IPCC – May 2018

PAPER 6 : AUDITING AND ASSURANCE

Test Code:
Branch (MULTIPLE) Date :

(100 Marks)

Note: ***Question No.1 is compulsory. Candidates are required to answer any five questions from the remaining six questions.***

Question 1

a. **Identification of significant related party transaction outside business:** As per SA 550 on "Related Parties", for identified significant related party transactions outside the entity's normal course of business, the auditor shall:

   a. Inspect the underlying contracts or agreements, if any, and evaluate whether: **(4 marks)**

      i. The business rationale (or lack thereof) the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;

      ii. The terms of the transactions are consistent with management's explanations; and

      iii. The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and

   b. Obtain audit evidence that the transactions have been appropriately authorized and approved.**(1 mark)**

b. **Audit Sampling:** As per SA 530 on "Audit Sampling" the meaning of the term "Audit Sampling" is the application of audit procedures to less than 100% of items within a population of audit evidence such that all sampling units have a chance of selection in order to provide the auditors with a reasonable basis on which to draw conclusions about the entire population. **(2 marks)**

According to the said SA, requirements relating to sample design, sample size and selection of items for testing are explained below: **(3 marks)**

Sample design – When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.

Sample size – The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

Selection of items for testing – The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

c. **Relationship Between Statutory Auditor and Internal Auditor:** The function of an internal auditor is an integral part of the system of internal control. It is statutory requirement too as per section 138 of the Companies Act, 2013 where the Audit Committee of the company or the Board shall, in consultation with the internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit. However, it is obligatory for a statutory auditor to examine the scope and effectiveness of the work carried out by the internal auditor.**(2 marks)**

Though the roles and primary objectives of internal and statutory audit differs, some of their means of achieving their respective objectives are similar. Thus, much of the work of the internal auditor may be useful to the statutory auditor in determining the nature, timing and extent of his audit procedures. Depending upon such evaluation, the statutory auditor may be able to adopt less extensive procedures. **(1 mark)**

If the statutory auditor is satisfied on an examination of the work of the internal auditor, that the internal audit has been efficient and effective, he may accept the checking/evaluation carried out by the internal auditor in the area of internal control, verification of assets and liabilities etc. **(1 mark)**

It must however be mentioned that the area of co-operation between the statutory and internal auditor is limited by the fact that both owe their allegiance to separate authorities, the shareholders in the case of statutory auditor and the management in the case of internal auditor. **(1 mark)**

d. **Audit Procedures in respect of Opening Balances for a New Audit Engagement:** As per SA 510 "Initial Audit Engagements – Opening Balances", the auditor should undertake the following procedures in respect of opening balances in case of new audit engagement:

(i) The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures. **(1 mark)**

(ii) The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by: **(3 marks)**

(a) Determining whether the prior period's closing balances have b een correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of
Profit and Loss;

(b) Determining whether the opening balances reflect the application of appropriate accounting policies; and

Performing one or more of the following:

(1) Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;

(2) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or

(3) Performing specific audit procedures to obtain evidence regarding the opening balances.

If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance. **(2 marks)**

Question 2 (2 marks each)

i) **Correct.** The scope of work of an internal auditor may extend even beyond the financial accounting and may include cost investigation, inquiries relating to losses and wastages, production audit, performance audit, etc.

ii) **Incorrect.** Companies Act, 2013 requires the company auditor to go beyond the functions of reporting and express an opinion about the propriety or prudence of certain transactions. Also, the auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Therefore it would not be correct to say that an auditor has nothing to do with prudence or profitability of a company because it may impact the going concern.

iii) **Correct.** A Chartered Accountant appointed as an auditor of a company, should ensure the independence in respect of his appointment. In this case, Mr. Pawan is a "Tax Consultant" and not a "Statutory Auditor" or "Tax Auditor" of ABC Ltd., hence he is not subject to the above requirements.

iv) **Incorrect:** Risk of material misstatement may be defined as the risk that the financial statements are materially misstated prior to audit.

v) **Incorrect.** Substantive procedure is an audit procedure designed to detect material misstatements at the assertion level. It comprise (i) tests of details (of classes of transactions, account balances, and disclosures), and (ii) substantive analytical procedures.

vi) **Correct .** In cluster sampling population is divided into group called cluster and a number of cluster is selected on random basis. In case of random sampling, each item is randomly chosen and so every item has an equal chance of being selected. Thus, cluster sampling is less effective.

vii) **Correct :** Error of duplication is another type of error of commission which means recording the same transaction twice. Therefore, this error will not affect the trial balance.

viii) **Incorrect.** As per the Standard on Auditing (SA) 520 "Analytical Procedure s" 'the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non -financial data.

ix) **Incorrect:** As per section 141(3) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company whose relative is a Director or is in the employment of the Company as a director or Key Managerial Personnel.

x) **Incorrect:** According to section 139(7) of the Companies Act, 2013, in the case of a Government company, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. If C&AG fails to make the appointment within 60 days, the Board shall appoint in next 30 days.

Question 3

i **Consignment Sale:** Where the number of consignments sent out in a year is large, usually a separate consignment Sales Day Book and Ledger are kept. In that case, the entries in the Day Book in respect of price of goods sent out and expenses incurred on their transport and insurance should be verified with copies of proforma invoices and other relevant documents; the sale price of goods sold and expenses incurred by the consignee should be verified from the Account Sales. **(2 marks)**

The balances in the Consignment Ledger, at the end of the year in such a case, would represent the cost of unsold goods, including a proportion of non-recurring expenses incurred on their transport and insurance. These balances should agree with those shown in the respective account sales received from the consignees**.(1 mark)**

If the goods sent out for sale on consignment have been charged at the invoice price, the difference between the cost and the invoice price would be credited to the Consignment Stock Adjustment Account. The appropriate part of the amount credited in this account attributable to the inventory remaining unsold at the year end, should be reversed so that credit can be taken for the net amount representing the difference for the part actually sold. **.(1 mark)**

ii **Customs and Excise Duties:** The audit procedures for custom duties are listed below- **(2 marks)**

- **Examine Cash Book:** Examine the payment of custom duties in the cash book with reference to bill of entry.
- **Examine the Bill of Entry:**
  - ✓ Check the amount of custom duty was calculated correctly, i.e., in accordance with the applicable rate for dutiable goods.
  - ✓ If the duty has been paid by dealing and forwarding agent, examine bill of entry with reference to agent's bill.

- ✓ If the duty has been paid by the client directly, examine bill of entry together with receipt evidencing payment of customs duty.

- **Examine Disputed Cases Carefully:** In case of a dispute about the amount of duty payable, a provisional payment may have been made. The auditor should determine the duty payable and ensure any additional duty to be paid or refund expected should have been adjusted.

- **Verify for Duty Drawback:** Duty drawback refers to a scheme under which central excise and customs duties paid for raw-materials and other inputs used in the manufacture of the product prior to its export are refunded to the exporter. The auditor should verify the claim of duty drawback with reference to acknowledgement issued by the Directorate of duty drawback.

- Excise duty becomes payable at the time of releasing of excisable goods from the factory/godown to the manufacturer. Normally, the excise duty payable is deposited with the designated bank to the credit of the controller of excise and one copy of the challan is forwarded to him for obtaining the permit and another copy is sent to the dispatch department evidencing payment of required duty. The auditor may adopt the following procedures to vouch the payment of excise duties:

(i) Verify payment of excise duties by examining the duly paid as per Challans with reference to the quantity of goods in respect of which issue permits have been received.

(ii) Test check the accuracy of the amount of duty paid by multiplying the rate of excise duty with the value of goods issued as per the client's inventory register.

(iii) In respect of excisable goods manufactured but remaining to be released, ensure that necessary provision for unpaid excise duty has been made.

(iv) Ensure that in every case CENVAT credit has been adjusted and only net excise duty has been paid.

(2 marks)

iii) **Retirement Gratuity to Employees.**

i Examine the basis on which the gratuity payable to employees is worked out. The liability for gratuity may either be worked out on actuarial rules or agreement or on the presumption that all employees retire on the balance sheet date. **(1 mark)**

Verify computation of liability of gratuity on the aggregate basis. **(1 mark)**

Check the amount of gratuity paid to employees who retired during the year with reference to number of years of service rendered by them. **(1 mark)**

See that the annual premium has been charged to the Statement of Profit and Loss. **(1/2 mark)**

Ensure that the accounting treatment is in accordance with AS 15 " Employee Benefits". **(1/2 mark)**

iv) Repairs to Assets: Since the line demarcating repairs from renewals is slender, usually it is not a simple matter to determine the amount of the expenditure, if any, included as charges for repairs, which should be considered as that incurred for renewal of an asset and added to its cost. **(1 mark)**

It may sometimes be possible to determine this on a consideration of the nature of repairs carried out. The proportion of the charges which had the effect of increasing the value of an asset or enhancing its capacity or life should be treated as capital expenditure. **(1 mark)**

Where, however, it is not possible to form an opinion accurately on the basis of evidence as regards the nature of repairs, a certificate from the engineer under whose supervision the repairs were carried out, confirming the classification of expenditure should be obtained. **(1 mark)**

It should be ensured that Repairs to ‘Certain Assets’ like Building and Machinery have been separately disclosed as per the requirements of Schedule III. **(1 mark)**

Question 4

a. **Difference between Narrative records and Check-list:**

(i) The Narrative Record is a complete and exhaustive description of the system as found in operation by the auditor whereas checklist is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. When he completes instruction, he initials the space against the instruction. Answers to the check list instructions are usually Yes, No or Not Applicable**(2 marks)**

(ii) The Narrative Record may be recommended in cases where no formal control system is in operation and would be more suited to small business whereas check list is an on the job requirement and instructions are framed having regard to the desirable elements of control. **(2 marks)**

b.

(i) Modification of Opinion: The auditor shall modify the opinion in the auditor’s report when-

The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. **(1 mark)**

(ii) Disclaimer of Opinion: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative ef fect on the financial statements. **(2 marks)**

(iii) Adverse Opinion: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements. **(1 mark)**

(iv) Qualified Opinion: The auditor shall express a qualified opinion when **-**

The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive. **(2 marks)**

c.

Significant matters to be recorded in Audit Note Book: Significant matters observed during the course of audit, a record of which should be kept in the Audit Note Book are as follows: Audit queries not cleared immediately e.g. missing receipts, vouchers, etc.

(i) The mistakes or irregularities observed during the course of audit e.g. cases of failure to comply with the requirements of the Companies Act, 2013 or the provisions contained in the Memorandum or articles, a chance in the basis of valuation of finished inventory and work-in-progress or in computation of depreciation; failure to provide adequate depreciation, etc.

(ii) Unsatisfactory book-keeping arrangements, costing method, internal or financial administration or organization.

(iii) Important information about the company which is not apparent from the accounts.

(iv) Special points requiring consideration at the time of verification of final accounts.

(v) Important matters for future reference.

(1 mark for each point)

Question 5

a. **Disclosure requirements of current investment:** In Schedule III Part I of the Companies Act, 2013, Current Investments are shown under the head Current Assets. Further, Schedule III requires that company shall disclose "Current Investments" in notes to accounts as follows-

(i) Current Investments shall be classified as**: (4 marks)**

(a) Investments in equity instruments;

(b) Investments in preference shares;

(c) Investments in government or trust securities;

(d) Investments in debentures or bonds;

(e) Investment in mutual funds;

(f) Investments in partnership firms;

(g) Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate (indicating separately whether bodies are subsidiaries, associates, joint ventures or controlled special purpose entities) in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly paid). In regards to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

(ii) The following shall also be disclosed:

(a) The basis of valuation of individual investments.

(b) Aggregate amount of quoted investments and market value thereof.

(c) Aggregate amount of unquoted investments.

(d) Aggregate provision made for diminution in value of investments.

(2 marks)

b. Joint Auditors: When one of the joint auditors of the previous years is considered for ratification by the members as the sole auditor for the next year, it is similar to nonre - appointment of one of the retiring joint auditors. As per sub-section 4 of section 140 of the Companies Act, 2013, special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be reappointed, except where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139 of the said Act. **(2 marks)**

Accordingly, provisions of the Companies Act, 2013 to be complied with are as under – **(4 marks)**

a. Ascertain that special notice u/s 140(4) of the Companies Act, 2013 was received by the company from such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not less than five lakh rupees has been paid up on the date of the notice not earlier than 3 months but at least 14 days before the AGM date as per Section 115 of the Companies Act, 2013 read with the Companies (Management and Administration) Rules, 2014.
b. Check whether the said notice has been sent to all the members at least 7 days before the date of the AGM as per Section 115 of the Companies Act, 2013 read with the Companies (Management and Administration) Rules, 201 4.
c. Verify the notice contains an express intention of a member for proposing the resolution for appointing a sole auditor in place of both the joint auditors who retire at the meeting but are eligible for re-appointment.
d. The notice is also sent to the retiring auditor as per Section 140(4)(ii) of the Companies Act, 2013.
e. Verify whether any representation, received from the retiring auditor was sent to the members of the company to whom notice of the meeting was sent.
f. Verify from the minutes book whether the representation received from the retiring joint auditor was considered at the AGM.

c. Role of C&AG in the Audit of a Government company: Role of C&AG is prescribed under sub-section (5), (6) and (7) of section 143 of the Companies Act, 2013.

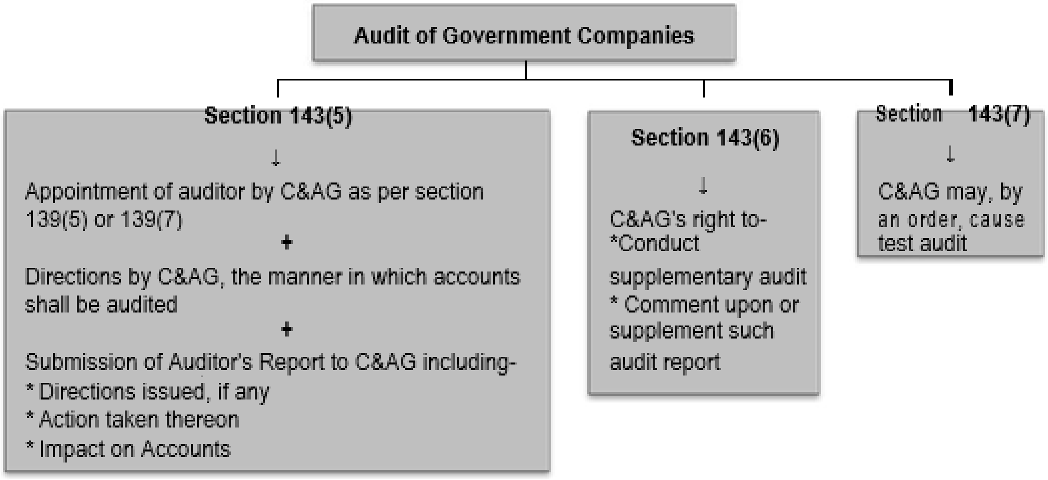
In the case of a Government company, the comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub- section (7) of section 139 i.e. appointment of First Auditor or Subsequent Auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor- General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company. **(1 mark)**

The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to,

(i) **conduct a supplementary audit** of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and **(1 mark)**

(ii) **comment upon or supplement such audit report:** It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report. **(1 mark)**

Test Audit: Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub -section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor -General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit. **(1 mark)**



Question 6

a. Different Design and Procedural Aspects of a Computerised Information System (CIS):

The development of Computerised Information Systems (CIS) will generally result in design and procedural characteristics that are different from those found in manual systems. These different design and procedural aspects of CIS are-

(i) Consistency of Performance: Computerised Information Systems (CIS) perform functions exactly as programmed and are potentially more reliable than manual systems, provided that all transaction type and conditions that could occur are anticipated and incorporated into the system. **(1 mark)**

(ii) Programmed Control Procedures: The nature of computer processing allows the design of internal control procedures in computer programs. These procedures can be designed to provide controls with limited visibility (e.g., protection of data against unauthorized access may be provided by passwords). Other procedures can be designed for use with manual intervention, such as review of reports printed for exception and error reporting, and reasonableness and limit checks of data. **(1 mark)**

(iii) Single Transaction Update of Multiple or Data Base Computer Files: A single input to the accounting system may automatically update all records associated with the transaction (e.g., shipment of goods documents may update the sales and customers' accounts receivable files as well as the inventory file). Thus, anerroneous entry in such a system may create errors in various financial accounts. **(1 mark)**

(iv) **Systems Generated Transactions:** Certain transactions may be initiated by the Computerised Information System (CIS) itself without the need for an input document.
The authorisation of such transactions may neither be supported by visible input documentation nor documented in the same way as transactions which are initiated outside the CIS (e.g., interest may be calculated and charged automatically to customers' account balances on the basis of -authorizedpre terms contained in a computer program). **(1/2 mark)**

(v) Vulnerability of Data and Programme Storage Media: Large volumes of data and the computer programs used to process such data may be stored on portable or fixed storage media, such as magnetic discs and tapes. These media are vulnerable to theft, or international or accidental destruction. **(1/2 mark)**

b. Audit of Hospital: (1 /2 mark each point)

The audit points to be considered by the auditor during the audit of a Hospital are stated below -

(i) **Income from Services:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.

(ii) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.

(iii) **Income from Investments:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities settled on the hospital, has been collected.

(iv) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.

(v) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).

(vi) **Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.

(vii) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.

(viii) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee significant variations which have taken place.

(ix) **Internal Check:** Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.

(x) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.

(xi) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.

(xii) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.

(xiii) **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

c. **Purchase of Goods on Credit by the Auditor:** Section 141(3)(d)(ii) of the Companies Act, 2013 specifies that a person shall be disqualified to act as an auditor if he is indebted to the company for an amount exceeding five lakh rupees. **(2 marks)**

Where an auditor purchases goods or services from a company audited by him on credit, he is definitely indebted to the company and if the amount outstanding exceeds rupees five lakh, he is disqualified for appointment as an auditor of the company. **(2 marks)**

It will not make any difference if the company allows him the same period of credit as it allows to other customers on the normal terms and conditions of the business. The auditor cannot argue that he is enjoying only the normal credit period allowed to other customers. In fact, in such a case he has become indebted to the company and consequently he has deemed to have vacated his office. **(2 marks)**

Question 7

a.

Applicability of CARO, 2016: It shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013 except–

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined under the Insurance Act,1938 (4 of 1938);

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act and a small company as defined under clause (85) of section 2 of the Companies Act; and

(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

(1 mark for each point, last point 2 marks)

b.

Issue of Sweat Equity Shares: As per section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares".

"Sweat Equity Shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called. **(1 mark)**

The auditor may see that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions are fulfilled -

(i) The issue is authorized by a special resolution passed by the company; **(1 mark)**

(ii) The resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued; **(1 mark)**

(iii) Not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and**(1 mark)**

(iv) Where the equity shares of the company are listed on a recognized sto ck exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed. **(1 mark)**

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *paripassu* with other equity shareholders. **(1 mark)**

c. **Weaknesses in the Internal Control System:** Following two essential features of internal control are relevant here-

a) Breaking the chain of the work in a manner so that no single person can handle a transaction from the beginning to the end, and

b) Segregation of accounting and custodial functions. **(2 marks)**

Weakness in internal control system in the instant case-

(a) The accountant is receiving cash and also passing the entries in the books. The accountant should not have been allowed to effect recoveries.

(b) It also appears that system for issuing receipts for amount received-whether cash or cheque is also lacking.

(c) In a small and to some extent medium size organization, the supervision of the owner offsets the deficiencies in internal control system. But in this case, it appears, that supervision and personal control is also lacking.

Thus, in the given case, the main aknesswe of the system is that it is ignoring the basic requirements of a good internal control system. **(2 marks)**

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