagement partner** shall take **responsibility for the overall quality** on each audit engagement to which that partner is assigned.

The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking **responsibility for the overall quality on each audit engagement**, emphasis:

(a) **The importance to audit quality of:**

- (i) Performing work that complies with professional standards and regulatory and legal requirements;
- (ii) Complying with the firm’s quality control policies and procedures as applicable;
- (iii) Issuing auditor’s reports that are appropriate in the circumstances; and
- (iv) The engagement team’s ability to raise concerns without fear of reprisals; and

(b) The fact that quality is essential in performing audit engagements.

Engagement partner means: (definition)

Engagement partner refers to the partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor’s report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

9. The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm’s system of quality control, including a periodic inspection of a selection of completed engagements. Explain in the above context the purpose of monitoring compliance with quality control policies and procedures. (RTP Nov. 19, RTP Nov 2020 and MTP Oct 22)

Ans. The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm’s system of quality control, including a periodic inspection of a selection of completed engagements.

The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

(a) Adherence to **professional standards and regulatory and legal requirements;**

(b) Whether the quality control system has been **appropriately designed and effectively implemented;** and

(c) Whether the firm’s quality control **policies and procedures have been appropriately applied**, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

(d) **Follow-up by appropriate firm personnel** so that necessary modifications are promptly made to the quality control policies and procedures.

10. M/s Suresh Chandra & Co. has been appointed as an auditor of SC Ltd. for the financial year 2014-15. CA. Suresh, one of the partners of M/s Suresh Chandra & Co., completed entire routine audit work by 29th May, 2015. Unfortunately, on the very next morning, while roving towards office of SC Ltd. to sign final audit report, he met with a road accident and died. CA. Chandra, another partner of M/s Suresh Chandra & Co., therefore, signed the accounts of SC Ltd., without reviewing the work performed by CA. Suresh State with reasons whether CA. Chandra is right in expressing an opinion on financial statements the audit of which is performed by another auditor. (ILLUSTRATION SM)

Ans. Relying on Work Performed by Another Auditor: As per SA 220 “Quality Control for an Audit of Financial Statements”, an engagement partner taking over an audit during the engagement may **apply the review procedures** such as the work has been performed in accordance with **professional standards and regulatory and legal requirements; significant matters** have been raised for further consideration; **appropriate consultations** have taken place and the **resulting conclusions have been documented and**

implemented; there is a need to **revise the nature, timing and extent of work performed**; the **work performed supports the conclusions reached** and is **appropriately documented**; the **evidence obtained is sufficient and appropriate** to support the auditor's report; and the **objectives of the engagement procedures have been achieved**.

Further, one of the **basic principles**, which govern the auditor's professional responsibilities and which should be complied with wherever an audit is carried, is that when the auditor **delegates work to assistants or uses work performed by other auditor and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. This is the fundamental principle which is ethically required as per Code of Ethics.**

However, the auditor should **carefully direct, supervise and review work delegated**. He should **obtain reasonable assurance** that work performed by other auditors/experts and assistants is adequate for his purpose.

Conclusion: In the given case, all the auditing procedures before the moment of signing of final report have been performed by CA. Suresh. However, the report could not be signed by him due to his unfortunate death. Later on, CA. Chandra signed the report relying on the work performed by CA. Suresh. Here, CA. Chandra is allowed to sign the audit report, though, will be responsible for expressing the opinion. He may rely on the work performed by CA. Suresh provided he further exercises adequate skill and due care and review the work performed by him.

11. The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Explain. (RTP MAY 18)

Ans. Timeliness of Financial Reporting and the Balance between Benefit and Cost:

The matter of difficulty, time, or cost involved **is not in itself a valid basis** for the auditor to omit an audit procedure for **which there is no alternative** or to be with audit evidence **that is less than persuasive**. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there **is a balance to be struck between the reliability of information and its cost**. There is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognizing that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.

12. The IAASB functions as an independent standard-setting body under the auspices of IFAC. Explain stating the objective of IAASB and also how it achieves those objectives. (RTP May 19)

Ans. Objectives of International Auditing and Assurance Standards Board: In 1977, the International Federation of Accountants (IFAC) was set up with a view to bringing harmony in the profession of accountancy on an international scale. In pursuing this mission, the IFAC Board has established the International Auditing and Assurance Standards Board (IAASB) to develop and issue, in the public interest and under its own authority, high quality auditing standards for use around the world. The IFAC Board has determined that designation of the IAASB as the responsible body, under its own authority and within its stated terms of reference, best serves the public interest in achieving this aspect of its mission.

The **IAASB functions as an independent standard-setting** body under the auspices of IFAC. The objective of the IAASB is to serve the public interest by setting high quality auditing standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB achieves this objective by.

- Establishing high quality auditing standards and guidance for financial statement audits that are generally accepted and recognized by investors, auditors, governments, banking regulators, securities regulators and other key stakeholders across the world;
- Establishing high quality standards and guidance for other types of assurance services on both financial and non-financial matters;
- Establishing high quality standards and guidance for other related services;

- Establishing high quality standards for quality control covering the scope of services addressed by the IAASB; and

Publishing other pronouncements on auditing and assurance matters, there by advancing public understanding of the roles and responsibility of professional auditors and assurance service providers.

13. Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. Explain stating also the qualities of Auditor.

(RTP May 19 and MTP Oct 21)

Ans. It is not enough to realize what an auditor should be. He is concerned with the reporting on financial matters of business and other institutions. Financial matters inherently are to be set with the problems of human fallibility, errors and frauds are frequent. **The qualities required, according to Dicksee, are tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability.** In short, all those personal qualities that go to make a good businessman contribute to the making of a good auditor. In addition, **he must have the shine of culture for attaining a great height.** He must have the **highest degree of integrity backed by adequate independence.** In fact, **Code of ethics mentions integrity, objectivity and independence** as one of the fundamental principles of professional ethics.

He must have a **thorough knowledge of the general principles of law** which govern matters with which he is likely to be in intimate contact. The Companies Act need special mention but mercantile law, specially the law relating to contracts, is no less important. Needless to say, where undertakings are governed by a special statute, its knowledge will be imperative; in addition, a sound knowledge of the law and practice of taxation is unavoidable.

He must pursue an intensive program of theoretical education in subjects like **financial and management accounting, general management, business and corporate laws, computers and information systems, taxation, economics**, etc. Both practical training and theoretical education are equally necessary for the development of professional competence of an auditor for undertaking any kind of audit assignment. The auditor should be equipped not only with a sufficient knowledge of the way in which business generally is conducted but also with an understanding of the special features peculiar to a particular business whose accounts are under audit. The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education.

He is called upon **constantly to critically review financial statements** and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert. An exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of auditing. He must know thoroughly all accounting principles and techniques.

Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. He said, “an auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true”.

14. “An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.”

Explain stating clearly how the person conducting this task should take care to ensure that financial statements would not mislead anybody.

(MTP Oct. 19 and RTP May 2020)

Ans. “An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.”

Analysis of the Definition

1. Audit is Independent examination of financial information.
2. of any entity – that entity may be profit oriented or not and irrespective of its size or legal form. For example – Profit oriented – Audit of Listed Company engaged in business. On the other hand, Audit of NGO – not profit oriented.
3. The objective of the audit is to express an opinion on the financial statements.

The person conducting this task should take care to ensure that, **financial statements would not mislead anybody. This he can do honestly by satisfying himself that:**

- (i) The accounts have been drawn up with reference to entries in the books of account;

- (ii) The entries in the books of account are adequately supported by sufficient and appropriate evidence;
- (iii) None of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
- (iv) The information conveyed by the statements is clear and unambiguous;
- (v) The financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
- (vi) The statement of accounts presented true and fair picture of the operational results and of the assets and liabilities.

15. The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statement to be materially misstated. Discuss any four examples of professional skepticism.

(Exam Nov. 19, RTP Nov 2020; RTP Nov 2022 and MTP Sep 23)

Ans. Professional skepticism refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

Professional Skepticism Requirement and Auditor Expectation.

1. The auditor shall **plan and perform an audit with professional skepticism.**

2. It **Reduces risk** of:

- Overlooking unusual circumstances.
- Over generalizing when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining Nature, Time, Extent of audit procedures & evaluating the results thereof.

3. **Professional skepticism includes being alert to:**

- Contradictory audit evidence.
- Questions on reliability of documents.
- Conditions indicating possible frauds.
- Circumstances suggesting need for audit procedures in addition to those suggested in SAs.

Professional skepticism is necessary to the critical assessment of audit evidence. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud, the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism.

16. DEF & Co. Chartered Accountants successfully carried out the audit of Shree Garments for the F.Y. 2015-2016. After the completion of the audit, there were found material misstatements due to fraud in the financial statements which were not noticed and reported by the auditor. Management alleges that it is failure on the part of auditor. Comment.

(ILLUSTRATION SM and MTP Nov 2020)

Ans: Because of the **limitations of an audit**, there is an **unavoidable risk that some material misstatements of the financial statements may not be detected**, even though the audit is properly planned and performed in accordance with SAs. Accordingly, the **subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs.**

However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence. Whether the auditor has performed an audit in accordance with SAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.

Category B

17. Principal aspects to be considered by an auditor while conducting an audit of final statements of accounts. (Exam May 18)

OR

GST & Co., a firm of Chartered Accountants has been appointed to audit the accounts of XYZ Ltd. The partner wanted to cover principal aspects while conducting its audit of financial statements. Advise those principal aspects. (RTP MAY 18)

OR

SWM is proprietorship firm engaged in the manufacturing of different kind of yarns. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of Rs. 30 crores. It has also availed cash credit limit of Rs. 3 crores from Dena Bank. In the year 2018-19. Proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore firm might not run well. He approaches an Internal Auditor about as to what would be covered in Audit. Advise regarding principal aspects (any four) to be covered in getting accounts audited. (MTP Mar. 19)

Ans. The principal aspects to be covered in an audit concerning final statements of account are the following:

- a) An **examination of the system of accounting and internal control** to ascertain whether it is appropriate for the business and helps in properly recording all transactions.
- b) **Reviewing the system and procedures** to find out whether they are adequate and comprehensive and incidentally whether material inadequacies and weaknesses exist to allow frauds and errors going unnoticed.
- c) **Checking of the arithmetical accuracy** of the books of account by the verification of postings, balances, etc.
- d) **Verification of the authenticity and validity of transaction** entered into by making an examination of the entries in the books of accounts with the relevant supporting documents.
- e) **Ascertaining that a proper distinction** has been made between items of capital and of revenue nature and that the amounts of various items of income and expenditure adjusted in the accounts corresponding to the accounting period.
- f) **Comparison of the balance sheet and profit and loss account** or other statements with the underlying record in order to see that they are in accordance therewith.
- g) **Verification of the title, existence and value** of the assets appearing in the balance sheet.

18. What constitutes a 'true and fair' view, is the matter of an auditor's judgement in the particular circumstances of a case. In order to ensure 'true and fair' view, auditor has to review certain points. Mention any such 5 (five) points in brief. (Exam May 18)

Ans. True and Fair View: To ensure true and fair view, an auditor has to see:

- (i) That the assets are neither undervalued or overvalued, according to the applicable accounting principles,
- (ii) No material asset is omitted;
- (iii) The charge, if any, on assets are disclosed;
- (iv) Material liabilities should not be omitted;
- (v) The profit & loss account and balance sheet discloses all the matters required to be disclosed;
- (vi) Accounting policies have been followed consistently; and
- (vii) All unusual, exceptional or non-recurring items have been disclosed separately.

19. "Professional judgment is essential to the proper conduct of an audit." Discuss.

(Exam Nov. 18 and MTP Nov 2020)

Ans. Professional judgment is essential to the proper conduct of an audit. This is because **interpretation of relevant ethical requirements and the SAs and the informed decisions required throughout the audit** cannot be made without the application of relevant knowledge and experience to the facts and circumstances.

Professional judgment is necessary in particular regarding decisions about:

- (i) Materiality and audit risk.
- (ii) The nature, timing, and extent of audit procedures used to meet the requirements of the SAs and gather audit evidence.
- (iii) Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor.
- (iv) The evaluation of management's judgments in applying the entity's applicable
- (v) Financial reporting framework.
- (vi) The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

20. MNO Ltd requested the auditor CA P to provide for absolute assurance in respect of its ten branches scattered in Delhi and confirm that the financial statements are free from material misstatement due to fraud or error. Advise. (ILLUSTRATION SM)

OR

In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters.

[RTP May 2020]

OR

An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance.

[New SM Question and MTP Oct 23]

OR

There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples.

[RTP Nov 23]

OR

In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Discuss those subject matters.

[RTP Nov 23]

Ans. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. **This is because there are inherent limitations of an audit**, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

In view of the above, CA P cannot provide audit absolute assurance to MNO Ltd in respect of its branches.

The Inherent limitations of an audit arise from:

- (i) **The Nature of Financial Reporting:** The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.
- (ii) **The Nature of Audit Procedures:** There are practical and legal limitations on the auditor's ability to obtain audit evidence.

For example:

There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.

- (iii) **Timeliness of Financial Reporting and the Balance between Benefit and Cost:** The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.
- (iv) **Other Matters that Affect the Limitations of an Audit:** In the case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:
 - Fraud, particularly fraud involving senior management or collusion.
 - The existence and completeness of related party relationships and transactions.
 - The occurrence of non-compliance with laws and regulations.
 - Future events or conditions that may cause an entity to cease to continue as going concern.

CATEGORY C

21. State the objectives of Audit according to SA 200

OR

Explain the overall objective of the auditor as contained in SA 200.

(RTP May 19; RTP May 2020, Exam May 22 and MTP Apr 23]

OR

Mr. Z, auditor of the Company, Different and Capable Limited for the financial year 2022-23, explained to audit team members about the objectives of the Independent Auditor in accordance with the relevant Standard on Auditing. Explain those objectives. [RTP Nov 23]

Ans. Overall Objectives of the Auditor

As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, **the overall objectives of the auditor are:**

- a) To **obtain reasonable assurance** about whether the F. S. as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the F.S. are prepared, in all material respects, in accordance with an applicable FRF, and
- b) To **report on the Financial Statements** and communicate as required by the SAs, in accordance with the auditor's findings.

In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient, the SAs require that the auditor disclaim an opinion or withdraw from the engagement.

22. The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

In the above context, explain the guiding principles.

(RTP Nov. 19, RTP Nov 21, Exam Nov 20 and RTP May 23)

Ans. The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

The following are the guiding principles in this regard: -

For the public to have confidence in the quality of audit, it is essential that auditors should always be and **appears to be independent** of the entities that they are auditing.

1. In the case of audit, the key fundamental principles are **integrity, objectivity and professional skepticism**, which necessarily require the auditor to be independent.
2. Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.
3. When such **threats exist**, the auditor should either desist from the task or put in place safeguards that eliminate them.
4. If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

23. There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance. Explain. [MTP Nov 2020 and RTP May 23]

Ans. There are **two interlinked perspectives of independence of auditors**, one, **independence of mind**; and two, **independence in appearance**. The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows:

"Independence is:

(i) Independence of mind – the state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and

(ii) Independence in appearance – the avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an auditor's integrity, objectivity or professional skepticism had been compromised."

24. The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements.

(MTP April 19)

OR

Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements. Discuss with reference to those fundamental principles of professional ethics.

(RTP May 19 and RTP May 22)

Ans. Ethical Requirements Relating to an Audit of FS: The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements.

The Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements:

- a) Integrity;
- b) Objectivity;
- c) Professional competence and due care;
- d) Confidentiality; and
- e) Professional behavior.

25. State six important advantages of audit of accounts of a Partnership firm.

(MTP April 19)

Ans. Advantages of Audit of Accounts of a Partnership: On broad considerations, the advantages of audit of accounts of a partnership could be stated as follows:

1. Audited accounts provide a **convenient and reliable means of settling accounts between the partners** and, thereby, the possibility of occurrence of a dispute among them is mitigated. On this consideration, it is usually provided in and accepted by the partners, shall be binding upon them, unless some manifest error is brought to light within a specified period subsequent to the accounts having been signed.
2. On the retirement or death of a partner, audited accounts, which have been accepted by the partners, **constitute a reliable evidence for computing the amounts due** to the retiring partner or to the representative of the deceased partner in respect of his share of capital, profits and goodwill.
3. The accounts of a partnership, which have been audited, are generally **accepted by the Income Tax Department** as the basis for computing the assessable income of the partners.
4. Audited statement of accounts is **relied upon by the banks** when advancing loans, as well as by prospective purchasers of the business, as evidence of the profitability of the concern and its financial position.
5. Audited statements of account can be **helpful in the negotiations to admit a person as a partner**, especially when they are available for a number of past years.
6. An audit is **an effective safeguard against any undue advantage** being taken by a working partner or partners especially in the case of those partners who are not actively associated with the working of the firm.

26. "The independent audit of an entity's financial statements is a vital service to investors, trade payables, and other participants in economic exchange." Explain (SM)

Ans. Auditing along with other disciplines such as accounting and law, equips you with all the knowledge that is required to enter into auditing as a profession. No business or institution can effectively carry on its activities without the help of **proper records and accounts**, since transactions take place at different points of time with numerous persons and entities.

The **effect of all transactions has to be recorded** and suitably analyses to see the results as regards the business as a whole. **Periodical statements of account** are drawn up to measure the success or failure of the activities in achieving the objective of the organization. This would be impossible without a systematic record of transactions.

Financial Statements are often the basis for decision making by the management and for corrective action so as to even closing down the organization or a part of it. All this would be possible only **if the statements are reliable**; decisions based on wrong accounting statements may prove very harmful or even fatal to the business.

For example, if the business has really earned a profit but because of wrong accounting, the annual accounts show a loss, the proprietor may take the decision to sell the business at a loss. Thus, from the point of view of the management itself, **authenticity of financial statements is essential**. It is more essential for those who have invested their money in the business but, cannot take part in its management, for example, shareholders in a company, such persons certainly need an assurance that the annual statements of accounts sent to them are fully reliable. It is auditing which ensures that the accounting statements are authentic. In today's economic environment, information and accountability have assumed a larger role than ever before. As a result, the independent audit of an entity's financial statements is a vital service to investors, trade payables, and other participants in economic exchange.

27. Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Explain the matters to be addressed in this context.

(RTP May 2021 and MTP Mar 23)

Ans. The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances.

Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed include the following:

- ◆ How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.
- ◆ Processes for complying with applicable engagement standards.
- ◆ Processes of engagement supervision, staff training and coaching.
- ◆ Methods of reviewing the work performed, the significant judgments made and the form of report being issued.
- ◆ Appropriate documentation of the work performed and of the timing and extent of the review.
- ◆ Processes to keep all policies and procedures current.

28. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties. Explain.

(RTP Nov 2021)

Ans. The field of auditing as a discipline involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. Thus, it is quite logical and natural that the function of audit can be performed if and only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.

The discipline of behavioural science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organisation. As against the financial auditor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures. One of the basic elements in designing the internal control system is personnel. However, if a sound internal control structure is designed, it cannot work until and unless the people who are working in the organisation are competent and honest. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties.

29. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles. Discuss the personnel issues addressed by such policies and procedures. Also explain how addressing the personnel issues would empower the firm.

(RTP Nov 21 and RTP Nov 2022)

Ans. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal

requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

Such policies and procedures address the following personnel issues:

- (a) Recruitment;
- (b) Performance evaluation;
- (c) Capabilities;
- (d) Competence;
- (e) Career development;
- (f) Promotion;
- (g) Compensation; and
- (h) Estimation of personnel needs.

Addressing these issues enables the firm to ascertain the number and characteristics of the individuals required for the firm's engagements. The firm's recruitment processes include procedures that help the firm select individuals of integrity as well as the capacity to develop the capabilities and competence necessary to perform the firm's work.

30. CA S is required to accept the appointment as an auditor of Luck Ltd. With reference to SA 210, what should the auditor determine in order to establish whether the preconditions for an audit are present? (Exam Dec 21 and MTP Sep 22)

Ans. Preconditions for an audit:

The use by management of an acceptable FRF in the preparation of the financial statements & the agreement of management &, where appropriate, TCWG to the premise on which an audit is conducted. In order to establish whether the preconditions for an audit are present, the auditor shall:

- I. Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
- II. Obtain the agreement of management that it acknowledges and understands its responsibilities for followings:
 - The preparation of the F.S. in accordance with the applicable FRF.
 - Exercising necessary internal control to enable the preparation of F.S. that are free from material misstatement, whether due to fraud or error.
 - to provide the auditor with:
 - Access to all relevant information such as records, documentation and other matters;
 - Additional information that the auditor may request from management for the purpose of the audit and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

31. "Choosing of appropriate accounting policies in relation to accounting issues is responsibility of management". Do you agree? Discuss duty of auditor, if any, in relation to accounting policies. [New SM Question]

Ans. Choosing of appropriate accounting policies is responsibility of management. The role of auditor lies in evaluating selection and consistent application of accounting policies by management.

The auditor evaluates selection & consistent application of accounting policies by management; whether such a selection is proper & whether chosen policy has been applied consistently.

Understand that financial statements of an entity are prepared on historical financial information basis. "Historical financial information" means information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

For example, when purchases and sales are reflected in financial statements of an entity, these are examples of historical financial information. These are about transactions which have occurred in past.

32. Assurance engagements are not restricted to audit of financial statements alone. Discuss. [New SM Question]

Ans. Assurance engagements are not restricted to audit of financial statements alone. Following engagements also form part of assurance engagements:

- Audit of financial statements

- Review of financial statements
- Examination of Prospective financial information
- Report on controls operating at an organization

33. An assurance engagement involves a three-party relationship. Discuss meaning of three parties in such an engagement. [New SM Question]

Ans. A three party relationship involving a practitioner, a responsible party, and intended users: An assurance engagement involves abovesaid three parties. A practitioner is a person who provides the assurance. The term practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.

A responsible party is the party responsible for preparation of subject matter.

Intended users are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.

34. A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement. [New SM Question]

Ans. The above engagement is in the nature of investigation.

An audit is not an official investigation into alleged wrong doing. He does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official investigation.

Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.

The objective of audit, on the other hand, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.

The scope of audit is general and broad whereas scope of investigation is specific and narrow.

35. Discuss how performing preliminary engagement activities as part of planning an audit assists auditor. [New SM Question]

Ans. The auditor considers whether relationship with client should be continued and whether ethical requirements including independence continue to be complied with. It includes: -

1. Performing procedures regarding the continuance of the client relationship
2. Evaluating compliance with ethical requirements, including independence
3. Establishing an understanding of terms of engagement

Preliminary engagement activities include the following: -

- (A) Performing procedures regarding the Continuance of Client Relationships and Audit Engagements
- (B) Evaluating compliance with ethical requirements including independence
- (C) Establishing an understanding of terms of engagement

Performing preliminary engagement activities assists the auditor in identifying and evaluating events or circumstances that may affect auditor's ability to plan and perform audit engagement.

36. Discuss how an engagement partner ensures that firm complies with relevant ethical requirements including independence in relation to client. [New SM Question]

Ans. The auditor shall continuously evaluate compliance with ethical requirements including independence. "Independence" means that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.

Throughout the audit engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team. If matters come to the engagement partner's attention that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall determine the appropriate action.

The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall: -

- Obtain relevant information from the firm to identify and evaluate circumstances and relationships that create threats to independence
- Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement and
- Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Besides, consideration for client continuance and compliance with ethical requirements, preliminary engagements activities also include establishing an understanding of terms of engagement

37. Briefly outline how principles-based approach differs from rules-based approach to ethics.

[New SM Question]

Ans. Ethical guidance may follow principles-based approach or rules-based approach. The essence of principles-based approach to ethics is that it requires compliance with spirit of ethics. It requires accountants to exercise professional judgment in every situation based upon their professional knowledge, skill and expertise. It requires that accountants should use professional judgment to evaluate every situation to arrive at conclusions.

However, rules-based approach to ethics strictly follows clearly established rules. It may lead to a narrow outlook and spirit of ethics may be overlooked while strictly adhering to rules. Further, rules-based approach is somewhat rigid as it may not be possible to deal with every practical situation relying upon rules.

38. A Chartered accountant is conducting audit of a client for last two years. Before proceeding to start audit for next year, he notices that there is substantial change in management. Besides, client has ventured into areas of business activity which were not present at time of accepting initial audit engagement. Discuss responsibility of auditor in this regard in context of SA 210.

[New SM Question]

Ans. As per SA 210, the auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- a) Any indication that the entity misunderstands the objective and scope of the audit.
- b) Any revised or special terms of the audit engagement.
- c) A recent change of senior management.
- d) A significant change in ownership.
- e) A significant change in nature or size of the entity's business.
- f) A change in legal or regulatory requirements.
- g) A change in the financial reporting framework adopted in the preparation of the financial statements.
- h) A change in other reporting requirements.

Hence, in the given case, the auditor may consider sending a new engagement letter.

39. An engagement partner takes overall responsibility for maintaining audit quality in an audit engagement in accordance with SA 220. What are his objectives in taking and emphasizing such responsibility?

[New SM Question]

Ans. SQC 1 requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm's chief executive officer or the firm's managing partners to assume ultimate responsibility for the firm's system of quality control. The example set by firm's leadership encourages an inner culture that recognizes high quality audit work. Further, persons assigned operational responsibilities for the firm's quality control system by the firm's chief executive officer or managing partners should have sufficient and appropriate experience, ability and the necessary authority to assume that responsibility.

Chapter 1 -

•NATURE, OBJECTIVE AND SCOPE OF AUDIT

Objective Type Questions (True/False, Correct/Incorrect)

- 1. Along with other disciplines such as accounting and law, equips you with all the knowledge that is required to enter auditing as a profession.**
 - (a) Auditing
 - (b) Taxation
 - (c) Finance
 - (d) Taxation and Finance both
- 2. No business or institution can effectively carry on its activities without the help of proper--**
 - (a) Audit
 - (b) Record and accounts
 - (c) Neither (a) nor (b)
 - (d) Both (a) and (b)
- 3. As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:**
 - (a) To obtain reasonable assurance
 - (b) To report on the financial statements
 - (c) Both (a) and (b) above
 - (d) none of the above
- 4. (IESBA Code) related to an audit of financial statements establishes which of the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements:**
 - (a) Integrity;
 - (b) Objectivity;
 - (c) Professional competence and due care;
 - (d) All of the above
- 5. The auditor's _____ safeguards the auditor's ability to form an audit opinion without being affected by any influences.**
 - (a) Objectivity
 - (b) Independence
 - (c) Confidentiality
 - (d) Integrity
- 6. The preparation of financial statements of a company is the responsibility of -**
 - (a) Shareholders
 - (b) Auditor
 - (c) Management
 - (d) All of these
- 7. The financial statements shall include the following:**
 - (a) Profit and Loss Account
 - (b) Balance Sheet
 - (c) Notes to accounts
 - (d) All of these
- 8. As per SA-200, financial statements shall be prepared as per -**
 - (a) Accounting Standards
 - (b) Statute
 - (c) Applicable financial reporting framework
 - (d) Auditing Standards
- 9. Auditing is an independent examination of of an entity.**
 - (a) Operations
 - (b) Internal controls
 - (c) Financial information
 - (d) All of these
- 10. Auditor is expected to express..... On the financial statements.**
 - (a) Opinion
 - (b) Conclusion
 - (c) Negative assurance
 - (d) All of these
- 11. Auditor should have sound knowledge about -**
 - (a) Accounting concepts
 - (b) Auditing concepts
 - (c) Both (a) and (b)
 - (d) None of these

12. The financial statements of a company shall give a true and fair view of the state of affairs of the company as per -

- (a) Section 129
- (b) Section 130
- (c) Section 143
- (d) Section 133

13. Auditing is an independent examination of financial information of ____ to express an opinion thereon.

- (a) Company
- (b) HUF
- (c) Partnership firm
- (d) An entity

14. Independent means that -

- (a) Judgment of person is not subordinated to wishes of another
- (b) Auditor should not act under any influence
- (c) Auditor should be unbiased
- (d) All of these

15. If auditor maintains high degree of independence, it will result in -

- (a) Attention of media
- (b) Penalty by Central Government
- (c) Enhanced readability of financial statements
- (d) Deteriorating trust on auditor

16. Auditor should not disclose any confidential information acquired during the conduct of his audit to any third party except -

- (a) Permitted by client
- (b) Required by law
- (c) Both (a) and (b)
- (d) None of these

17. Auditor should have communication skills in following areas:

- (a) Oral skills
- (b) Written skills
- (c) Both (a) and (b)
- (d) He does not require any communication skills

18. Auditor should have sound knowledge about -

- (a) Economics
- (b) Chemistry
- (c) Physics

(d) History

19. Auditing is to be conducted in accordance with-

- (a) Accounting Standards
- (b) Auditing Standards
- (c) Cost Auditing Standards
- (d) Both (a) and (b)

20. Statement (1): Accounts are prepared by auditor prior to get them audited. Statement (2): Statutory audit can be conducted only by a chartered accountant.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Statements (1) and (2) both are true
- (d) Both the statements are false

21. Auditor can rely on work performed by others provided -

- (a) He exercises due skill and care
- (b) There is nothing to doubt
- (c) The other party is professional
- (d) Both (a) and (b)

22. Working papers are property of -

- (a) The client
- (b) ROC
- (c) Central Government
- (d) Auditor

23. State which of the sequences is correct in describing audit process:

- (a) Planning - Procedures - Evidences - Conclusion - Opinion
- (b) Procedures - Evidences - Conclusions - Opinion - Planning
- (c) Evidences - Procedures - Conclusions - Planning - Opinion
- (d) Planning - Evidences - Procedures - Conclusions - Opinion

24. Statement (1): Auditor should perform compliance procedures to determine nature, timing and extent of substantive procedures. Statement (2): Auditor should perform substantive procedures to determine the nature, timing and extent of compliance procedures.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the Statements are true
- (d) None of the Statements is true

25. The objective of auditor is -

- (a) To express opinion on financial statements
- (b) To detect fraud and error
- (c) To communicate inefficiencies in internal control to the management
- (d) All of these

26. Statement (1): Auditor may not reveal all the misstatements due to inherent limitations of audit. Statement (2): In case of doubtful situations, the auditor should extend his procedures to confirm or dispel the doubt.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the Statements are true
- (d) None of the Statements is true

27. FRF is adopted by -

- (a) The auditor
- (b) The management
- (c) TCWG
- (d) Both (b) and (c)

28. Management and TCWG have the responsibility to provide the auditor with -

- (a) All information
- (b) Additional information
- (c) Unrestricted access to persons
- (d) All of these

29. Professional judgment is the application of in making appropriate decisions.

- (a) Training
- (b) Knowledge
- (c) Experience
- (d) All of these

30. A reasonable assurance islevel of assurance.

- (a) High, but not absolute
- (b) High and absolute
- (c) Low, but not absolute |
- (d) Low and negative

31. Audit risk consists of -

- (a) Risk of material misstatements
- (b) Detection risk
- (c) Both (a) and (b)

(d) None of these

32. The scope of audit is determined considering -

- (a) Requirement of law
- (b) Pronouncements of Institute
- (c) Terms of engagement
- (d) All of these

33. Auditor is required to obtain level of assurance about the misstatements in the financial statements.

- (a) Negative.
- (b) Low
- (c) Reasonable
- (d) Absolute

34. Due to inherent limitations of an audit -

- (a) Auditor cannot obtain absolute assurance
- (b) Auditor obtains persuasive evidences rather than conclusive evidences
- (c) He cannot reduce audit risk to zero
- (d) All of these

35. The auditor shall comply with -

- (a) Relevant Accounting Standards
- (b) Relevant Standards on Auditing
- (c) All of Standards on Auditing
- (d) All Accounting Standards and all Standards on Auditing

36. Professional skepticism requires that the auditor should be ____ indicating

- (a) Ignorant; Possible misstatements
- (b) Alert; Possible misstatements
- (c) Alert; Management bias
- (d) Ignorant; Possible misstatements

37. Sufficiency refers to ____ of evidences whereas appropriateness refers to

- (a) Quality; Quantity
- (b) Quantity; Quality
- (c) Absoluteness; Quality
- (d) Risk; Quantum

38. It is the auditor's ____ to comply with Standards on Auditing.

- (a) Right
- (b) Moral responsibility
- (c) Duty
- (d) Willingness

39. Standards on Auditing are -

- (a) Mandatory
- (b) Optional
- (c) Discretionary
- (d) All of these

40. Statement (1): Doubt about competence and integrity of management increases the risk of mis-statement in the financial statements. Statement (2): Unusual pressure and unusual transactions increase the risk of mis-statements in the financial statements.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Statements (1) and (2) both are true
- (d) None of the statements is true

41. Statement (1): The use of fundamental accounting assumption cannot be assumed. Statement (2): If any fundamental accounting assumption is followed, the fact should be disclosed in the financial statements.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Statements (1) and (2) both are true
- (d) None of the statements is true

42. Holding financial interest in a client and close business relationship with him gives rise to -

- (a) Self review Threat
- (b) Advocacy threat
- (c) Familiarity threat
- (d) Self-interest threat

43. If auditor finds an error after submission of his report, it will give rise to -

- (a) Self review Threat
- (b) Advocacy threat
- (c) Familiarity threat
- (d) Self-interest threat

44. If the professional who is preparing the books of account is also auditing the financial statements, it shall give rise to -

- (a) Self review Threat

- (b) Advocacy threat
- (c) Familiarity threat
- (d) Self-interest threat

45. If the professional becomes a witness where the party to litigation is his client, it will result in -

- (a) Self review Threat
- (b) Advocacy threat
- (c) Familiarity threat
- (d) Self-interest threat

46. If the auditor is having long association with the client it will give rise to -

- (a) Self review Threat
- (b) Advocacy threat
- (c) Familiarity threat
- (d) Self-interest threat

47. If the auditor is facing threat from the client to be dismissed if he refuses to act as per their wishes, it shall give rise to -

- (a) Familiarity Threat
- (b) Advocacy threat
- (c) Self review threat
- (d) Intimidation threat

48. Auditor should obtain sufficient and appropriate evidences. 'Sufficient and appropriate' refers to -

- (a) Quantum of audit evidence
- (b) Quality of audit evidence
- (c) Quantum and quality of audit evidence
- (d) None of these

49. Statement (1): Internal evidences are generally more reliable than external evidences. Statement (2): Oral evidences are generally more reliable than written evidences.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the statements are true
- (d) None of the statements is true

50. Statement (1): Evidences obtained directly by auditor is more reliable than that obtained through client. Statement (2): Evidences provided by photocopies are generally more reliable than the original documents.

- (a) Only Statement (1) is true

- (b) Only Statement (2) is true
- (c) Both the statements are true
- (d) None of the statements is true

51. Compliance procedures are performed to check following about the internal control systems:

- (a) Existence
- (b) Operating effectiveness
- (c) Continuity
- (d) All of these

52. Substantive procedures are performed in respect of

- (a) Internal control systems
- (b) Accounting systems
- (c) Both of them
- (d) None of these

53. Substantive procedures seek to obtain assurance regarding following assertion about transactions:

- (a) Measurement
- (b) Valuation
- (c) Rights and Obligations
- (d) All of these

54. Statement (1): Inspection consists of witnessing a process being performed by others. Statement (2): Inquiry consists of seeking appropriate information from knowledgeable persons inside or outside the entity.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the statements are true
- (d) None of the statements is true

55. Management expert is an individual possessing expertise in a field other than whose work in that field is used by

- (a) Accounting; management
- (b) Accounting or auditing; entity
- (c) Accounting or auditing; auditor
- (d) Accounting; auditor

56 _____ refers to studying significant ratios and trends and investigating unusual fluctuations.

- (a) Substantive procedures
- (b) Inquiry and confirmations
- (c) Re-performance
- (d) Analytical procedures

57. When information to be used as audit evidence has been prepared using the work of management's expert, the auditor -

- (a) Shall not rely on him
- (b) Shall always rely on him
- (c) Shall consider the work done by him and evaluate whether his work appears to be appropriate
- (d) All of these

58. Statement (1): If audit evidence obtained from one source is consistent with that obtained from another, the auditor shall obtain extra evidences to resolve the same.

Statement (2): If auditor has doubts about reliability of information, he shall perform extended procedures.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the statements are true
- (d) None of the statements is true

59. If management uses the work of regarding the provision to be made in respect of a case filed against the company, the expert can be treated as competent.

- (a) Advocate
- (b) Actuary
- (c) Engineer
- (d) Valuer

60. If the management uses the work of..... While preparing the financial statements, it can be treated as the management's use of work of management's expert.

- (a) Accountant
- (b) Auditor
- (c) Actuary
- (d) None of these

61. SA- states that auditor shall obtain sufficient and appropriate audit evidences.

- (a) 230
- (b) 700
- (c) 500
- (d) 610

62. Auditor shall obtain sufficient and appropriate evidences with respect to..... Of inventory as per SA-501.

- (a) Existence
- (b) Condition
- (c) Existence and condition both
- (d) None of these

63. If auditor is unable to attend inventory count due to unforeseen circumstances, he shall -

- (a) Rely on written representation
- (b) Make some count on alternate date
- (c) Make some count on alternate date and perform procedures on intervening transactions as well
- (d) All of these

64. If inventory is under control of a third party, as per SA-501 auditor shall -

- (a) Obtain evidences by performing additional procedures
- (b) Rely on written representation
- (c) Need not do anything about it
- (d) None of these

65. As per SA-501, auditor shall perform procedures to identify litigation and claims by -

- (a) Inquiring management and others
- (b) Reviewing minutes of meetings
- (c) Reviewing legal expenses
- (d) All of these

66. If management does not permit auditor to communicate with legal counsel or legal counsel refuses to respond, then auditor shall -

- (a) Express unmodified opinion
- (b) Modify his opinion
- (c) Provide other matter paragraph
- (d) All of these

67. With respect to segment information, auditor shall obtain evidences regarding of segment information as per

- (a) Presentation; SA
- (b) Disclosure; SA
- (c) Presentation; FRF
- (d) Presentation and disclosure; FRF

68. Statement (1): Management representation cannot be treated as a

substitute for other audit evidences. Statement (2): Management representation can only be regarded as an additional evidence.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the statements are true
- (d) None of the statements is true

69. The responsibility for properly determining the quantity and value of inventory rests with -

- (a) Management
- (b) Auditor
- (c) Auditor and management both
- (d) None of these

70. Auditor obtains a written representation with respect to stock lying with transporter. It can be regarded -

- (a) As sufficient evidence
- (b) As just an additional evidence
- (c) Having no significance at all
- (d) None of these

71. Analytical procedures includes comparison with -

- (a) Comparable information for prior period
- (b) Anticipated results
- (c) Similar industry information
- (d) All of these

72. Analytical procedures means evaluation of financial information through analysis of relationship among -

- (a) Financial data
- (b) Non-financial data
- (c) Financial and non- financial data both
- (d) Only operational data

73. Analytical procedures as per SA-520 are performed on following stages:

- (a) Obtaining evidences when using substantive analytical procedures
- (b) Near end of the audit
- (c) Substantive analytical procedures and near end of audit both
- (d) SA-520 does not relate to analytical procedures

74. Substantive analytical procedures are generally adopted for following:

- (a) Predictable items
- (b) Gross profit ratios
- (c) Items wherein there is a particular trend over a period of time
- (d) All of these

75. Statement (1): Reliability of data to be compared depends upon the control over preparation of information. Statement (2): The development of expectation as per SA-520 need not be precise.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the statements are true
- (d) None of the statements is true

76. Audit materiality is to be considered from -

- (a) Quantitative angle
- (b) Qualitative angle
- (c) Both (a) and (b)
- (d) None of these

77. Materiality depends upon -

- (a) Size of item
- (b) Nature of item
- (c) Statutory provisions
- (d) All of these

78. The relationship between degree of audit risk and materiality level is -

- (a) Direct
- (b) Inverse
- (c) It can be both depending upon the circumstances
- (d) There is no relationship at all

79. As per SA-320, materiality is to be applied -

- (a) In planning the audit
- (b) In performing an audit
- (c) In planning and performing an audit
- (d) In planning, performing and concluding an audit

80. State which of the following sequence is correct as per SA-320:

- (a) Selection of benchmark - Application of percentage - Determination of materiality
- (b) Determination of materiality - Application of percentage - Selection of Benchmark

- (c) Selection of Benchmark- Determination of materiality - Application of percentage
- (d) Application of percentage - Selection of Benchmark- Determination of materiality

81. Factors that may affect identification of an appropriate benchmark include -

- (a) Elements of financial statements
- (b) Nature of entity
- (c) Entity's ownership structure
- (d) All of these

82. Statement (1): Auditor shall revise materiality during the process of his audit depending upon the progress. Statement (2): Performance materiality is always higher than in the materiality level.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the statements are true
- (d) None of the statements is true

83. Performance materiality means the amounts set by the auditor at materiality as per SA-320.

- (a) More than
- (b) Less than
- (c) Equal to
- (d) He need not set such a level

84. SA-580 relates to -

- (a) External confirmation
- (b) Audit materiality
- (c) Opening balances
- (d) Written representation

85. Written representations are obtained from -

- (a) Those charged with governance
- (b) Management
- (c) Those charged with governance or management
- (d) Third parties

86. Statement (1): Written representations do not include financial statements and supporting records etc. Statement (2): Written representation should be addressed to the management and those charged with governance.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the statements are true
- (d) None of the statements is true

87. If auditor concludes that there is a sufficient doubt about the integrity of management such that written representations are not reliable or management does not provide the necessary written representations, he shall -

- (a) Express unqualified opinion
- (b) Disclaim an opinion
- (c) Express adverse opinion
- (d) Provide a disclosure in his audit opinion

88. SA 505 states that external confirmation process should be under the control of -

- (a) Management
- (b) TCWG
- (c) Auditor
- (d) All of these

89. External confirmation shall be in -

- (a) Paper form
- (b) Electronic form
- (c) Other form
- (d) All of these

90. If management refuses to allow the auditor to send the confirmation request, the auditor shall -

- (a) Withdraw from engagement
- (b) Inquire the management's reasons for refusal and assess their validity and
- (c) Accept the management's request
- (d) Not listen to such a request at all decide appropriately

91. Reliability of response of third party depends upon -

- (a) Objectivity of confirmation party
- (b) Knowledge about the
- (c) Willingness of third party
- (d) All of these matter

92. Positive confirmation request requires the third party to reply to the auditor-

- (a) In the case of agreement with given information
- (b) In the case of disagreement with given information
- (c) In the case of agreement / disagreement with the given information
- (d) None of these

93. Negative confirmation request requires the third party to respond if -

- (a) There is agreement
- (b) There is disagreement
- (c) Whether there is agreement or disagreement
- (d) None of these

94. Statement (1): Responses to confirmation requests should be obtained directly by the auditor. Statement (2): Negative confirmation requests are considered to be more persuasive than the positive confirmation requests.

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the statements are true
- (d) None of the statements is true

95. should carefully plan and control external confirmation.

- (a) Auditor
- (b) Management
- (c) TCWG
- (d) All of these in consultation with one another

96. Auditor should consider Of evidences

- (a) Sufficiency
- (b) Appropriateness
- (c) Consistency
- (d) Sufficiency, Appropriateness and Consistency – All

97. Which of the following is not an advantage of audit?

- (a) It provides high quality financial information.
- (b) It acts as a moral check on employees
- (c) It enhances risk of management bias.
- (d) It helps in safeguarding interests of shareholders.

98. Which of the following is NOT TRUE about an assurance engagement?

- (a) It relates to providing assurance about historical financial information only.
- (b) The practitioner obtains sufficient appropriate evidence.

- (c) There is some information to be examined by practitioner.
- (d) A written assurance report in appropriate form is issued by practitioner.

99. Which of the following is TRUE about Engagement Standards?

- (a) Engagement standards ensure proper rights to practitioners in course of performance of their duties.
- (b) Engagement standards ensure preparation and presentation of financial statements in a standardized manner.
- (c) Engagement standards ensure uniformity by practitioners in course of performance of their duties.
- (d) Engagement standards ensure savings in resources of clients.

100. Consider following statements in relation to “Limited assurance engagement”:-

Statement I - It involves obtaining sufficient appropriate evidence to draw reasonable conclusions.

Statement II - Review of interim financial information of a company is an example of limited assurance engagement.

- (a) Statement I is correct. Statement II is incorrect.
- (b) Both Statements I and II are correct.
- (c) Both Statements I and II are incorrect.
- (d) Statement I is incorrect. Statement II is correct.

101. Which of the following is TRUE about Standards on auditing?

- (a) These deal mainly with voluntary responsibilities of auditors.
- (b) These deal mainly with mandatory responsibilities of auditors.
- (c) Their sole purpose is to help government authorities in augmenting revenues.
- (d) These deal mainly in carrying out audit according to legal provisions.

Answer Key:

1	(a)	16	(c)	31	(c)	46	(c)	61	(c)	76	(c)	91	(d)
2	(b)	17	(c)	32	(d)	47	(d)	62	(c)	77	(d)	92	(c)
3	(c)	18	(a)	33	(c)	48	(c)	63	(c)	78	(b)	93	(b)
4	(d)	19	(b)	34	(d)	49	(d)	64	(a)	79	(c)	94	(a)
5	(b)	20	(b)	35	(b)	50	(a)	65	(d)	80	(a)	95	(a)
6	(c)	21	(d)	36	(b)	51	(d)	66	(b)	81	(d)	96	(d)
7	(d)	22	(d)	37	(b)	52	(b)	67	(d)	82	(a)	97	(c)
8	(c)	23	(a)	38	(c)	53	(a)	68	(c)	83	(b)	98	(a)
9	(c)	24	(a)	39	(a)	54	(b)	69	(a)	84	(d)	99	(c)
10	(a)	25	(a)	40	(c)	55	(b)	70	(b)	85	(c)	100	(d)
11	(c)	26	(c)	41	(d)	56	(d)	71	(d)	86	(a)	101	(b)
12	(a)	27	(d)	42	(d)	57	(c)	72	(c)	87	(b)		
13	(d)	28	(d)	43	(a)	58	(b)	73	(c)	88	(c)		
14	(d)	29	(d)	44	(a)	59	(a)	74	(d)	89	(d)		
15	(c)	30	(a)	45	(b)	60	(c)	75	(a)	90	(b)		

CHAPTER 1 – PRELIMINARY

STUDY MATERIAL QUESTIONS

Question 1.

MNP Private Ltd. is a company registered under the Companies Act, 2013 with a paid-up share capital of Rs. 2 crore and turnover of Rs. 60 crore. Explain the meaning of the “Small Company” and examine the following in accordance with the provisions of the Companies Act, 2013:

- Whether the MNP Private Ltd. can avail the status of small company?
- What will be your answer if the turnover of the company is Rs. 30 crore?

[Exam May 18; RTP May 19; MTP Oct 20; MTP Oct 21]

Ans.

Small Company: According to Section 2(85) of the Companies Act, 2013, Small Company means a company, other than a public company,—

- paid-up share capital of which does not exceed 4 crore rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and
- turnover of which as per its last profit and loss account does not exceed 40 crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees.

Nothing in this clause shall apply to—

- a holding company or a subsidiary company;
- a company registered under section 8; or
- a company or body corporate governed by any special Act.

- In the present case, MNP Private Ltd., is a company registered under the Companies Act, 2013 with a paid up share capital of Rs. 2 crore and having turnover of Rs. 60 crore. Since only one criteria of share capital not exceeding Rs. 4 crore is met, but the second criteria of turnover not exceeding Rs. 40 crore is not met and the provisions require both the criteria to be met in order to avail the status of a small company, MNP Ltd. **cannot avail the status of small company.**
- If the turnover of the company is Rs. 30 crore, then both the criteria will be fulfilled and MNP Ltd. **can avail the status of small company.**

Question 2.

Flora Fauna Limited was registered as a public company. There are 230 members in the company as noted below:

(a)	Directors and their relatives	50
(b)	Employees	15
(c)	Ex-Employees (Shares were allotted when they were employees)	10
(d)	5 couples holding shares jointly in the name of husband and wife (5 x 2)	10
(e)	Others	145

The Board of Directors of the company propose to convert it into a private company. Also advise whether reduction in the number of members is necessary.

[Exam May 22]

Ans.

According to **section 2(68)** of the Companies Act, 2013, "Private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles, except in case of One Person Company, limits the number of its members to two hundred.

However, where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member.

It is further provided that -

- (A) persons who are in the employment of the company; and
- (B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members.

In the instant case, Flora Fauna Limited may be converted into a private company only if the total members of the company are limited to 200. Total Number of members

(i)	Directors and their relatives	50
(ii)	5 Couples (5 x 1)	5
(iii)	Others	145
	Total	200

Therefore, there is **no need for reduction** in the number of members since existing number of members are 200 which does not exceed maximum limit of 200.

ADDITIONAL QUESTIONS**Question 3.**

The paid-up share capital of Saras Private Limited is Rs. 1 crore, consisting of 8 lacs Equity Shares of Rs. 10 each, fully paid-up and 2 lacs Cumulative Preference Shares of Rs. 10 each, fully paid-up. Jeevan (JVN) Private Limited and Sudhir Private Limited are holding 3 lacs Equity Shares and 50,000 Equity Shares respectively in Saras Private Limited. Jeevan Private Limited and Sudhir Private Limited are the subsidiaries of Piyush Private Limited.

With reference to the provisions of the Companies Act, 2013 examine whether Saras Private Limited is a subsidiary of Piyush Private Limited? Would your answer be different if Piyush Private Limited has 8 out of 9 Directors on the Board of Saras Private Limited? [RTP May 18]

Ans.

As per **sec 2 (87) of the Companies Act 2013**, "subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Explanation - For the purposes of this clause, -

- (a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
- (b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors.

In the present case, Jeevan Pvt. Ltd. and Sudhir Pvt. Ltd. together hold less than one half of the total share capital. Hence, Piyush Private Ltd. (holding of Jeevan Pvt. Ltd. and Sudhir Pvt) will not be a holding company of Saras Pvt. Ltd.

However, if Piyush Pvt. Ltd. has 8 out of 9 Directors on the Board of Saras Pvt. Ltd. i.e. controls the composition of the Board of Directors; it (Piyush Pvt. Ltd.) will be treated as the holding company of Saras Pvt. Ltd.

Question 4.

What does the term Financial Statements include in relation to a company under the Companies Act, 2013? Which companies need not prepare a cash flow statement? [Exam Nov 18]

OR

Geeta Private Limited is a start-up company. Mr. Prabodh has been appointed as Accounts Manager of Geeta Private Limited. The Board meeting for approval of accounts is to be held on 01.08.2022 and he has to prepare the financial statements for approval by the Board. Referring to section 2(40) of the Companies Act, 2013, advise Mr. Prabodh about the statements that are required to be prepared.

[RTP Nov 22]

Ans.

According to **section 2(40) of the Companies Act, 2013**, Financial statement in relation to a company, includes—

- (i) a balance sheet as at the end of the financial year;
- (ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
- (iii) cash flow statement for the financial year;
- (iv) a statement of changes in equity, if applicable; and
- (v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv):

Provided that the financial statement, with respect to one person company, small company, dormant company and private company (if such private company is a start-up company) may not include the cash flow statement.

Question 5.

Teresa Ltd. is a company registered in New York (U.S.A.). The company has no place of business established in India, but it is doing online business through data interchange in India. Explain with reference to relevant provisions of the Companies Act, 2013 whether Teresa Ltd. will be treated as Foreign Company. [Exam Nov 18]

OR

Herry Limited is a company registered in Thailand. It has no place of business established in India, yet it is doing online business through telemarketing in India having its main server for online business outside India. State the status of the Company under the provisions of the Companies Act, 2013. [Exam Nov 19]

Ans.

According to **section 2(42)** of the Companies Act, 2013, foreign company means any company or body corporate incorporated outside India which,-

- (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- (b) conducts any business activity in India in any other manner.

As per the Rule given in the Companies (Specification of Definitions Details) Rules, 2014, the term “electronic mode”, means carrying out electronically based, whether main server is installed in India or not, including, but not limited to-

- (i) Business to business and business to consumer transactions, data interchange and other digital supply transactions;

- (ii) Offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India;
- (iii) Financial settlements, web based marketing, advisory and transactional services, database services and products, supply chain management;
- (iv) Online services such as telemarketing, telecommuting, telemedicine, education and information research; and
- (v) All related data communication services, whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise;

In the given question, Teresa Ltd. will be **treated as a foreign company** within the meaning of section 2(42) of the Companies Act, 2013 since it is doing online business through data interchange in India even though the company has no place of business established in India.

Question 6.

The persons (not being members) dealing with the company are always protected by the doctrine of Indoor management. Explain. Also, explain when doctrine of Constructive Notice will apply.

[Exam Nov 18]

OR

The role of doctrine of 'Indoor management' is opposed to that of the role of 'Constructive notice'. Comment on this statement with reference to the Companies Act, 2013.

[Exam Jan 21 and MTP Sep 23]

Ans.

Doctrine of Indoor Management: According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps to protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

The doctrine of indoor management is opposite to the doctrine of constructive notice. Whereas the doctrine of constructive notice protects a company against outsiders, the doctrine of indoor management protects outsiders against the actions of a company. This doctrine also is a safeguard against the possibility of abusing the doctrine of constructive notice.

Exceptions to Doctrine of Indoor Management (Applicability of doctrine of constructive notice)

- (i) **Knowledge of irregularity:** In case an 'outsider' has actual knowledge of irregularity within the company, the benefit under the rule of indoor management would no longer be available. In fact, he/she may well be considered part of the irregularity.
- (ii) **Negligence:** If, with a minimum of effort, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply. The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry.
- (iii) **Forgery:** The rule does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

Question 7.

SKP Limited (Registered in India), a wholly owned subsidiary company of Herry Limited decided to follow different financial year for consolidation of its accounts outside India. State the procedure to be followed in this regard.

[Exam Nov 19]

Ans.

Where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year.

Any application pending before the Tribunal as on the date of commencement of the Companies (Amendment) Act, 2019, shall be disposed of by the Tribunal in accordance with the provisions applicable to it before such commencement.

Also, a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause.

SKP Limited is advised to follow the above procedure accordingly.

Question 8.

The directors of Smart Computers limited borrowed a sum of money from Mr. Tridev. The company's articles provided that the directors may borrow on bonds such sums as may, from time to time, be authorized by resolution passed at a general meeting of the company. The shareholders claimed that there had been no such resolution authorizing the loan, and therefore, it was taken without their authority and the company is not bound to repay the loan to Tridev. In the light of the contention of shareholders, decide whether the company is bound to pay the loan. [MTP May 20]

Ans.

Doctrine of Indoor Management: According to this doctrine, persons dealing with the company need not enquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps to protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

Thus,

1. What happens internal to a company is not a matter of public knowledge. An outsider can only presume the intentions of a company, but not know the information he/she is not privy to.
2. If not for the doctrine, the company could escape creditors by denying the authority of officials to act on its behalf.

In the given question, Mr. Tridev being a person external to the company, need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. Even if the shareholders claim that no resolution authorizing the loan was passed, the **company is bound to pay the loan to Mr. Tridev.**

Question 9.

The information extracted from the audited Financial Statement of Smart Solutions Private Limited as at 31st March, 2020 is as below:

- (1) **Paid-up equity share capital Rs. 50,00,000 divided into 5,00,000 equity shares (carrying voting rights) of Rs. 10 each. There is no change in the paid-up share capital thereafter.**
- (2) **The turnover is Rs. 2,00,00,000.**

It is further understood that Nice Software Limited, which is a public limited company, is holding 2,00,000 equity shares, fully paid-up, of Smart Solutions Private Limited. Smart Solutions Private Limited has filed its Financial Statement for the said year with the Registrar of Companies (ROC) excluding the Cash Flow Statement within the prescribed time line during the financial year 2020-21. The ROC has issued a notice to Smart Solutions Private Limited as it has failed to file the cash flow

statement along with the Balance Sheet and Profit and Loss Account. You are to advise on the following points explaining the provisions of the Companies Act, 2013:

- (i) Whether Smart Solutions Private Limited shall be deemed to be a small company whose significant equity shares are held by a public company?
- (ii) Whether Smart Solutions Private Limited has defaulted in filing its financial statement?

[Exam Jul 21 and MTP Oct 23]

Ans.

- (i) According to **section 2(85)** of the Companies Act, 2013, small company means a company, other than a public company, having-
 - (A) paid-up share capital not exceeding 4 crore rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and
 - (B) turnover as per profit and loss account for the immediately preceding financial year not exceeding 40 crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Provided that nothing in this clause shall apply to a holding company or a subsidiary company.

Also, according to **section 2(87)**, subsidiary company, in relation to any other company (that is to say the holding company), means a company in which the holding company exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies.

In the given question, Nice Software Limited (a public company) holds 2,00,000 equity shares of Smart Solutions Private Limited (having paid up share capital of 5,00,000 equity shares @ Rs. 10 totalling Rs. 50 lakhs). Hence, Smart Solutions Private Limited is **not a subsidiary** of Nice Software Limited and hence it is a private company and not a deemed public company.

Further, the paid up share capital (Rs. 50 lakhs) and turnover (Rs. 2 crores) is within the limit as prescribed under section 2(87), hence, Smart Solutions Private Limited **can be categorised as a small company**.

- (ii) According to **section 2 (40)**, Financial statement in relation to a company, includes—
 - (a) a balance sheet as at the end of the financial year;
 - (b) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
 - (c) cash flow statement for the financial year;
 - (d) a statement of changes in equity, if applicable; and
 - (e) any explanatory note annexed to, or forming part of, any document referred to in points (a) to (d):

Provided that the financial statement, with respect to OPC, small company & dormant company, may not include the cash flow statement.

Smart Solutions Private Limited **being a small company** is **exempted from filing a cash flow statement** as a part of its financial statements. Thus, Smart Solutions Private Limited has **not defaulted** in filing its financial statements with ROC.

Question 10.

The persons (not being members) dealing with the company are always protected by the doctrine of indoor management. Explain. [MTP Oct 21 and MTP Sep 22]

Ans.

Doctrine of Indoor Management: According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Stakeholders need not enquire whether necessary meeting was convened & held properly or whether necessary resolution was passed properly.

The doctrine helps to protect external members from the company & states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

The doctrine of indoor management is opposite to the doctrine of constructive notice. Whereas the doctrine of constructive notice protects a company against outsiders, the doctrine of indoor management protects outsiders against the actions of a company.

Question 11.

AJD Pvt. Ltd. is having paid up share capital of Rs. 45 Lakhs & annual turnover of Rs.185 Lacs. It is a wholly owned subsidiary of K Ltd - a listed company. Can AJD Pvt. Ltd. be called a small company as per the provisions of the Companies Act, 2013. [MTP Apr 22]

OR

H Ltd. is the holding company of S Pvt. Ltd. As per the last profit and loss account for the year ending 31st March, 2022 of S Pvt. Ltd., its turnover was Rs. 1.80 crore; and paid up share capital was Rs. 80 lakh. The Board of Directors wants to avail the status of a small company. The Company Secretary of the company advised the directors that the company cannot be categorized as a small company. In the light of the above facts and in accordance with the provisions of the Companies Act, 2013, you are required to examine whether the contention of Company Secretary is correct, explaining the relevant provisions of the Act. [Exam May 23 and RTP May 24]

Ans.

As per **Section 2(85)** of the Companies Act 2013 read with Rule 2, “Small Company” means a company, other than a public company, having—

- (i) paid-up share capital of which does not exceed 4 crores rupees; and
- (ii) turnover as per profit & loss account for the immediately preceding FY does not exceed Rs. 40 crore:

Provided that nothing in this clause shall apply to—

- (A) a holding company or a subsidiary company;
- (B) a company registered under section 8; or
- (C) a company or body corporate governed by any special Act;

In the given case, AJD Pvt. Ltd. satisfies the turnover & paid up share capital criteria, but being a subsidiary of K Ltd (a listed), it falls under the exclusions to the definition and hence is **not a small Company**.

Question 12.

Following are some of securities, issued by different companies related with each other, as follows:-

Company	Securities Issued	Remarks
Kleshrahit Ltd.	Listed non-convertible redeemable preference shares issued on private placement basis in terms SEBI Regulations.	Has the power to appoint 2/3rd directors in Indriyadaman Ltd.
Indriyadaman Ltd.	Listed non-convertible debt securities issued on private placement basis in terms of relevant SEBI Regulations.	Holding 60% voting power in Sajagta (P) Ltd.
Sajagta (P) Ltd.	Listed non-convertible debt securities issued on private placement basis in terms of relevant SEBI Regulations.	The company holds 52% equity shares in Pratibodh Ltd. as an investment on behalf of another company in a capacity of a trustee.

Equity shares issued by Kleshrahit Ltd. & Indriyadaman Ltd. are not listed in any stock exchanges.

In the context of aforesaid facts, answer the following question(s):-

- (a) Whether the aforesaid companies can be considered as listed company(ies)?
- (b) Explain the relationship between the aforesaid companies?

[RTP May 22]

Ans.

a) According to **section 2(52)** of the Companies Act, 2013, listed company means a company which has any of its securities listed on any recognised stock exchange;
Provided that such class of companies, which have listed or intend to list such class of securities, as may be prescribed in consultation with the Securities and Exchange Board, shall not be considered as listed companies.

According to rule 2A of the Companies (Specification of definitions details) Rules, 2014, the following classes of companies shall not be considered as listed companies, namely:-

1. Public companies which have not listed their equity shares on a recognized stock exchange but have listed their –
 - (i) non-convertible debt securities issued on private placement basis in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008; or
 - (ii) non-convertible redeemable preference shares issued on private placement basis in terms of SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013; or
 - (iii) both categories of (i) and (ii) above.
2. Private companies which have listed their non-convertible debt securities on private placement basis on a recognized stock exchange in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008;
3. Public companies which have not listed their equity shares on a recognized stock exchange but whose equity shares are listed on a stock exchange in a jurisdiction as specified in sub-section (3) of section 23 of the Act.

Co Name	Analysis and Conclusion
Kleshrahit Ltd.	Equity shares issued by the company are not listed. However, the company has issued listed non- convertible redeemable preference shares issued on private placement basis in terms of relevant SEBI Regulations which falls in the exceptions to the listed company, given as per clause (a)(ii) to Rule 2A, as aforesaid, and accordingly, Kleshrahit Ltd. shall not be considered as a listed company .
Indriyadaman Ltd.	Equity shares issued by the company are not listed. However, the company has issued listed non- convertible debt securities issued on private placement basis in terms of relevant SEBI Regulations which falls in the exceptions to the listed company, given as per clause (a)(i) to Rule 2A, as aforesaid, and accordingly, Indriyadaman Ltd. shall not be considered as a listed company .
Sajagta (P) Ltd.	The company has issued listed non-convertible debt securities issued on private placement basis on a recognised Stock Exchange in terms of relevant SEBI Regulations which falls in the exceptions to the listed company given as per clause (b) to Rule 2A, as aforesaid, and accordingly, Sajagta (P) Ltd. shall not be considered as a listed company .

b) According to **section 2(46)** of the Companies Act, 2013, holding company in relation to one or more other companies, means a company of which such companies are subsidiary companies.

According to **section 2(87)** of the Companies Act, 2013, subsidiary company or subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

- Relationship between Kleshrahit Ltd. & Indriyadaman Ltd.:** It is given that Kleshrahit Ltd. has the power to appoint 2/3rd directors in Indriyadaman Ltd.. Accordingly, as per section 2(87)(i), it can be understood that Indriyadaman Ltd. is the **subsidiary company of Kleshrahit Ltd.** while the latter is the **holding company of Indriyadaman Ltd.**
- Relationship between Indriyadaman Ltd. & Sajagta (P) Ltd.:** It is given that Indriyadaman Ltd. is holding 60% voting power in Sajagta (P) Ltd. Accordingly, as per section 2(87)(ii), it can be understood that Sajagta (P) Ltd. is the **subsidiary company of Indriyadaman Ltd.** while the latter is the **holding company of Sajagta (P) Ltd.**
- Relationship between Kleshrahit Ltd. & Sajagta (P) Ltd.:** It is given that Indriyadaman Ltd. is holding 60% voting power in Sajagta (P) Ltd. and it has been derived that Indriyadaman Ltd. is the subsidiary company of Kleshrahit Ltd. and Sajagta (P) Ltd. is the subsidiary company of Indriyadaman Ltd., respectively.
A company shall be deemed to be a subsidiary company of the holding company even if the control is of another subsidiary company of the holding company i.e. subsidiary of subsidiary company will be deemed to be a subsidiary of the holding company.
Hence, it can be understood that Sajagta (P) Ltd. is deemed to be **subsidiary company of Kleshrahit Ltd.** while the latter would be considered as the **holding company of Sajagta (P) Ltd.**
- Relationship between Sajagta (P) Ltd. & Pratibodh Ltd.:** It is given that Sajagta (P) Ltd. holds 52% equity shares in Pratibodh Ltd. as an investment on behalf of another company in a capacity of a trustee i.e. in a fiduciary capacity.
As per the notification, MCA clarified that shares held by a company or power exercisable by it in another company in a fiduciary capacity shall not be counted for the purpose of determining the holding–subsidiary relationship.
Accordingly, **Sajagta (P) Ltd. & Pratibodh Ltd. do not share any holding– subsidiary relationship** as the former holds shares in latter just in a fiduciary capacity on behalf of another company.

Question 13.

Mr. Abhi is a Chartered Accountant and MBA by profession, has been appointed as an Executive Director on the Board of XYZ Limited. His job profile includes advising the Board of Directors of the company on various compliance matters, strategies, business plans, and risk matters relating to the company. Keeping in view of above position whether Mr. Abhi can be classified as the Promoter of XYZ Limited? Please examine the same under the provisions of the Companies Act, 2013.

[RTP May 22]

Ans.

According to **section 2(69)** of the Companies Act, 2013, Promoter means a person:-

- Who has been named as such in a prospectus or is identified by the company in the annual return; or
- Who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- In accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act.

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity.

As the job profile of Mr. Abhi is only limited to advise the Board of Directors on various compliance matters, strategies, business plans and risk matters relating to business of the company and that too only in a professional capacity, he will **not be classified as a Promoter** of XYZ Limited.

Question 14.

ABC Private Ltd. has two wholly owned subsidiary companies, D Private Limited and E Private Limited. Examine, whether, D Private Limited and E Private Limited will be treated as related party as per the provisions of the Companies Act, 2013? [Exam May 22]

Ans.

According to **section 2(76)(viii)** of the Companies Act, 2013, Related party, with reference to a company, means any body corporate which is -

- (A) a holding, subsidiary or an associate company of such company;
- (B) a subsidiary of a holding company to which it is also a subsidiary; or
- (C) an investing company or the venturer of the company;

In the given question, D Pvt Ltd & E Pvt Ltd are wholly owned subsidiary companies of ABC Pvt Ltd. According to stated clause (B), above, **D Pvt Ltd & E Pvt Ltd are related parties.**

However, as per the Notification No. G.S.R. 464(E) dated 5th June, 2015, clause (viii) shall not apply with respect to section 188 to a private company, though being a related parties.

Question 15.

Hastprat Ltd. is an unlisted public company, having five directors in its board which includes two independent directors.

Sankul (P) Ltd., is subsidiary company of Hastprat Ltd., actively carrying on its business, having paid up capital of Rs. 1.5 crore with 40 members and turnover of Rs. 18 crore, respectively and the said company is not a start-up company.

In the context of aforesaid case-scenario, please answer to the following question(s):-

Whether Sankul (P) Ltd. is mandatorily required to prepare cash flow statement for the financial year as a part of its financial statements?

Provide your answer by analyzing Sankul (P) Ltd. into following category of companies:-

- (i) One person company,
- (ii) Small company,
- (iii) Dormant company and
- (iv) Private company, respectively.

[RTP May 23]

Ans.

According to **section 2(10)** of the Companies Act, 2013, Financial statement in relation to a company, includes—

- (i) a balance sheet as at the end of the financial year;
- (ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
- (iii) cash flow statement for the financial year;
- (iv) a statement of changes in equity, if applicable; and
- (v) any explanatory note annexed to, or forming part of, any document referred to in sub- clause (i) to sub- clause (iv):

Provided that the financial statement, with respect to one person company, small company, dormant company and private company (if such private company is a start-up) may not include the cash flow statement.

For considering the applicability of preparation cash flow statement in case of Sankul (P) Ltd., it is required first to be analyzed that Sankul (P) Ltd. does not fall in any of the categories of companies mentioned under proviso to section 2(10) of the Companies Act, 2013:

- (i) **One person company** – It is given that the company is having 40 members and also its name does not contain the words ‘OPC’, so it is not a one person company.
- (ii) **Small company** – A company which is a subsidiary company cannot be categorized as a small company as per proviso to section 2(85) and accordingly, as Sankul (P) Ltd. is a subsidiary company of Hastprat Ltd., it cannot be considered as small company also.
- (iii) **Dormant company** – It is given that the company is actively carrying on its business, so it cannot be also categorized as a dormant company based upon the facts given.
- (iv) **Private company (which is a start-up)** – It is given that Sankul (P) Ltd. is not a start-up company and also, as per proviso to section 2(71) of the Act, a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

So, Sankul (P) Ltd. shall be deemed to be a public company as it is subsidiary of Hastprat Ltd., an unlisted public company and so it will not fall into this category of exemption as well.

Thus, it can be concluded that Sankul (P) Ltd. is **mandatorily required to prepare cash flow statement** for the financial year as a part of its financial statements as it does not fall in any of the categories of companies mentioned under proviso to section 2(10) of the Companies Act, 2013.

Question 16.

XYZ a One-Person Company (OPC) was incorporated during the year 2014-15 with an authorized capital of Rs. 45.00 lakhs (4.5 lakh shares of Rs. 10 each), The capital was fully subscribed and paid up. Turnover of the company during 2014-15 and 2015-16 was Rs. 2.00 crores & Rs. 2.5 crores respectively. Promoter of the company seeks your advice in following circumstances, whether XYZ (OPC) can convert into any other kind of company during 2016-17. Please, advise with reference to relevant provisions of the Companies Act, 2013 in the below mentioned circumstances:

- (i) **If promoter increases the paid up capital of the company by Rs. 10.00 lakhs during 2016-17.**
 (ii) **If turnover of the company during 2016-17 was Rs. 3.00 crores.**

[Exam Nov 18; MTP Apr 19; RTP May 19 and MTP Oct 20]

Ans.

As per **Rule 3** of the Companies (Incorporation) Rules, 2014, no OPC can convert voluntarily into any kind of company unless 2 years have expired from the date of its incorporation, except where paid up share capital is increased beyond 50 lakh rupees or its average annual turnover exceeds 2 crore rupees.

Besides, **Section 18** of the Companies Act, 2013 provides that a company of any class registered under this Act may convert itself as a company of other class under this Act by alteration of memorandum and articles of the company in accordance with the provisions of Chapter II of the Act.

Based on the above provisions, our advice in the given circumstances will be as under:

- (i) The promoter increases paid up capital by Rs. 10.00 lakh during 2016-2017, i.e., to Rs. 55 lakhs (45+10= 55). In this situation, XYZ (OPC) can convert itself voluntarily into any other kind of company by alteration of memorandum & articles in compliance with the Provisions of the Act.
- (ii) Where the turnover of XYZ (OPC) during 2016-17 was Rs. 3.00 crore, there will be no change in the answer. In this situation also, XYZ (OPC) can convert itself voluntarily into any other kind of company by alteration of memorandum & articles in compliance with the Provisions of the Act.

Question 17.

Naveen incorporated a "One Person Company" making his sister Navita as the nominee. Navita is leaving India permanently due to her marriage abroad. Due to this fact, she is withdrawing her consent of nomination in the said One Person Company. Taking into considerations the provisions of the Companies Act, 2013 answer the questions given below.

- (A) **If Navita is leaving India permanently, is it mandatory for her to withdraw her nomination in the said One Person Company?**
 (B) **If Navita maintained the status of Resident of India after her marriage, then can she continue her nomination in the said One Person Company?**

[Exam Nov 19 and RTP May 21]

Ans.

As per **Rule 3 & 4** of the Companies (Incorporation) Rules, 2014 following the answers :

- (A) **Yes, it is mandatory** for Navita to withdraw her nomination in the said OPC as she is leaving India permanently as only a natural person who is an Indian citizen & resident in India shall be a nominee.
- (B) **Yes, Navita can continue** her nomination, if she maintained status of Resident of India after her marriage by staying in India for a period of not less than 182 days during immediately preceding FY.

Question 18.

Mr. Raja along with his family members is running successfully a trading business. He is capable of developing his ideas and participating in the market place. To achieve this, Mr. Raja formed a single person economic entity in the form of One Person Company with his brother Mr. King as its nominee. On 4th May 2020, Mr. King withdrew his consent as Nominee of the One Person Company. Can he do so under the provisions of the Companies Act, 2013?

Examine whether the following individuals are eligible for being nominated as Nominee of the One Person Company as on 5th May 2020 under the above said Act.

- (i) **Mr. Shyam, son of Mr. Raja who is 15 years old as on 5th May 2020.**
- (ii) **Ms. Devaki an Indian Citizen, sister of Mr. Raja stays in Dubai and India. She stayed in India during the period from 2nd January 2019 to 16th August 2019. Thereafter she left for Dubai and stayed there.**
- (iii) **Mr. Ashok, an Indian Citizen residing in India who is presently a member of a 'OPC'.**

[Exam Nov 20]

Ans.

As per **section 3** of the Companies Act, 2013, the memorandum of OPC shall indicate name of other person (nominee), who shall, in event of the subscriber's death or his incapacity to contract, become the member of the company.

The other person (nominee) whose name is given in the memorandum shall give his prior written consent in prescribed form and the same shall be filed with Registrar of companies at the time of incorporation along with its Memorandum & Articles.

Such other person (nominee) may withdraw his consent in such manner as may be prescribed.

Therefore, in terms of the above law, Mr. King, the nominee, whose name was given in the memorandum, can withdraw his consent as a nominee of the OPC by giving a notice in writing to the sole member and to the One Person Company.

Following are the answers to the second part of the question as regards the eligibility for being nominated as nominee:

- (i) As per the **Rule 3** of the Companies (Incorporation) Rules, 2014, no minor shall become member or nominee of the OPC. Therefore, Mr. Shyam is **not eligible for being nominated as Nominee**.
- (ii) As per the **Rule 3** of the Companies (Incorporation) Rules, 2014, only a natural person who is an Indian citizen and resident in India, shall be a nominee or the sole member of a One Person Company. The term "Resident in India" means a person who has stayed in India for a period of not less than 182 days during the immediately preceding financial year. Here Ms. Devaki though an Indian Citizen but not resident in India as she stayed for a period of less than 182 days during the immediately preceding financial year in India. So, she is **not eligible for being nominated as nominee** of the OPC.
- (iii) As per the **Rule 3** of the Companies (Incorporation) Rules, 2014, a person shall not be a member of more than one OPC at any point of time and the said person shall not be a nominee of more than one OPC. Mr. Ashok, an Indian Citizen residing in India who is a member of an OPC (Not a nominee in any OPC), **can be nominated as nominee**.

Question 19.

Chhavish, an Indian citizen and resident of India formed “Ekta Readymade Garments (OPC) Private Ltd.” as One Person Company on 1st April 2018 with his wife Mrs. Jyoti as nominee. The authorized and paid-up share capital of the company is Rs. 35 lakhs. He got in touch with a readymade garments buyer and was expecting to receive a substantial order by August 2020 where final delivery will be completed by December 2020. To expand the production capacity, the decided to invest an additional capital of Rs. 10 lakhs in plant and machinery. As a result, the company’s authorized and paid-up share capital is now Rs. 45 Lakhs. Promoter of the company seeks your advice. Considering the case and referring the provisions of the Companies Act, 2013, advice:

- (A) Who is eligible to act as a member of OPC?**
(B) Whether “Ekta Readymade Garments (OPC) Private Ltd.” can convert into any other kind of company as on 1st December 2020?
(C) If the company increases its paid up share capital by Rs. 30 lakhs in August, 2019, can it be converted in any other kind of company immediately? [Exam Dec 21]

Ans.

- (A)** The memorandum of OPC shall indicate the name of the other person (nominee), who shall, in the event of the subscriber’s death or his incapacity to contract, become the member of the company.
 Only a natural person who is an Indian citizen whether resident in India or otherwise-
 - shall be eligible to incorporate One Person Company (OPC);
 - shall be a nominee for the sole member of One Person Company (OPC).
- (B)** OPC cannot convert voluntarily into any kind of company unless two years have expired from the date of incorporation, except where the paid up share capital is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.1
 Ekta Readymade Garments Ltd. was incorporated on 1st April, 2018.
 Ekta Readymade Garments Ltd. cannot voluntarily convert the OPC into any other kind of company before expiry of two years from 1st April, 2018 i.e. upto 31st March, 2020. Thus, it can convert into any other kind of company as on 1st December, 2020.
- (C)** If the paid up share capital of Ekta Readymade Garments Ltd. is increased to Rs. 65 lakhs (35+30), it will be converted into other forms company immediately.

Question 20.

Referring the relevant provisions of the Companies Act, 2013, examine, whether following companies will be considered as listed company or unlisted company:

- (i) ABC Limited, a public company, has listed its non-convertible Debt securities issued on private placement basis in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008.**
(ii) CHG Limited, a public company, has listed its non-convertible redeemable preference shares issued on private placement basis in terms of SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013.
(iii) PRS Limited, a public company, which has not listed its equity shares on a recognized stock exchange but whose equity shares are listed on a stock exchange in a jurisdiction as specified in sub-section (3) of section 23 of the Companies Act, 2013. [Exam Nov 22]

Ans.

According to **Section 2(52)** of the Companies Act, 2013, listed company means a company which has any of its securities listed on any recognised stock exchange.

RULE 2A: According to Rule 2A of the Companies (Specification of definitions details) Rules, 2014, the following classes of companies shall not be considered as listed companies, namely:-

- (a) Public companies which have not listed their equity shares on a recognized stock exchange but have listed their –**

- non-convertible debt securities issued on private placement basis in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008; or
 - non-convertible redeemable preference shares issued on private placement basis in terms of SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013; or
 - both categories of (i) and (ii) above.
- (b) Public companies which have not listed their equity shares on a recognized stock exchange but whose equity shares are listed on a stock exchange in a jurisdiction as specified in sub-section (3) of section 23 of the Act.

In view of the above provisions of the Act:

- (i) **ABC Limited is an unlisted company.**
 (ii) **CHG Limited is an unlisted company.**
 (iii) **PRS Limited is an unlisted company.**

MULTIPLE CHOICE BASED QUESTIONS:

1.	Green Ltd. is incorporated on 3rd January, 2022. As per the Companies Act, 2013, what will be the financial year for the company:			
	a) 31st March 2022	b) 31st December, 2022	c) 31st March 2023	d) 30th September 2023
2.	Roma along with her six friends has incorporated Roma Trading Ltd. in May 2021. The paid-up share capital of the company is Rs. 2 crore. Further, in April 2022, she noticed that in the last financial year, the turnover of the company was well below Rs. 40 crore. Advise whether the company can be treated as a 'small company'.			
	a) Roma Trading Ltd. is definitely a 'small company' since its paid-up capital is much below ` 4 crore and also its turnover has not exceeded the threshold limit of ` 40 crore.	b) The concept of 'small company' is applicable only in case of a private limited company/OPC and therefore, despite meeting the criteria of 'small company' it being a public limited company it cannot enjoy benefits of 'small company'.	c) Unlike a pvt ltd co/ OPC automatically becomes a 'small company' as soon as it meets the criteria, Roma Trading Ltd. being a public limited company has to maintain norms applicable to a 'small company' continuously for 2 years so that, thereafter, it will be treated as a 'small company'.	d) If all the shareholders of Roma Trading Ltd. give an undertaking to the ROC stating that they will not let the paid-up share capital and also turnover exceed the limits applicable to a 'small company' in the next two years, then it can be treated as a 'small company'.
3.	Abhilasha & Amrita have incorporated a 'not for profit' private limited company which is registered under Sec 8. One of their friends has informed them that their company can be categorized as a 'small company' because as per last P/L account, its turnover was less than Rs. 40 crore and its paid up share capital was less than Rs. 4 crore. Advise.			
	a) A sec 8 company, which meets criteria of 'turnover' & 'paid-up share capital' in last FY, can avail status of 'small company'	b) If acquisition of minimum 5% stake in another 'small company' materializes in 2 nd FY (& not in immediately following FY) after meeting criteria of	c) The status of 'small company' cannot be bestowed upon a 'not for profit' company which is registered under Section 8 of	d) A section 8 company, if incorporated as a private limited company (and not as public limited company) can avail the status of 'small company' with the permission of concerned

	only if it acquires at least 5% stake in another 'small company' within immediately following FY.	'turnover' & 'paid-up share capital' then with written permission of concerned ROC, it can acquire status of 'small company'.	the Companies Act, 2013.	ROC, after it meets the criteria of 'turnover' and 'paid-up share capital'.
4.	Kaveri Goods Carriers Private Limited (KGCPL) issued 9% Non-convertible Debentures worth Rs. 10 lakhs and thereafter, the directors contemplated to get them listed. After due formalities, these privately placed non-convertible debentures of Rs. 10 lakhs were listed. Which of the following options is applicable in the given situation:			
	a) KGCPL shall be considered as a listed company.	b) KGCPL shall not be considered as a listed company.	c) KGCPL shall be considered as a listed company only when minimum amount of listed privately placed non-convertible debentures is Rs. 15 lakhs.	d) KGCPL shall be considered as a listed company only when minimum amount of listed privately placed non-convertible debentures is minimum Rs. 20 lakhs.
5.	"Associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence & includes a joint venture company. Here, words 'significant influence' means:			
	a) Control of at least 10% of total voting power	b) Control of at least 15% of total voting power	c) Control of at least 20% of total voting power	d) Control of at least 25% of total voting power
6.	Fixture Surface Coatings Limited incorporated in February 2022, is a subsidiary company of Luxture Prime Limited incorporated outside India. Board of directors of Luxture Surface Coatings Limited want to follow a different financial year for the purpose of consolidation of its accounts outside India, to make it align with holding company. Luxture Surface Coatings Limited seeks your advice whether it can follow different financial year as per the provisions of the Companies Act, 2013. Choose the correct option out of the following:			
	a) Yes, but Company has to make application to CG, then CG may allow to follow a different financial year for consolidation of its accounts outside India, CG may allow any period as its financial year, whether or not that period is a year.	b) No, Luxture Surface Coatings Limited has to follow financial year as per the Companies Act, 2013 and as per Act company has to close its accounts on 31-03-2023 as company is registered after first date of January.	c) No, Luxture Surface Coatings Limited has to follow financial year as per the Companies Act, 2013 and as per Act company has to close its accounts on 31-03-2022.	d) Yes, it can follow different financial year but Company has to make application to ROC for following different financial year for consolidation of its accounts with holding company outside India.
7.	Financial Statement in relation to a company do not include:			

	a) Cash Flow Statement	b) Funds Flow Statement	c) Statement of Changes in Equity	d) Explanatory note annexed to the financial statements
8.	Newage Private Limited issued 9% Non-convertible Debentures worth Rs. 10 lakh and thereafter, the directors contemplated to get them listed. After due formalities, these privately placed non-convertible debentures of Rs. 10 lakh were listed. Which of the following options is applicable in the given situation:			
	a) Newage Private Limited shall be considered as a listed company.	b) Newage Private Limited shall not be considered as a listed company.	c) Newage Pvt Ltd shall be considered as a listed company only when minimum amount of listed privately placed non-convertible debentures is Rs. 15 lakh.	d) Newage Private Limited shall be considered as a listed company only when minimum amount of listed privately placed non-convertible debentures is minimum Rs. 20 lakh.
9.	The paid-up share capital of ABC Ltd is 5 crore shares of 10 rupees each. The share holding pattern is as under: P Ltd: 1 crore shares, Q Ltd: 0.90 crore shares, R Ltd: 0.50 crore shares, S Ltd: 0.20 crore shares, Promoters: 2 crore shares, Public: 0.40 crore shares. Which company shall be treated as Associate Company of ABC Ltd:			
	a) P Ltd	b) Q Ltd	c) R Ltd	d) S Ltd
10.	Which among the following is not a Court:			
	a) Special Court	b) Court of Session	c) NCLT	d) Metropolitan Magistrate
11.	In which company, a Partnership Firm is eligible to become a member of company:			
	a) Any Public Limited Company	b) Any Private Limited Company	c) Any Public Ltd Company which is registered u/s 8 of the Act	d) Any One Person Company
12.	ABC Limited is a company engaged in manufacturing and distributing pharmaceutical products. The company has a paid-up share capital of Rs. 50 crores, free reserves of Rs. 25 crores, and securities premium amounting to Rs. 10 crores. The credit balance of the profit and loss account is Rs. 5 crores after deducting all miscellaneous expenditures and deferred revenue expenditure. The company has not created any reserves on the revaluation of assets. On the basis of given information, what is the net worth of ABC Limited?			
	a) Rs. 50 crores	b) Rs. 85 crores	c) Rs. 90 crores	d) Rs. 60 crores
13.	Abridged prospectus means a memorandum containing such salient features of a prospectus as may be specified by:			
	a) The Company issuing such prospectus	b) The Auditor of the company	c) The Promoter of the Company	d) The SEBI by making regulations in this behalf
14.	Which among the following is not allowed to be registered under section 8 of the Companies Act, 2013:			

	a) A limited company which has in its objects the promotion of religion	b) A limited company which prohibits the payment of dividend	c) A private limited company which has in its objects the promotion of social welfare	d) A limited company which apply its profits in promoting education
15.	Aniket Builders Ltd (ABL) was promoted by Aniket and his family members and is in construction business for more than 10 years. Aniket's brother Saket purchased a running cement manufacturing company named Unique Cements Ltd (UCL) and removed the existing directors of the company and appointed majority of the directors of ABL in the Board of UCL. What shall be the status of UCL in such situation:			
	a) UCL is an Associate Company of ABL	b) UCL is a Subsidiary Company of ABL	c) UCL is a Holding Company of ABL	d) UCL is a Joint Venture Company of ABL
16.	Which among the following company is not required to include Cash Flow Statement in its Financial Statements:			
	a) Private Limited company	b) Small Company	c) Sec 8 Company	d) Producer Company

ANSWERS:

1.	(c)	2.	(b)	3.	(c)	4.	(b)	5.	(c)
6.	(a)	7.	(b)	8.	(b)	9.	(a)	10.	(c)
11.	(c)	12.	(c)	13.	(d)	14.	(c)	15.	(b)
16.	(b)								

CHAPTER 1 – BASIC CONCEPTS

STUDY MATERIAL QUESTIONS

Question 1.

Mr. B grows sugarcane and uses the same for the purpose of manufacturing sugar in his factory. 30% of sugarcane produce is sold for Rs. 10 lakhs, and the cost of cultivation of such sugarcane is Rs. 5 lakhs. The cost of cultivation of the balance sugarcane (70%) is Rs. 14 lakhs and the market value of the same is Rs. 22 lakhs. After incurring Rs. 1.5 lakhs in the manufacturing process on the balance sugarcane, the sugar was sold for Rs. 25 lakhs. Compute B's business income and agricultural income.

Ans.

Computation of Business and Agriculture income of Mr. B

Particulars	Business Income (Rs.)	Agricultural Income	
		(Rs.)	(Rs.)
<u>Sale of Sugar</u>			
<u>Business Income</u>			
Sale Proceeds of sugar	25,00,000		
Less: Market Value of sugarcane (70%)	22,00,000		
Less: Manufacturing expense	1,50,000		
	1,50,000		
<u>Agricultural Income</u>			
Market Value of sugarcane (70%)		22,00,000	
Less: Cost of cultivation		14,00,000	8,00,000
<u>Sale of Sugarcane</u>			
<u>Agricultural Income</u>			
Sale proceeds of sugarcane (30%)		10,00,000	
Less: Cost of cultivation		5,00,000	5,00,000
			13,00,000

Question 2.

Mr. C manufactures latex from the rubber plants grown by him in India. These are then sold in the market for Rs. 30 lakhs. The cost of growing rubber plants is Rs. 10 lakhs and that of manufacturing latex is Rs. 8 lakhs. Compute his total income and tax liability.

Ans.

The total income of Mr. C comprises of agricultural income and business income.

Total profits from the sale of latex = Rs. 30 lakhs – Rs. 10 lakhs – Rs. 8 lakhs = **Rs. 12 lakhs.**

Agricultural income = 65% of Rs. 12 lakhs = Rs. 7.8 lakhs

Business income = 35% of Rs. 12 lakhs = Rs. 4.2 lakhs

The tax liability of Mr. C has to be computed applying the concept of partial integration, since his total income comprises of both agricultural income and non- agricultural income and his agricultural income

exceeds Rs. 5,000 p.a and his non- agricultural income exceeds the basic exemption limit i.e., Rs. 2,50,000 (applicable, in his case).

Accordingly, his tax liability would be computed in the following manner:

Computation of tax liability of Mr. C for AY 2024-25

Particulars	Amount (Rs.)
Tax on total income of Rs. 12,00,000, being agricultural income and non-agricultural income	1,72,500
Less: Tax on agricultural income and basic exemption limit i.e., Rs. 10,30,000 [Rs. 7,80,000 plus Rs. 2,50,000]	1,21,500
	51,000
Add: Health & Education Cess @4%	2,040
Total Tax Liability	53,040

Question 3.

Mr. X has a total income of Rs. 16,00,000 for P.Y.2023-24, comprising of income from house property and interest on fixed deposits. Compute his tax liability for A.Y.2024- 25 under the default tax regime under section 115BAC.

Ans.

Computation of Tax liability of Mr. X for A.Y. 2024-25

Tax Liability:

First Rs. 3,00,000	-	Nil	
Next Rs. 3,00,001 – Rs. 6,00,000	-	@5% of Rs. 3,00,000	= Rs. 15,000
Next Rs. 6,00,001 – Rs. 9,00,000	-	@10% of Rs. 3,00,000	= Rs. 30,000
Next Rs. 9,00,001 – Rs. 12,00,000	-	@15% of Rs. 3,00,000	= Rs. 45,000
Next Rs. 12,00,001 – Rs. 15,00,000	-	@20% of Rs. 3,00,000	= Rs. 60,000
Balance i.e. Rs. 16,00,000 minus Rs. 15,00,000	-	@30% of Rs. 1,00,000	= Rs. 30,000
			Rs. 1,80,000
Add: Health & Education cess @4%			= Rs. 7,200
			Rs. 1,87,200

Question 4.

Mr. X has a total income of Rs. 16,00,000 for P.Y.2023-24, comprising of income from house property and interest on fixed deposits. Compute his tax liability for A.Y.2024- 25 assuming his age is –

- a) 45 years
- b) 63 years
- c) 82 years

Assume that Mr. X has exercised the option to shift out/ opt out of the default tax regime.

Ans.

a) Computation of Tax Liability of Mr. X (aged 45 years)

Tax Liability:

First Rs. 2,50,000	-	Nil	
Next Rs. 2,50,001 – Rs. 5,00,000	-	@5% of Rs. 2,50,000	= Rs. 12,500

Next Rs. 5,00,001 – Rs. 10,00,000	-	@20% of Rs. 5,00,000	= Rs. 1,00,000
Balance i.e. Rs. 16,00,000 minus Rs. 10,00,000	-	@30% of Rs. 6,00,000	= Rs. 1,80,000
			<hr/> Rs. 2,92,500
Add: Health & Education cess @4%			= Rs. 11,700
			<hr/> Rs. 3,04,200

b) Computation of Tax Liability of Mr. X (aged 63 years)**Tax Liability:**

First Rs. 3,00,000	-	Nil	
Next Rs. 3,00,001 – Rs. 5,00,000	-	@5% of Rs. 2,00,000	= Rs. 10,000
Next Rs. 5,00,001 – Rs. 10,00,000	-	@20% of Rs. 5,00,000	= Rs. 1,00,000
Balance i.e. Rs. 16,00,000 minus Rs. 10,00,000	-	@30% of Rs. 6,00,000	= Rs. 1,80,000
			<hr/> Rs. 2,90,000
Add: Health & Education cess @4%			= Rs. 11,600
			<hr/> Rs. 3,01,600

c) Computation of Tax Liability of Mr. X (aged 82 years)**Tax Liability:**

First Rs. 5,00,000	-	Nil	
Next Rs. 5,00,001 – Rs. 10,00,000	-	@20% of Rs. 5,00,000	= Rs. 1,00,000
Balance i.e. Rs. 16,00,000 minus Rs. 10,00,000	-	@30% of Rs. 6,00,000	= Rs. 1,80,000
			<hr/> Rs. 2,80,000
Add: Health & Education cess @4%			= Rs. 11,200
			<hr/> Rs. 2,91,200

Question 5.

Compute the tax liability of Mr. A (aged 42), having total income of Rs. 51 lakhs for the Assessment Year 2024-25. Assume that his total income comprises of salary income, Income from house property and interest on fixed deposit. Assume that Mr. A has exercised option to shift out of section 115BAC.

Ans.**Computation of tax liability of Mr. A for the A.Y. 2024-25**

(A)	Income tax (including surcharge) computed on total income of Rs. 51,00,000		
	Next Rs. 2,50,000 – Rs. 5,00,000 @5%	Rs. 12,500	
	Next Rs. 5,00,001 – Rs. 10,00,000 @20%	Rs. 1,00,000	
	Next Rs. 10,00,001 – Rs. 51,00,000 @30%	Rs. 12,30,000	
	Total	Rs. 13,42,500	
	Add: Surcharge @10%	Rs. 1,34,250	Rs. 14,76,750
(B)	Income tax computed on total income of Rs. 50 lakhs (Rs. 12,500 plus Rs. 1,00,000 plus Rs. 12,00,000)		Rs. 13,12,500
(C)	Excess tax payable (A) – (B)		Rs. 1,64,240
(D)	Marginal Relief (Rs. 1,64,250 – Rs. 1,00,000, being the amount of income in excess of Rs. 50,00,000)		Rs. 64,250

(E) Tax Liability (A) – (D)	Rs. 14,12,500
Add; Health and Education cess @4%	Rs. 56,500
Tax liability (including cess)	Rs. 14,69,000

Question 6.

Compute the tax liability of Mr. B (aged 51) under the default tax regime, having total income of Rs. 1,01,00,000 for the Assessment Year 2024-25. Assume that his total income comprises of salary income, Income from house property and interest on fixed deposit.

Ans.**Computation of tax liability of Mr. A for the A.Y. 2024-25**

(A) Income tax (including surcharge) computed on total income of Rs. 1,01,00,000		
Rs. 3,00,001 – Rs. 6,00,000 @5%	Rs. 15,000	
Rs. 6,00,001 – Rs. 9,00,000 @10%	Rs. 30,000	
Rs. 9,00,001 – Rs. 12,00,000 @15%	Rs. 45,000	
Rs. 12,00,001 – Rs. 15,00,000 @20%	Rs. 60,000	
Rs. 15,00,001 – Rs. 1,01,00,000 @30%	Rs. 25,80,000	
Total	Rs. 27,30,000	
Add: Surcharge @15%	Rs. 4,09,500	Rs. 31,39,500
(B) Income tax computed on total income of Rs. 1 crore [(Rs. 1,50,000 plus Rs. 25,50,000) plus surcharge @10%]		Rs. 29,70,000
(C) Excess tax payable (A) – (B)		Rs. 1,69,500
(D) Marginal Relief (Rs. 1,69,500 – Rs. 1,00,000, being the amount of income in excess of Rs. 1,00,00,000)		Rs. 69,500
(E) Tax Liability (A) – (D)		Rs. 30,70,000
Add; Health and Education cess @4%		Rs. 1,22,800
Tax liability (including cess)		Rs. 31,92,800

Question 7.

Compute the tax liability of Mr. C (aged 58), having total income of Rs. 2,01,00,000 for the Assessment Year 2024-25. Assume that his total income comprises of salary income, Income from house property and interest on fixed deposit. Assume that Mr. C has exercised the option to shift out of section 115BAC.

Ans.**Computation of tax liability of Mr. C for the A.Y. 2024-25**

(A) Income tax (including surcharge) computed on total income of Rs. 2,01,00,000		
Rs. 2,50,001 – Rs. 5,00,000 @5%	Rs. 12,500	
Rs. 5,00,001 – Rs. 10,00,000 @20%	Rs. 1,00,000	
Rs. 10,00,001 – Rs. 2,01,00,000 @30%	Rs. 57,30,000	
Total	Rs. 58,42,500	
Add: Surcharge @25%	Rs. 14,60,625	Rs. 73,03,125
(B) Income tax computed on total income of Rs. 2 crore (Rs. 12,500 plus Rs. 1,00,000 plus Rs. 57,00,000)		Rs. 58,12,500

Add: Surcharge @15%	Rs. 8,71,875
	Rs. 66,84,375
(C) Excess tax payable (A) – (B)	Rs. 6,18,750
(D) Marginal Relief (Rs. 6,18,750 – Rs. 1,00,000, being the amount of income in excess of Rs. 2,00,00,000)	Rs. 5,18,750
(E) Tax Liability (A) – (D)	Rs. 67,84,375
Add; Health and Education cess @4%	Rs. 2,71,375
Tax liability (including cess)	Rs. 70,55,750

Question 8.

Compute the tax liability of Mr. D (aged 65) in a most beneficial manner. He is having total income of Rs. 5,01,00,000 for the Assessment Year 2024-25. Assume that his total income comprises of salary income, Income from house property and interest on fixed deposit and is the same under both tax regimes.

Ans.**Computation of tax liability of Mr. D for the A.Y. 2024-25**

(A) Income tax (including surcharge) computed on total income of Rs. 5,01,00,000		
Rs. 3,00,000 – Rs. 5,00,000 @5%	Rs. 10,000	
Rs. 5,00,001 – Rs. 10,00,000 @20%	Rs. 1,00,000	
Rs. 10,00,001 – Rs. 5,01,00,000 @30%	Rs. 1,47,30,000	
Total	Rs. 1,48,40,000	
Add: Surcharge @25%	Rs. 54,90,800	Rs. 2,03,30,800
(B) Income tax computed on total income of Rs. 5 crore [(Rs. 10,000 plus Rs. 1,00,000 plus Rs. 1,47,00,000) plus surcharge @25%		Rs. 1,85,12,500
(C) Excess tax payable (A) – (B)		Rs. 18,18,300
(D) Marginal Relief (Rs. 18,18,300 – Rs. 1,00,000, being the amount of income in excess of Rs. 5,00,00,000)		Rs. 17,18,300
(E) Tax Liability (A) – (D)		Rs. 1,86,12,500
Add; Health and Education cess @4%		Rs. 7,44,500
Tax liability (including cess)		Rs. 1,93,57,000

Question 9.

Mr. Raghav aged 26 years and a resident in India, has a total income of Rs. 6,50,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2024-25 under default tax regime under section 115BAC.

Ans.**Computation of Tax liability of Mr. Raghav for A.Y. 2024-25**

Particulars	Amount (Rs.)
Tax on total income of Rs. 6,50,000	
Tax @10% of Rs. 50,000 + Rs. 15,000	20,000
Less: Rebate u/s 87A (Lower of tax payable or Rs. 25,000)	20,000
Tax Liability	Nil

Question 10.

Mr. Pawan aged 35 years and a resident in India, has a total income of Rs. 7,15,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2024-25 under default tax regime under section 115BAC.

Ans.**Computation of Tax liability of Mr. Pawan for A.Y. 2024-25**

Particulars	Amount (Rs.)
Step 1: Total income of Rs. 7,15,000 – Rs. 7,00,000 (A)	15,000
Step 2: Tax on total income of Rs. 7,15,000 (B) Tax @10% of Rs. 1,15,000 + Rs. 15,000	26,500
Step 3: Since $B > A$, rebate u/s 87A would be $B - A$ [Rs. 26,500 – Rs. 15,000]	11,500
	15,000
Add: HEC @4%	600
Tax Liability	15,600

Question 11.

Mr. Piyush, aged 35 years and a resident in India, has a total income of Rs. 4,15,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2024-25 if he exercises the option to shift out of the default tax regime.

Ans.**Computation of Tax liability of Mr. Piyush for A.Y. 2024-25**

Particulars	Amount (Rs.)
Tax on total income of Rs. 4,15,000	
Tax @5% of Rs. 1,65,000	8,250
Less: Rebate u/s 87A (Lower of tax payable or Rs. 12,500)	8,250
Tax Liability	Nil

Question 12.

Mr. X, a resident, has provided the following particulars of his income for the P.Y. 2023-24.

- i. Income from salary (computed) - Rs. 4,80,000
- ii. Income from house property (computed) - Rs. 2,50,000
- iii. Agricultural income from a land in Jaipur - Rs. 4,80,000
- iv. Expenses incurred for earning agricultural income - Rs. 1,70,000

Compute his tax liability for A.Y. 2024-25 assuming his age is -

- a) 45 years
- b) 70 years

Ans.

- a) Computation of tax liability (age 45 years)

Computation of total income of Mr. X for the A.Y. 2024-25 under default tax regime under section 115BAC

For the purpose of partial integration of taxes, Mr. X has satisfied both the conditions i.e.

- Net agricultural income exceeds Rs. 5,000 p.a., and
- Non-agricultural income exceeds the basic exemption limit of Rs. 3,00,000.

His tax liability is computed in the following manner:

Particulars	Rs.	Rs.
Income from salary		4,80,000
Income from House Property		2,50,000
Net agricultural income [Rs. 4,80,000 – Rs. 1,70,000]	3,10,000	
Less; Exempt under section 10(1)	(3,10,000)	-
Gross Total Income		7,30,000
Less: Deductions under Chapter VI-A		-
Total Income		7,30,000

Step 1: Rs. 7,30,000 + Rs. 3,10,000 = Rs. 10,40,000

Tax on Rs. 10,40,000 = Rs. 66,000

(i.e., 5% of Rs. 3,00,000 plus 10% of Rs. 3,00,000 plus 15% of Rs. 1,40,000)

Step 2: Rs. 3,10,000 + Rs. 3,00,000 = Rs. 6,10,000

Tax on Rs. 6,10,000 = Rs. 16,000 (i.e. 5% of Rs. 3,00,000 plus 10% of Rs. 10,000)

Step 3: Rs. 66,000 – Rs. 16,000 = Rs. 50,000

Step 4 & 5: Total tax payable = Rs. 50,000

= Rs. 50,000 + 4% of Rs. 50,000 = **Rs. 52,000**

Computation of total income of Mr. X for the A.Y. 2024-25 under normal provisions of the Act

Particulars	Rs.	Rs.
Income from salary		4,80,000
Income from House Property		2,50,000
Net agricultural income [Rs. 4,80,000 – Rs. 1,70,000]	3,10,000	
Less; Exempt under section 10(1)	(3,10,000)	-
Gross Total Income		7,30,000
Less: Deductions under Chapter VI-A		-
Total Income		7,30,000

Step 1: Rs. 7,30,000 + Rs. 3,10,000 = Rs. 10,40,000

Tax on Rs. 10,40,000 = Rs. 1,24,500

(i.e., 5% of Rs. 2,50,000 plus 20% of Rs. 5,00,000 plus 30% of Rs. 40,000)

Step 2: Rs. 3,10,000 + Rs. 2,50,000 = Rs. 5,60,000

Tax on Rs. 5,60,000 = Rs. 24,500 (i.e. 5% of Rs. 2,50,000 plus 20% of Rs. 60,000)

Step 3: Rs. 1,24,500 – Rs. 24,500 = Rs. 1,00,000

Step 4 & 5: Total tax payable = Rs. 1,00,000
 = Rs. 1,00,000 + 4% of Rs. 1,00,000 = **Rs. 1,04,000**

b) Computation of tax liability (age 70 years)

Computation of total income of Mr. X for the A.Y. 2024-25 under default tax regime under section 115BAC

Tax liability of Mr. X would be same under default tax regime whether he is of age of 45 years of 70 years i.e., Rs. 52,000.

Computation of total income of Mr. X for the A.Y. 2024-25 under normal provisions of the Act

His tax liability is computed in the following manner:

Step 1: Rs. 7,30,000 + Rs. 3,10,000 = Rs. 10,40,000
 Tax on Rs. 10,40,000 = Rs. 1,22,000
 (i.e., 5% of Rs. 2,00,000 plus 20% of Rs. 5,00,000 plus 30% of Rs. 40,000)

Step 2: Rs. 3,10,000 + Rs. 3,00,000 = Rs. 6,10,000
 Tax on Rs. 6,10,000 = Rs. 32,000 (i.e. 5% of Rs. 2,00,000 plus 20% of Rs. 1,10,000)

Step 3: Rs. 1,22,000 – Rs. 32,000 = Rs. 90,000

Step 4 & 5: Total tax payable = Rs. 90,000
 = Rs. 90,000 + 4% of Rs. 90,000 = **Rs. 93,600**

Question 13.

Who is an “Assessee”? Explain

Ans.

As per section 2(7), assessee means a person by whom any tax or any other sum of money is payable under the Income-tax Act, 1961.

In addition, the term includes –

- Every person in respect of whom any proceeding under the Act has been taken for the assessment of –
 - his income; or
 - the income of any other person in respect of which he is assessable; or
 - the loss sustained by him or by such other person; or
 - the amount of refund due to him or to such other person.
- Every person who is deemed to be an assessee under any provision of the Act;
- Every person who is deemed to be an assessee in default under any provision of the Act.

Question 14.

State any four instances where the income of the previous year is assessable in the previous year itself instead of the assessment year.

Ans.

The income of an assessee for a previous year is charged to income-tax in the assessment year following the previous year. However, in a few cases, the income is taxed in the previous year in which it is earned. These exceptions have been made to protect the interests of revenue. The exceptions are as follows:

- a) Where a ship, belonging to or chartered by a non-resident, carries passengers, livestock, mail or goods shipped at a port in India, the ship is allowed to leave the port only when the tax has been paid or satisfactory arrangement has been made for payment thereof. 7.5% of the freight paid or payable to the owner or the charterer or to any person on his behalf, whether in India or outside India on account of such carriage is deemed to be his income which is charged to tax in the same year in which it is earned.
- b) Where it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and he has no present intention of returning to India, the total income of such individual for the period from the expiry of the respective previous year up to the probable date of his departure from India is chargeable to tax in that assessment year.
- c) If an AOP/BOI etc. is formed or established for a particular event or purpose and the Assessing Officer apprehends that the AOP/BOI is likely to be dissolved in the same year or in the next year, he can make assessment of the income up to the date of dissolution as income of the relevant assessment year.
- d) During the current assessment year, if it appears to the Assessing Officer that a person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets to avoid payment of any liability under this Act, the total income of such person for the period from the expiry of the previous year to the date, when the Assessing Officer commences proceedings under this section is chargeable to tax in that assessment year.
- e) Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year up to the date of such discontinuance may, at the discretion of the Assessing Officer, be charged to tax in that assessment year.

Question 15.

Whether the income derived from saplings or seedlings grown in a nursery is taxable under the Income-tax Act, 1961? Examine.

Ans.

As per Explanation 3 to section 2(1A), income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income and exempt from tax, whether or not the basic operations were carried out on land.

Question 16.

What are the two schools of Hindu law and where are they prevalent? Explain. Also, mention the difference between the two schools of Hindu Law.

Ans.

The two schools of Hindu law are Dayabaga school, prevalent in West Bengal and Assam, and Mitakshara school, prevalent in rest of India.

Under the Dayabaga school of Hindu Law, nobody acquires the right, share in the property by birth as long as the head of family is living. Thus, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Hence, the father and his brothers would be the coparceners of the HUF.

Under the Mitakshara school of Hindu Law, one acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living. Thus, every child born in the family acquires a right/share in the family property.

Question 17.

What is the difference between an Association of Persons and Body of Individuals?

Ans.

In order to constitute an Association of Persons (AOP), persons must join for a common purpose or action and their object must be to produce income; it is not enough that the persons receive the income jointly.

Body of Individuals denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus, co- executors or co-trustees are assessable as a BOI as their title and interest are indivisible.

The difference between an AOP and BOI is that in case of a BOI, only individuals can be the members, whereas in case of AOP, any person can be its member i.e. entities like company, firm etc. can be the member of AOP but not of BOI.

In case of an AOP, members voluntarily come together with a common will for a common intention or purpose, whereas in case of BOI, such common will may or may not be present.

Question 18.

Mr. Sumit, a resident Indian, earns income of Rs. 15 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in India and Rs. 20 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in Malaysia during the A.Y.2024-25. What would be his business income, assuming he has no other business?

Ans.

Since Mr. Sumit is a resident, his global income would be taxable in India. Income of Rs. 20 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in Malaysia would be his business income since it is from rubber plants grown outside India. 35% income from sale of rubber manufactured from latex obtained from rubber plants grown by him in India would be taxable as business income and balance 65% would be exempt as agricultural income.

Business income = 35% of Rs. 15 lakhs + Rs. 20 lakhs = **Rs. 25.25 lakhs**

Question 19.

Mr. Raja, a resident Indian, earns income of Rs. 10 lakhs from sale of coffee grown and cured in India during the A.Y.2024-25. His friend, Mr. Shyam, a resident Indian, earns income of Rs. 20 lakhs from sale of coffee grown, cured, roasted and grounded by him in India during the A.Y.2024-25. What would be the business income chargeable to tax in India of Mr. Raja and Mr. Shyam?

Ans.

In case of income derived from the sale of coffee grown and cured by the seller in India, 25% income on such sale is taxable as business income. In case of income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, 40% income on such sale is taxable as business income.

Business income of Mr. Raja = 25% of Rs. 10 lakhs = **Rs. 2.5 lakhs**

Business income of Mr. Shyam = 40% of Rs. 20 lakhs = **Rs. 8 lakhs**

Question 20.

The Jain HUF in Assam comprises of Mr. Suresh Jain, his wife Mrs. Sapna Jain, his son Mr. Sarthak Jain, his daughter-in-law Mrs. Preeti Jain, his daughter Miss Seema Jain and his unmarried brother Mr. Pritam Jain. Which of the members of the HUF are eligible for coparcenary rights?

Ans.

Dayabaga school of Hindu law is prevalent in Assam. In Dayabaga school of Hindu law, nobody acquires the right, share in the property by birth as long as the head of family is living.

Thus, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property.

Hence, Mr. Suresh Jain and his brother, Mr. Pritam Jain would be the coparceners of the Jain HUF and are eligible for coparcenary rights.

Question 21.

Compute the tax liability under default tax regime of Mr. Kashyap (aged 35), having total income of Rs. 51,75,000 for the Assessment Year 2024-25. Assume that his total income comprises of salary income, income from house property and interest on fixed deposit.

Computation of tax liability of Mr. Agarwal for the A.Y. 2024-25 under normal provisions

Particulars	Amount (Rs.)
Tax on total income of Rs. 2,30,00,000	
Tax @20% of Rs. 52,00,000	10,40,000
Tax @15% of Rs. 64,00,000	9,60,000
Tax on other income of Rs. 1,14,00,000	
Rs. 3,00,000 – Rs. 5,00,000 @5%	10,000
Rs. 5,00,000 – Rs. 10,00,000 @20%	1,00,000
Rs. 10,00,000 – Rs. 1,14,00,000 @30%	31,20,000
	52,30,000
Add: Surcharge @15%	7,84,500
	60,14,500
Add: Health and Education cess @4%	2,40,580
Tax Liability	62,55,080

ADDITIONAL QUESTIONS

Question 24.

Mrs. Sushma, born on 1st April, 1964 furnishes the following information for the year ended 31-03-2024:

Particulars	Amount (Rs.)
Long-term capital gains on sale of shares in XYZ Pvt. Ltd.	2,00,000
Short-term capital gains on sale of house property	30,000
Dividend income from ABC Ltd, an Indian company	11,50,000
Business Income	3,20,000
Salary	2,40,000
Lottery winning (Gross)	2,20,000
Net agricultural income	60,000
Mrs. Sushma has paid the following:	
LIC premium of self	40,000
LIC premium of husband	20,000
Deposit in Tax Saver Deposit with PNB Bank in the name of major son	25,000

Compute the tax payable by Mrs. Sushma for the Assessment Year 2024-25 under the normal provisions of the Act.

Ans.

Computation of tax payable by Mrs. Sushma for the A.Y.2024-25

	Particulars	Amt (Rs.)	Amt (Rs.)
Step 1			
	Agricultural income and Non-agricultural income (Rs. 60,000 + Rs. 20,00,000) [For computation of non-agricultural income, see Working Note below]	20,60,000	
	Tax on the above income		

(i)	Tax on long-term capital gain of Rs. 1,00,000 @ 20%	20,000	
(ii)	Tax on winning from lotteries Rs. 2,20,000 @ 30%	66,000	
(iii)	Tax on remaining income of Rs. 17,40,000 (Rs. 16,80,000 + Rs. 60,000) at normal slab rate i.e., 5% on income of Rs. 2,00,000 plus 20% on Rs. 5,00,000 plus 30% on Rs. 7,40,000	3,32,000	4,18,000
Total tax on Rs. 20,60,000			4,18,000
Step 2			
Basic exemption limit to agricultural income (Rs. 3,00,000 + Rs. 60,000)		3,60,000	
Tax on Rs. 3,60,000			3,000
Step 3			
Tax on non-agricultural income (Tax under Step 1 – Tax under Step 2) (Rs. 4,18,000 – Rs. 3,000)			4,15,000
Add: Health and Education cess @ 4%			16,600
Tax payable by Mrs. Sushma			4,31,600

Working Note:**Computation of total income of Mrs. Sushma for the A.Y. 2024-25**

Particulars	Amount (Rs.)	Amount (Rs.)
Business Income		3,20,000
Salary		2,40,000
Dividend Income		11,50,000
Long term capital gain on sale of shares in XYZ Pvt Ltd		1,00,000
Short term capital gains on sale of house property		30,000
Lottery Winnings (Gross)		2,20,000
Gross Total Income		20,60,000
Less: Deductions under Section 80C		
Life insurance premium of self	40,000	
Life insurance premium of husband	20,000	60,000
Total Income		20,00,000

Notes:

- Mrs. Sushma born on 1st April, 1964, turns 60 years of age on 31.03.2024. Therefore, she is a senior citizen for the P.Y. 2023-24 and is entitled to the higher basic exemption limit of Rs. 3,00,000.
- Short-term capital gains on sale of house property are taxable at normal rates.
- Tax saver deposit in the name of major son does not qualify for deduction under section 80C.
- It has been assumed that standard deduction of Rs. 50,000 has been already allowed from the salary income.
- Long term capital gain on sale of shares of a company are exempt upto Rs. 1,00,000 under Section 112A. Also, any excess over Rs. 1,00,000 is chargeable to tax at a fixed rate of 10%.

Question 25.

Briefly explain the purpose for which the words "PROVISO" and "EXPLANATION" are incorporated under various sections of the Income-tax Act, 1961.

Ans.

Proviso: The Proviso to a section is incorporated to specify the exception(s) to the provision contained in the respective section i.e., the proviso spells out the cases where the provision contained in the respective section would not apply or where the provision contained in the respective section would apply with certain modification.

Explanation: An Explanation is incorporated in a section to provide a clarification relating to the provision contained in that section. Generally, an Explanation is clarificatory in nature.

Question 26.

Explain the difference between Circulars and Notifications in the context to the Income-tax Act, 1961.

Ans.**Difference between Circulars and notifications**

Circulars	Notifications
Circulars are issued by CBDT.	Notifications are issued by the Central Government. The CBDT is also empowered to issue notifications.
Circular are issued with certain specific problems and to clarify doubt regarding the scope and meaning of certain provisions of the Act.	Central Government issues notifications to effect the provisions of the Act and CBDT issues notifications to make and amend Income-tax Rules.
The department is bound by the circulars. While such circulars are not binding on the assessees, they can take advantage of beneficial circulars.	Notifications are binding in nature. Both department and assessees are bound by the notifications.

Question 27.

Rent of Rs. 72,000 received by Mr. X for letting out agricultural land for a movie shooting is an agricultural income and hence exempt under section 10(1).

Ans.

False: Agricultural income means, inter alia, any rent or revenue derived from land which is situated in India and is used for agricultural purposes. In the present case, rent is being derived from letting out of agricultural land for a movie shoot, which is not an agricultural purpose. In effect, the land is not being put to use for agricultural purposes. Therefore, Rs. 72,000, being rent received by Mr. X from letting out of agricultural land for movie shooting, is not exempt under section 10(1). The same is chargeable to tax under the head "Income from other sources."

Question 28.

Mr. Rajat, aged 32 years, furnishes the following details of his total income for the A.Y. 2024-25:

Income from Salaries – Rs. 27,88,000

Income from House Property (Computed) – Rs. 15,80,000

Interest income from FDRs – Rs. 7,22,000

He has not claimed any deduction under Chapter VI-A. You are required to compute tax liability of Mr. Rajat Saini as per the provisions of Income-tax Act, 1961.

Ans.**Computation of tax liability of Mr. Rajat Saini for the A.Y. 2024-25**

Particulars		Amount (Rs.)	Amount (Rs.)
	Income from Salaries		27,88,000
	Income from House Property (Computed)		15,80,000
	Interest income from FDRs		7,22,000
	Total Income		50,90,000
	Tax Liability		
(A)	Income tax (including surcharge) computed on total income of Rs. 50,90,000		
	Upto Rs. 2,50,000	Nil	
	Rs. 2,50,001 – Rs. 5,00,000 @5%	12,500	
	Rs. 5,00,001 – Rs. 10,00,000 @20%	1,00,000	
	Rs. 10,00,000 – Rs. 50,90,000 @30%	12,27,000	
	Total	13,39,500	
	Add: Surcharge @10%, since total income exceeds Rs. 50 lakhs but not exceed Rs. 1 crore	1,33,950	14,73,450
(B)	Income tax computed on total income of Rs. 50 Lakhs (Rs. 1,12,500 plus Rs. 12,00,000)		13,12,500
(C)	Excess tax payable (A) – (B)		1,60,950
(D)	Marginal Relief (Rs. 1,60,950 – Rs. 90,000, being the amount of income in excess of Rs. 50,00,000)		70,950
(E)	Tax Liability (A) – (D)		14,02,500
	Add; Health and Education cess @4%		56,100
	Tax liability (including cess)		Rs. 14,58,600

Question 29.

Explain with brief reasons, whether the following income can be regarded as agricultural income, as per the provisions of the Income-tax Act, 1961:

- Rent received for letting out agricultural land for a movie shooting.
- Income from sale of seedlings in a nursery adjacent to agricultural lands owned by an assessee.

Ans.

- Rent received for letting out agricultural land for a movie shooting:** As per section 2(1A), "agricultural income" means, inter alia,
 - any rent or revenue derived from land
 - which is situated in India and is used for agricultural purposes.

In the present case, rent is being derived from letting out of agricultural land for a movie shoot, which is not an agricultural purpose and hence, it does not constitute agricultural income.

- Income from sale of seedlings in a nursery:** As per Explanation 3 to section 2(1A), income derived from saplings or seedlings grown in a nursery is deemed to be agricultural income, whether or not the basic operations were carried out on land.

Therefore, the amount received from sale of seedlings in a nursery adjacent to the agricultural lands owned by the assessee constitutes agricultural income.

Question 30.

Discuss the taxability of the following transactions giving reasons, in the light of relevant provisions, for your conclusion.

- a) Mr. Rajpal took a land on rent from Ms. Shilpa on monthly rent of Rs. 10,000. He sub-lets the land to Mr. Manish for a monthly rent of Rs. 11,500. Manish uses the land for grazing of cattle required for agricultural activities. Mr. Rajpal wants to claim deduction of Rs. 10,000 (being rent paid by him to Ms. Shilpa) from the rental income received by it from Mr. Manish.
- b) Mr. Netram grows paddy on land. He then employs mechanical operations on grain to make it fit for sale in the market, like removing hay and chaff from the grain, filtering the grain and finally packing the rice in gunny bags. He claims that entire income earned by him from sale of rice is agricultural income not liable to income-tax since paddy as grown on land is not fit for sale in its original form.

Ans.

- a) The rent or revenue derived from land situated in India and used for agricultural purposes would be agricultural income under section 2(1A)(a). Therefore, rent received from sub-letting of the land used for grazing of cattle required for agriculture activities is agricultural income. The rent can either be received by the owner of the land or by the original tenant from the sub-tenant.
Accordingly, rent received by Mr. Rajpal from Mr. Manish for using land for grazing of cattle required for agricultural activities is agricultural income exempt u/s 10(1). As per section 14A, no deduction is allowable in respect of exempt income.
- b) The income from the process ordinarily employed to render the produce fit to be taken to the market would be agricultural income under section 2(1A)(b)(ii). The process of making the rice ready from paddy for the market may involve manual operations or mechanical operations, both of which constitute processes ordinarily employed to make the product fit for the market.
Accordingly, the entire income earned by Mr. Netram from sale of rice is agricultural income.

Question 31.

Compute the tax liability of Ms. Kajal for A.Y. 2024-25, a female resident aged 40 years, where her total income is Rs. 2,00,50,000 comprising of business income. Ms. Kajal opts for the provisions of section 115BAC.

Ans.**Computation of tax liability of Ms. Kajal under section 115BAC for the A.Y.2024-25**

Particulars		Amount (Rs.)	Amount (Rs.)
(A)	Income tax (including surcharge) computed on total income of Rs. 2,00,50,000		
	Upto Rs. 3,00,000	Nil	
	Rs. 3,00,001 – Rs. 6,00,000 @5%	15,000	
	Rs. 6,00,001 – Rs. 9,00,000 @10%	30,000	
	Rs. 9,50,001 – Rs. 12,00,000 @15%	45,000	
	Rs. 12,00,001 – Rs. 15,00,000 @20%	60,000	
	Rs. 15,00,000 – Rs. 2,00,50,000 @30%	55,65,000	
	Total	57,15,000	
	Add: Surcharge @25%, since total income exceeds Rs. 2 crores	14,28,750	71,43,750
(B)	Income tax computed on total income of Rs. 2 crores (Rs. 15,000 plus Rs. 30,000 plus Rs. 45,000 plus Rs. 60,000 plus Rs. 55,50,000) plus Surcharge @15%		65,55,000
(C)	Excess tax payable (A) – (B)		5,88,750

(D)	Marginal Relief (Rs. 5,88,750 – Rs. 50,000, being the amount of income in excess of Rs. 2,00,00,000)		5,38,750
(E)	Tax Liability (A) – (D)		66,05,000
	Add; Health and Education cess @4%		2,64,200
	Tax liability (including cess)		Rs. 68,69,200

Question 32.

The assessee is found to be the owner of the gold (market value of which is Rs. 50,00,000) during the financial year ending 31-03-2024 but he recorded to have spent Rs. 10,00,000 in acquiring the same. Explain how the Assessing Officer will deal with the issue.

Ans.

As per section 69B, if the assessee is found to be the owner of gold (market value of which is Rs. 50 lakhs) during the financial year ending 31.3.2024 but he has recorded to have spent only Rs. 10 lakhs in acquiring it, the Assessing Officer can add the difference of the market value of such gold and Rs. 10 lakhs i.e., Rs. 40 lakhs as the income of the assessee for A.Y.2024-25, if the assessee offers no satisfactory explanation thereof. Such income would be chargeable to tax@78% (@60% plus surcharge @25% and cess @4%).

Question 33.

Mr. X a resident, aged 56 years, till recently was a successful businessman filing his return of incomes regularly and promptly ever since he obtained PAN card. During the COVID- Pandemic period his business suffered severely and he incurred huge losses. He was not able to continue his business and finally on 1st January, 2022 he decided to wind-up his business which he also promptly intimated to the jurisdictional Assessing Officer about the closure of his business.

The AO sent him a notice to tax income of A.Y. 2022-23 during the A.Y. 2021-22 itself. Does the Assessing Officer have the power to do so? Are there any exceptions to the general rule “Income of the previous year is assessed in the assessment year following the previous year”?

Ans.

Yes, he has the power to do so. Since the business of Mr. X is discontinued on 1st January, 2022, the income of the period from 1.4.2021 to 1.1.2022 may, at the discretion of the Assessing Officer, be charged to tax in A.Y.2021-22 itself.

Following are the other exceptions to the general rule “Income of the previous year is assessed in the assessment year following the previous year” i.e., the income of the previous year is assessed in the previous year itself.

- Shipping business of non-resident
- Persons leaving India with no present intention of returning
- AOP/BOI/Artificial Juridical Person formed for a particular event or purpose and likely to be dissolved
- Persons likely to transfer property to avoid tax.

MULTIPLE CHOICE BASED QUESTIONS:

1.	The rates of income-tax are mentioned in -											
	a) The Income tax Act, 1961 only	b) The First Schedule to the Annual Finance Act	c) Both Income-tax Act, 1961 & the First Schedule to the Annual Finance Act	d) Both Income-tax Act, 1961 and Income-tax Rules, 1962								
2.	For A.Y.2024-25, Mr. Hari, a resident Indian, earns income of Rs. 10 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in India and Rs. 15 lakhs from sale of rubber manufactured from latex obtained from rubber plants grown by him in Malaysia. What would be his business income chargeable to tax in India, assuming he has no other business?											
	a) Rs. 3,50,000	b) Rs. 4,00,000	c) Rs. 8,75,000	d) Rs. 18,50,000								
3.	Miss Nisha (45 years) is a non-resident individual. For the A.Y.2024-25, she has following income: Long-term capital gain on transfer of listed equity shares (STT has been paid on acquisition and transfer of the said shares) - Rs. 1,80,000 Other income - Rs. 2,75,000 Calculate the tax liability of Miss Nisha for A.Y. 2024-25 under default tax regime.											
	a) Nil	b) Rs. 9,620	c) Rs. 5,720	d) Rs. 8,320								
4.	The Gupta HUF in Maharashtra comprises of Mr. Harsh Gupta, his wife Mrs. Nidhi Gupta, his son Mr. Deepak Gupta, his daughter-in-law Mrs. Deepti Gupta, his daughter Miss Preeti Gupta and his unmarried brother Mr. Gautam Gupta. Which of the members of the HUF are eligible for coparcenary rights?											
	a) Only Mr. Harsh Gupta, Mr. Gautam Gupta and Mr. Deepak Gupta	b) Only Mr. Harsh Gupta, Mr. Gautam Gupta, Mr. Deepak Gupta and Miss Preeti Gupta	c) Only Mr. Harsh Gupta, Mr. Gautam Gupta, Mr. Deepak Gupta, Mrs. Nidhi Gupta and Mrs. Deepti Gupta	d) All the members are coparceners								
5.	Mr. Nekinsaan, aged 43 years, provides the following income details for P.Y. 2023-24 as follows:											
	<table border="1"> <thead> <tr> <th>Particulars</th> <th>Rs. In Lakhs</th> </tr> </thead> <tbody> <tr> <td>Capital Gains under Section 112A</td> <td>120</td> </tr> <tr> <td>Capital Gains under Section 111A</td> <td>110</td> </tr> <tr> <td>Other Income</td> <td>520</td> </tr> </tbody> </table>			Particulars	Rs. In Lakhs	Capital Gains under Section 112A	120	Capital Gains under Section 111A	110	Other Income	520	
Particulars	Rs. In Lakhs											
Capital Gains under Section 112A	120											
Capital Gains under Section 111A	110											
Other Income	520											
	What shall be the tax liability of Mr. Nekinsaan under optional tax regime as per normal provisions of the Income-tax Act, 1961 for A.Y. 2024-25?											
	a) Rs. 260.06 lakhs	b) Rs. 253.68 lakhs	c) Rs. 256.52 lakhs	d) Rs. 253.56 lakhs								
6.	Which of the following statements is/are true in respect of taxability of agricultural income under the Income-tax Act, 1961?											
	(i) Any income derived from saplings or seedlings grown in a nursery is agricultural income exempt from tax u/s 10(1).											
	(ii) 60% of dividend received from shares held in a tea company is agricultural income exempt from tax u/s 10(1).											

	<p>(iii) While computing income tax liability of an assessee aged 50 years, agricultural income is required to be added to total income only if net agricultural income for the P.Y. exceeds Rs. 5,000 and the total income (including net agricultural income) exceeds the basic exemption limit.</p> <p>(iv) While computing income tax liability of an assessee aged 50 years, agricultural income is required to be added to total income only if net agricultural income for the P.Y. exceeds Rs. 5,000 and the total income (excluding net agricultural income) exceeds the basic exemption limit.</p>			
	a) (i) and (iii)	b) (ii) and (iii)	c) (i) and (iv)	d) (i), (ii) and (iv)
7.	Which of the following is agriculture income?			
	a) Income from breeding of livestock	b) Income from fisheries	c) Income from juice centre	d) Income derived from saplings or seedlings grown in a nursey
8.	Mr. Raman, aged 64 years, was not able to provide satisfactory explanation to the Assessing Officer for the investments of Rs. 7 lakhs not recorded in the books of accounts. What shall be the tax payable by him on the value of such investments considered to be deemed income as per section 69?			
	a) Rs. 2,18,400	b) Rs. 55,000	c) Rs. 5,46,000	d) Rs. 54,600
9.	Income derived from farm building situated in the immediate vicinity of an agricultural land (not assessed to land revenue) would be treated as agricultural income if such land is situated in?			
	a) an area at a distance of 3 kms from the local limits of a municipality and has a population of 80,000 as per last census	b) an area within 1.5 kms from the local limits of a municipality and has a population of 12,000 as per last census	c) an area within 2 kms from the local limits of a municipality and has a population of 11,00,000 as per last census	d) an area within 8 kms from the local limits of a municipality and has a population of 10,50,000 as per last census
10.	Ms. Sowmya has three farm buildings situated in the immediate vicinity of a rural agricultural land. In the P.Y.2023-24, she earned Rs. 3 lakh from letting out her farm building 1 for storage of food grains, Rs. 10 lakh from letting out her farm building 2 for storage of dairy products and Rs. 15 lakh from letting out her farm building 3 for residential purposes of Mr. Sumanth, whose food grain produce is stored in farm building 1. What is the amount of agricultural income exempt from income-tax?			
	a) Nil	b) Rs. 3,00,000	c) Rs. 13,00,000	d) Rs. 18,00,000
11.	For A.Y.2024-25, Mr. Rajesh, a resident Indian, earns income of Rs.12 lakhs from sale of coffee grown and cured in India. His friend, Mr. Ganesh, a resident Indian, earns income of Rs. 25 lakhs from sale of coffee grown, cured, roasted and grounded by him in India. What would be the business income chargeable to tax in India of Mr. Rajesh and Mr. Ganesh?			
	a) Rs. 3,00,000 and Rs. 6,25,000, respectively	b) Rs. 3,00,000 and Rs. 10,00,000, respectively	c) Rs. 4,80,000 and Rs. 10,00,000, respectively	d) Rs. 9,00,000 and Rs. 15,00,000, respectively
12.	Mr. Ashutosh, aged 65 years and a resident in India, has a total income of Rs. 3,20,00,000, comprising long term capital gain taxable under section 112 of Rs. 57,00,000, long term capital gain taxable under section 112A of Rs. 65,00,000 and other income of Rs. 1,98,00,000. What would be his tax liability for A.Y. 2024-25 under default tax regime.			

	a) Rs. 88,74,320	b) Rs. 89,19,170	c) Rs. 96,46,000	d) Rs. 94,60,880
13.	<p>Mr. Ajay is a recently qualified doctor. He joined a reputed hospital in Delhi on 01.01.2024. He earned total income of Rs. 3,40,000 till 31.03.2024. His employer advised him to claim rebate u/s 87A while filing return of income for A.Y. 2024-25. He approached his father, a tax professional, to enquire regarding what is rebate u/s 87A of the Act. What would have his father told him?</p> <p>a. An individual who is resident in India and whose total income does not exceed Rs. 5,00,000 is entitled to claim rebate under section 87A.</p> <p>b. An individual who is resident in India and whose total income does not exceed Rs. 3,50,000 is entitled to claim rebate under section 87A.</p> <p>c. Maximum rebate allowable under section 87A is Rs. 5,000.</p> <p>d. Rebate under section 87A is available in the form of exemption from total income.</p> <p>e. Maximum rebate allowable under section 87A is Rs. 12,500.</p> <p>f. Rebate under section 87A is available in the form of deduction from basic tax liability.</p> <p>Choose the correct option from the following:</p>			
	a) (b), (c) and (f)	b) (a), (e) and (f)	c) (b), (c) and (d)	d) (a), (d) and (e)
14.	<p>The tax liability of Mr. Saral, a resident, who attained the age of 60 years on 01.04.2024 and does not opt for the provisions of section 115BAC for the P.Y. 2023-24, on the total income of Rs. 5,60,000, comprising of salary income and interest on fixed deposits would be -</p>			
	a) Rs. 9,880	b) Rs. 22,880	c) Rs. 25,480	d) Nil
15.	<p>The tax liability of Nirlep Co-operative Society (does not opt to pay tax under section 115BAD) on the total income of Rs. 90,000 for P.Y. 2023-24 is -</p>			
	a) Rs. 24,000	b) Rs. 28,080	c) Nil	d) Rs. 24,960
16.	<p>What is the amount of marginal relief available to Sadvichar Ltd., a domestic company, on the total income of Rs. 10,03,50,000 for P.Y. 2023-24 (comprising only of business income) whose turnover in P.Y. 2021-22 is Rs. 450 crore, paying tax as per regular provisions of Income-tax Act? Assume that the company does not exercise option under section 115BAA.</p>			
	a) Rs. 9,98,000	b) Rs. 12,67,600	c) Rs. 3,50,000	d) 13,32,304
17.	<p>The tax payable by Dharma LLP on total income of Rs. 1,01,00,000 for P.Y. 2023-24 is -</p>			
	a) Rs. 35,29,340	b) Rs. 32,24,000	c) Rs. 33,21,500	d) Rs. 31,51,200
18.	<p>Mr. Mahesh is found to be the owner of two gold chains of 50 gms each (value of which is Rs. 1,45,000 each) during the financial year ending 31.3.2024 which are not recorded in his books of account and he could not offer satisfactory explanation for the amount spent on acquiring these gold chains. As per section 115BBE, Mr. Mahesh would be liable to pay tax of -</p>			
	a) Rs. 1,80,960	b) Rs. 2,26,200	c) Rs. 90,480	d) Rs. 1,29,958
19.	<p>Mr. Suhaan (aged 35 years), a non-resident, earned dividend income of Rs. 12,50,000 from an Indian company which was declared on 30.09.2023 and credited directly to his bank account on 05.10.2023 in France and Rs. 15,000 as interest in saving A/c from State Bank of India for the previous year 2023-24. Assuming that he has no other income, what will be amount of income chargeable to tax in his hands in India for A.Y. 2024-25?</p>			
	a) Rs. 2,55,000	b) Rs. 12,65,000	c) Rs. 12,50,000	d) Rs. 12,55,000
20.	<p>For an assessee, who is a salaried employee who invests in equity shares, what is the benefit available in respect of securities transaction tax paid by him on sale and acquisition of 100 listed shares of X Ltd. which has been held by him for 14 months before sale?</p>			

	a) Rebate under section 88E is allowable in respect of securities transaction tax paid	b) Securities transaction tax paid is treated as expenses of transfer and deducted from sale consideration.	c) Capital gains without deducting STT paid is taxable at a concessional rate of 10% on such capital gains exceeding Rs. 1 lakh	d) Capital gains without deducting STT paid is taxable at concessional rate of 15%.					
21.	If Mr. Y's total income for A.Y. 2024-25 is Rs. 52 Lakhs, surcharge is payable at the rate of –								
	a) 15%	b) 12%	c) 10%	d) 2%					
22.	Unexhausted basic exemption limit of a resident individual can be adjusted against –								
	a) Only LTCG taxable @20% u/s 112	b) Only STCG taxable @15% u/s 111A	c) Both (a) and (b)	d) Casual income taxable @30% u/s 115BB					
23.	Unexhausted basic exemption limit of a non-resident individual can be adjusted against –								
	a) Only LTCG taxable @20% u/s 112	b) Only STCG taxable @15% u/s 111A	c) Both (a) and (b)	d) Neither (a) nor (b)					
24.	Ms. Rimjhim (aged 32 years), an interior decorator, has professional receipts of Rs. 25,60,000 for the previous year 2023-24.								
	She also earned Rs. 1,25,000 as dividend and Rs. 4,65,000 as interest income on fixed deposits. She incurred expenses of Rs. 13,00,000 for her profession and Rs. 30,000 as interest on loan for making investment in shares on which she received dividend. What would be her total income for the A.Y. 2024-25, assuming that she wishes to make maximum tax savings without getting her books of account audited?								
	a) Rs. 18,45,000	b) Rs. 18,70,000	c) Rs. 18,40,000	d) Rs. 18,25,000					
25.	Miss Nisha (68 years) is a resident individual. For the A.Y. 2024-25, she has following income:								
	Long-term capital gain on transfer of equity shares - Rs. 1,80,000								
	(Securities Transaction Tax has been paid on acquisition and transfer of the said shares)								
	Other income - Rs. 2,75,000								
	Calculate the tax liability of Miss Nisha for Assessment Year 2024-25.								
	a) Nil	b) Rs. 5,670	c) Rs. 5,720	d) Rs. 8,320					
ANSWERS:									
1.	(c)	2.	(d)	3.	(d)	4.	(b)	5.	(d)
6.	(c)	7.	(d)	8.	(c)	9.	(a)	10.	(b)
11.	(b)	12.	(a)	13.	(b)	14.	(b)	15.	(d)
16.	(b)	17.	(b)	18.	(b)	19.	(d)	20.	(c)
21.	(c)	22.	(c)	23.	(d)	24.	(a)	25.	(c)