PAPER –1: FINANCIAL REPORTING

QUESTIONS

Ind AS 2

1. The following is relevant information for an entity :
   - Full capacity is 10,000 labour hours in a year.
   - Normal capacity is 7,500 labour hours in a year.
   - Actual labour hours for current period are 6,500 hours.
   - Total fixed production overhead is ₹ 1,500.
   - Total variable production overhead is ₹ 2,600.
   - Total opening inventory is 2,500 units.
   - Total units produced in a year are 6,500 units.
   - Total units sold in a year are 6,700 units.
   - The cost of inventories is assigned by using FIFO cost formula.

   How overhead costs are to be allocated to cost of goods sold and closing inventory?

Ind AS 7

2. Entity A acquired a subsidiary, Entity B, during the year. Summarised information from the Consolidated Statement of Profit and Loss and Balance Sheet is provided, together with some supplementary information.

Consolidated Statement of Profit and Loss	Amount (₹)
Revenue	3,80,000
Cost of sales	(2,20,000)
Gross profit	1,60,000
Depreciation	(30,000)
Other operating expenses	(56,000)
Interest cost	(4,000)
Profit before taxation	**70,000**
Taxation	(15,000)
Profit after taxation	**55,000**

© The Institute of Chartered Accountants of India

Consolidated balance sheet	20X2	20X1
Assets	**Amount (₹)**	**Amount (₹)**
Cash and cash equivalents	8,000	5,000
Trade receivables	54,000	50,000
Inventories	30,000	35,000
Property, plant and equipment	1,60,000	80,000
Goodwill	18,000	—
Total assets	**2,70,000**	**1,70,000**
Liabilities		
Trade payables	68,000	60,000
Income tax payable	12,000	11,000
Long term debt	1,00,000	64,000
Total liabilities	**1,80,000**	**1,35,000**
Shareholders' equity	**90,000**	**35,000**
Total liabilities and shareholders'	**2,70,000**	**1,70,000**

Other information

All of the shares of entity B were acquired for ₹ 74,000 in cash. The fair values of assets acquired and liabilities assumed were:

Particulars	Amount (₹)
Inventories	4,000
Trade receivables	8,000
Cash	2,000
Property, plant and equipment	1,10,000
Trade payables	(32,000)
Long term debt	(36,000)
Goodwill	18,000
Cash consideration paid	**74,000**

Prepare the Consolidated Statement of Cash Flows for the year 20X2, as per Ind AS 7.

© The Institute of Chartered Accountants of India

Ind AS 10 and Ind AS 37

3. A company manufacturing and supplying process control equipment is entitled to duty draw back if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2 the company has exceeded the specified limit of turnover by the end of the reporting period. However, duty drawback can be claimed on filing of application within the stipulated time or on discretion of the Department if filing of application is late. The application for duty drawback is filed on April 20, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition. Duty drawback has been credited by the Department on June 28, 20X2 and financial statements have been approved by the Board of Directors of the company on July 26, 20X2. What would be the treatment of duty drawback credit as per the given information?

Ind AS 16

4. Company X performed a revaluation of all of its plant and machinery at the beginning of 20X1. The following information relates to one of the machinery:

	Amount ('000)
Gross carrying amount	₹ 200
Accumulated depreciation (straight-line method)	(₹ 80)
Net carrying amount	₹ 120
Fair value	₹ 150

The useful life of the machinery is 10 years and the company uses Straight line method of depreciation. The revaluation was performed at the end of 4 years.

How should the Company account for revaluation of plant and machinery and depreciation subsequent to revaluation? Support your answer with journal entries.

Ind AS 28

5. An entity P (parent) has two wholly-owned subsidiaries - X and Y, each of which has an ownership interest in an 'associate', entity Z. Subsidiary X is a venture capital organisation. Neither of the investments held in associate Z by subsidiaries X and Y is held for trading. Subsidiary X and Y account for their investment in associate Z at fair value through profit or loss in accordance with Ind AS 109 and using the equity method in accordance with Ind AS 28 respectively.

How should P account for the investment in associate Z in the following scenarios:

© The Institute of Chartered Accountants of India

Scenario 1: Where both investments in the associate result in significant influence on a stand-alone basis - Subsidiary X and Y ownership interest in associate Z is 25% and 20% respectively.

Scenario 2: When neither of the investments in the associate results in significant influence on a stand-alone basis, but do provide the parent with significant influence on a combined basis - Subsidiary X and Y ownership interest in associate Z is 10% each.

Scenario 3: When one of the investments in the associate results in significant influence on a stand-alone basis and the other investment in the associate does not result in significant influence on a stand-alone basis - Subsidiary X and Y ownership interest in associate Z is 30% and 10% respectively.

Assume there is significant influence if the entity has 20% or more voting rights.

Ind AS 37

6. Entity XYZ entered into a contract to supply 1000 television sets for ₹ 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ₹ 2.5 million. The penalty for non- performance of the contract is expected to be ₹ 0.25 million. Is the contract onerous and how much provision in this regard is required?

Ind AS 108

7. ABC Limited has 5 operating segments namely A, B, C, D and E. The profit/ loss of respective segments for the year ended March 31, 20X1 are as follows:

Segment	**Profit/(Loss) (₹ in crore)**
A	780
B	1,500
C	(2,300)
D	(4,500)
E	6,000
Total	**1,480**

Based on the quantitative thresholds, which of the above segments A to E would be considered as reportable segments for the year ending March 31, 20X1?

Ind AS 111

8. AB Limited and BC Limited establish a joint arrangement through a separate vehicle PQR, but the legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. Thus, both the parties have rights to the assets and obligations for the liabilities of PQR. As neither the contractual terms nor the other facts and circumstances indicate otherwise, it is concluded that the arrangement is a joint operation and not a joint venture.

© The Institute of Chartered Accountants of India

Both the parties own 50% each of the equity interest in PQR. However, the contractual terms of the joint arrangement state that AB Limited has the rights to all of Building No. 1 owned by PQR and the obligation to pay all of the debt owed by PQR to a lender XYZ. AB Limited and BC Limited have rights to all other assets in PQR, and obligations for all other liabilities of PQR in proportion of their equity interests (i.e. 50% each).

PQR's summarized balance sheet is as follows: (Rs. in crore)

	Amount
Building 1	240
Building 2	200
Cash	40
Total Assets	**480**
Equity	140
Debt owed to XYZ	240
Employee benefit plan obligation	100
Total Liabilities	**480**

How would AB Limited present its interest in PQR in its financial statements?

Ind AS 36

9. PQR Ltd. is the company which has performed well in the past but one of its major assets, an item of equipment, suffered a significant and unexpected deterioration in performance. Management expects to use the machine for a further four years after 31st March 20X6, but at a reduced level. The equipment will be scrapped after four years. The financial accountant for PQR Ltd. has produced a set of cash-flow projections for the equipment for the next four years, ranging from optimistic to pessimistic. CFO thought that the projections were too conservative, and he intended to use the highest figures each year. These were as follows:

	₹ '000
Year ended 31st March 20X7	276
Year ended 31st March 20X8	192
Year ended 31st March 20X9	120
Year ended 31st March 20Y0	114

The above cash inflows should be assumed to occur on the last day of each financial year. The pre-tax discount rate is 9%. The machine could have been sold at 31st March 20X6 for ₹ 6,00,000 and related selling expenses in this regard could have been ₹ 96,000. The machine had been re valued previously, and at 31st March 20X6 an amount of ₹ 36,000 was held in revaluation surplus in respect of the asset. The carrying value of the asset at

© The Institute of Chartered Accountants of India

31st March 20X6 was ₹ 660,000. The Indian government has indicated that it may compensate the company for any loss in value of the assets up to its recoverable amount.

Calculate impairment loss, if any and revised depreciation of asset. Also suggest how Impairment loss, if any would be set off and how compensation from government be accounted for?

Ind AS 32

10. XYZ issued ₹ 4,80,000 4% redeemable preference shares on 1st April 20X5 at par. Interest is paid annually in arrears, the first payment of interest amounting ₹ 19,200 was made on 31st March 20X6 and it is debited directly to retained earnings by accountant. The preference shares are redeemable for a cash amount of ₹ 7,20,000 on 31st March 20X8. The effective rate of interest on the redeemable preference shares is 18% per annum. The proceeds of the issue have been recorded within equity by accountant as this reflects the legal nature of the shares. Board of directors intends to issue new equity shares over the next two years to build up cash resources to redeem the preference shares.

    Mukesh, Accounts manager of XYZ has been told to review the accounting of aforesaid issue. CFO has asked from Mukesh the closing balance of preference shares at the year end. If you were Mukesh, then how much balance you would have shown to CFO on analysis of the stated issue. Prepare necessary adjusting journal entry in the books of account, if required.

Ind AS 38 / Ind AS 36

11. One of the senior engineers at XYZ has been working on a process to improve manufacturing efficiency and, consequently, reduce manufacturing costs. This is a major project and has the full support of XYZ's board of directors. The senior engineer believes that the cost reductions will exceed the project costs within twenty four months of their implementation. Regulatory testing and health and safety approval was obtained on 1 June 20X5. This removed uncertainties concerning the project, which was finally completed on 20 April 20X6. Costs of ₹ 18,00,000, incurred during the year till 31st March 20X6, have been recognized as an intangible asset. An offer of ₹ 7,80,000 for the new developed technology has been received by potential buyer but it has been rejected by XYZ. Utkarsh believes that the project will be a major success and has the potential to save the company ₹ 12,00,000 in perpetuity. Director of research at XYZ, Neha, who is a qualified electronic engineer, is seriously concerned about the long term prospects of the new process and she is of the opinion that competitors would have developed new technology at some time which would require to replace the new process within four years. She estimates that the present value of future cost savings will be ₹ 9,60,000 over this period. After that, she thinks that there is no certainty about its future. What would be the appropriate accounting treatment of aforesaid issue?

© The Institute of Chartered Accountants of India

Ind AS 19

12. On 1 April 20X1, the fair value of the assets of XYZ Ltd's defined benefit plan were valued at ₹ 20,40,000 and the present value of the defined obligation was ₹ 21,25,000. On 31st March,20X2 the plan received contributions from XYZ Ltd amounting to ₹ 4,25,000 and paid out benefits of ₹ 2,55,000. The current service cost for the financial year ending 31 March 20X2 is ₹ 5,10,000. An interest rate of 5% is to be applied to the plan assets and obligations. The fair value of the plan's assets at 31 March 20X2 was ₹ 23,80,000, and the present value of the defined benefit obligation was ₹ 27,20,000. Provide a reconciliation from the opening balance to the closing balance for Plan assets and Defined benefit obligation. Also show how much amount should be recognised in the statement of profit and loss, other comprehensive income and balance sheet?

Ind AS 20

13. Rainbow Limited is carrying out various projects for which the company has either received government financial assistance or is in the process of receiving the same. The company has received two grants of ₹ 1,00,000 each, relating to the following ongoing research and development projects:

    (i) The first grant relates to the "Clean river project" which involves research into the effect of various chemicals waste from the industrial area in Madhya Pradesh. However, no major steps have been completed by Rainbow limited to commence this research as at 31st march, 20X2.

    (ii) The second grant relates to the commercial development of a new equipment that can be used to manufacture eco-friendly substitutes for existing plastic products. Rainbow Limited is confident about the technical feasibility and financial viability of this new technology which will be available for sale in the market by April 20X3.

    In September 20X1, due to the floods near one of its factories, the entire production was lost and Rainbow Limited had to shut down the factory for a period of 3 months. The State Government announced a compensation package for all the manufacturing entities affected due to the floods. As per the scheme, Rainbow Limited is entitled to a compensation based on the average of previous three months' sales figure prior to the floods, for which the company is required to submit an application form on or before 30th June, 20X2 with necessary figures. The financial statements of Rainbow Limited are to be adopted on 31st May, 20X2, by which date the claim form would not have been filed with the State Government.

    Suggest the accounting treatment of, if any, for the two grants received and the flood-related compensation in the books of accounts of Rainbow Limited as on 31st March, 20X2.

© The Institute of Chartered Accountants of India

Ind AS 110

14. Gamma Limited, a parent company, is engaged in manufacturing and retail activities. The group holds investments in different entities as follows:

- Gamma Limited holds 100% Investment in G Limited and D Limited;
- G Limited and D Limited hold 60% and 40% in GD Limited respectively;
- Delta Limited is a 100% subsidiary of GD Limited

Firstly, Gamma Limited wants you to suggest whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements as per applicable Ind AS?

Secondly, if all other facts remain the same as above except that G Limited and D Limited are both owned by an Individual (say, Mr. X) instead of Gamma Limited, then explain whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements.

Ind AS 33

15. CAB Limited is in the process of preparation of the consolidated financial statements of the group for the year ending 31st March, 20X3 and the extract of the same is as follows:

Particulars	Attributable to CAB Limited	Non-controlling interest	Total (₹ in '000)
Profit for the year	39,000	3,000	42,000
Other Comprehensive Income	5,000	Nil	5,000
Total Comprehensive Income	44,000	3,000	47,000

The long-term finance of the company comprises of the following:

(i) 20,00,00,000 equity shares at the beginning of the year and the company has issued 5,00,00,000 shares on 1st July, 20X2 at full market value.

(ii) 8,00,00,000 irredeemable preference shares. These shares were in issue for the whole of the year ended 31st March, 20X3. The dividend on these preference shares is discretionary.

(iii) ₹ 18 crores of 6% convertible debentures issued on 1st April, 20X1 and repayable on 31st March, 20X5 at par. Interest is payable annually. As an alternative to repayment at par, the holder on maturity can elect to exchange their convertible debentures for 10 crores ordinary shares in the company. On 1st April, 20X1, the prevailing market interest rate for four-year convertible debentures which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of ₹ 1 payable in four years is 0.74 and the cumulative present value of ₹ 1 payable at the end of years one to four is 3.31.

© The Institute of Chartered Accountants of India

In the year ended 31st March, 20X3, CAB Limited declared an ordinary dividend of 0.10 paise per share and a dividend of 0.05 paise per share on the irredeemable preference shares.

Compute the following:

- the finance cost of convertible debentures and its closing balance as on 31st March, 20X3 to be presented in the consolidated financial statements.
- the basic and diluted earnings per share for the year ended 31st March, 20X3.

Assume that income tax is applicable to CAB Limited and its subsidiaries at 25%.

Ind AS 8

16. While preparing the financial statements for the year ended 31st March, 20X3, Alpha Limited has observed two issues in the previous year Ind AS financial statements (i.e. 31st March, 20X2) which are as follows:

    Issue 1:

    The company had presented certain material liabilities as non-current in its financial statements for periods as on 31st March, 20X2. While preparing annual financial statements for the year ended 31st March, 20X3, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31st March, 20X2).

    Issue 2:

    The company had charged off certain expenses as finance costs in the year ended 31st March, 20X2. While preparing annual financial statements for the year ended 31st March, 20X3, it was discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 20X2).

    What is your analysis and recommendation in respect of the issues noted with the previously presented set of financial statements for the year ended 31st March, 20X2?

Ind AS 21

17. On 1st April, 20X1, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. It incurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31st March, starting from 31st March, 20X2. The loan is repayable in FCY on 31st March, 20X7 at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

    - 1st April, 20X1 - FCY 1 = ₹ 2.50.

© The Institute of Chartered Accountants of India

- 31st March, 20X2 – FCY 1 = ₹ 2.75.
- Average rate for the year ended 31st Match, 20X2 – FCY 1 = ₹ 2.42. The functional currency of the group is Indian Rupee.

What would be the appropriate accounting treatment for the foreign currency loan in the books of Makers Ltd. for the FY 20X1-20X2? Calculate the initial measurement amount for the loan, finance cost for the year, closing balance and exchange gain / loss.

Ind AS 115

18. (a) Entity I sells a piece of machinery to the customer for ₹ 2 million, payable in 90 days. Entity I is aware at contract inception that the customer might not pay the full contract price. Entity I estimates that the customer will pay atleast ₹ 1.75 million, which is sufficient to cover entity I's cost of sales (₹ 1.5 million) and which entity I is willing to accept because it wants to grow its presence in this market. Entity I has granted similar price concessions in comparable contracts.

Entity I concludes that it is highly probable that it will collect ₹ 1.75 million, and such amount is not constrained under the variable consideration guidance.

What is the transaction price in this arrangement?

(b) On 1 January 20x8, entity J enters into a one-year contract with a customer to deliver water treatment chemicals. The contract stipulates that the price per container will be adjusted retroactively once the customer reaches certain sales volume, defined, as follows:

Price per container	Cumulative sales volume
₹ 100	1 - 1,000,000 containers
₹ 90	1,000,001 - 3,000,000 containers
₹ 85	3,000,001 containers and above

Volume is determined based on sales during the calendar year. There are no minimum purchase requirements. Entity J estimates that the total sales volume for the year will be 2.8 million containers, based on its experience with similar contracts and forecasted sales to the customer.

Entity J sells 700,000 containers to the customer during the first quarter ended 31 March 20X8 for a contract price of ₹ 100 per container.

How should entity J determine the transaction price?

(c) Entity K sells electric razors to retailers for C 50 per unit. A rebate coupon is included inside the electric razor package that can be redeemed by the end consumers for C 10 per unit.

© The Institute of Chartered Accountants of India

Entity K estimates that 20% to 25% of eligible rebates will be redeemed, based on its experience with similar programmes and rebate redemption rates available in the market for similar programmes. Entity K concludes that the transaction price should incorporate an assumption of 25% rebate redemption, as this is the amount for which it is highly probable that a significant reversal of cumulative revenue will not occur if estimates of the rebates change.

How should entity K determine the transaction price?

(d) A manufacturer enters into a contract to sell goods to a retailer for ₹ 1,000. The manufacturer also offers price protection, whereby it will reimburse the retailer for any difference between the sale price and the lowest price offered to any customer during the following six months. This clause is consistent with other price protection clauses offered in the past, and the manufacturer believes that it has experience which is predictive for this contract.

Management expects that it will offer a price decrease of 5% during the price protection period. Management concludes that it is highly probable that a significant reversal of cumulative revenue will not occur if estimates change.

How should the manufacturer determine the transaction price?

Ind AS 102

19. An entity which follows its financial year as per the calendar year grants 1,000 share appreciation rights (SARs) to each of its 40 management employees as on 1st January 20X5. The SARs provide the employees with the right to receive (at the date when the rights are exercised) cash equal to the appreciation in the entity's share price since the grant date. All of the rights vest on 31st December 20X6; and they can be exercised during 20X7 and 20X8. Management estimates that, at grant date, the fair value of each SAR is ₹ 11; and it estimates that overall 10% of the employees will leave during the two-year period. The fair values of the SARs at each year end are shown below:

Year	Fair value at year end
31 December 20X5	12
31 December 20X6	8
31 December 20X7	13
31 December 20X8	12

10% of employees left before the end of 20X6. On 31st December 20X7 (when the intrinsic value of each SAR was ₹ 10), six employees exercised their options; and the remaining 30 employees exercised their options at the end of 20X8 (when the intrinsic value of each SAR was equal to the fair value of ₹ 12).

How much expense and liability is to be recognized at the end of each year? Pass Journal entries.

© The Institute of Chartered Accountants of India

Ind AS 101

20. On April 1, 20X1, Sigma Ltd. issued 30,000 6% convertible debentures of face value of ₹ 100 per debenture at par. The debentures are redeemable at a premium of 10% on March 31, 20X5 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentures without conversion rights would have been 10%. The date of transition to Ind AS is April 1, 20X3.

    Suggest how should Sigma Ltd. account for this compound financial instrument on the date of transition.

    The present value of Re. 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

End of year	6%	10%
1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

SUGGESTED ANSWERS/HINTS

1. **Hours taken to produce 1 unit** = 6,500 hours / 6,500 units = 1 hour per unit.

    Fixed production overhead absorption rate:

    = Fixed production overhead / labour hours for normal capacity

    = ₹ 1,500 / 7,500

    = ₹ 0.2 per hour

    Management should allocate fixed overhead costs to units produced at a rate of ₹ 0.2 per hour.

    Therefore, fixed production overhead allocated to 6,500 units produced during the year (one unit per hour) = 6,500 units x1 hour x ₹ 0.2 = ₹ 1,300.

    The remaining fixed overhead incurred during the year of ₹ 200 (₹ 1500 – ₹ 1300) that remains unallocated is recognised as an expense.

    The amount of fixed overhead allocated to inventory is not increased as a result of low production by using normal capacity to allocate fixed overhead.

    Variable production overhead absorption rate:

    = Variable production overhead/actual hours for current period

    = ₹ 2,600 / 6,500 hours = ₹ 0.4 per hour

© The Institute of Chartered Accountants of India

Management should allocate variable overhead costs to units produced at a rate of ₹ 0.4 per hour.

The above rate results in the allocation of all variable overheads to units produced during the year.

Closing inventory = Opening inventory + Units produced during year – Units sold during year

= 2,500 + 6,500 – 6,700 = 2,300 units

As each unit has taken one hour to produce (6,500 hours / 6,500 units produced), total fixed and variable production overhead recognised as part of cost of inventory:

= Number of units of closing inventory x Number of hours to produce each unit x (Fixed production overhead absorption rate + Variable production overhead absorption rate)
= 2,300 units x 1 hour x (₹ 0.2 + ₹ 0.4) = **₹ 1,380**

The remaining ₹ 2,720 [(₹ 1,500 + ₹ 2,600) – ₹ 1,380] is recognised as an expense in the income statement as follows:

	₹
Absorbed in cost of goods sold (FIFO basis) (6,500 – 2,300) = 4,200 x ₹ 0.6	2,520
Unabsorbed fixed overheads, not included in the cost of goods sold	200
Total	**2,720**

2. This information will be incorporated into the Consolidated Statement of Cash Flows as follows:

Statement of Cash Flows for the year ended 20X2 (extract)

	Amount (₹)	**Amount (₹)**
Cash flows from operating activities		
Profit before taxation	70,000	
Adjustments for non-cash items:		
Depreciation	30,000	
Decrease in inventories (W.N. 1)	9,000	
Decrease in trade receivables (W.N. 2)	4,000	
Decrease in trade payables (W.N. 3)	(24,000)	
Interest paid to be included in financing activities	4,000	
Taxation (11,000 + 15,000 – 12,000)	(14,000)	
Net cash generated from operating activities		79,000

© The Institute of Chartered Accountants of India

Cash flows from investing activities		
Cash paid to acquire subsidiary (74,000 – 2,000)	(72,000)	
Net cash outflow from investing activities		(72,000)
Cash flows from financing activities		
Interest paid	(4,000)	
Net cash outflow from financing activities		(4,000)
Increase in cash and cash equivalents during the year		**3,000**
Cash and cash equivalents at the beginning of the year		**5,000**
Cash and cash equivalents at the end of the year		**8,000**

Working Notes:

1. **Calculation of change in inventory during the year**

	₹
Total inventories of the Group at the end of the year	30,000
Inventories acquired during the year from subsidiary	(4,000)
	26,000
Opening inventories	35,000
Decrease in inventories	9,000

2. **Calculation of change in Trade Receivables during the year**

	₹
Total trade receivables of the Group at the end of the year	54,000
Trade receivables acquired during the year from subsidiary	(8,000)
	46,000
Opening trade receivables	50,000
Decrease in trade receivables	4,000

3. **Calculation of change in Trade Payables during the year**

	₹
Trade payables at the end of the year	68,000
Trade payables of the subsidiary assumed during the year	(32,000)
	36,000
Opening trade payables	60,000
Decrease in trade payables	24,000

© The Institute of Chartered Accountants of India

3. In the instant case, the condition of exceeding the specified turnover was met at the end of the reporting period and the company was entitled for the duty drawback. However, the application for the same has been filed after the stipulated time. Therefore, credit of duty drawback was discretionary in the hands of the Department. Since the claim was to be accrued only after filing of application, its accrual will be considered in the year 20X2-20X3 only.

Accordingly, the duty drawback credit is a contingent asset as at the end of the reporting period 20X1-20X2, which will be realised when the Department credits the same.

As per para 35 of Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.

In accordance with the above, the duty drawback credit which was contingent asset for the F.Y. 20X1 -20X2 should be recognised as asset and related income should be recognized in the reporting period in which the change occurs. i.e., in the period in which realisation becomes virtually certain, i.e., F.Y. 20X2 - 20X3.

4. According to paragraph 35 of Ind AS 16, when an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

(a) The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses.

In such a situation, the revised carrying amount of the machinery will be as follows:

Gross carrying amount	₹ 250	[(200/120) x 150]
Net carrying amount	₹ 150	
Accumulated depreciation	₹ 100	(₹ 250 – ₹ 150)

Journal entry

Plant and Machinery (Gross Block)	Dr.	₹ 50	
To Accumulated Depreciation			₹ 20
To Revaluation Reserve			₹ 30

© The Institute of Chartered Accountants of India

Depreciation subsequent to revaluation

Since the Gross Block has been restated, the depreciation charge will be ₹ 25 per annum (₹ 250/10 years).

Journal entry

Accumulated Depreciation	Dr.	₹ 25 p.a.	
To Plant and Machinery (Gross Block)			₹ 25 p.a.

(b) The accumulated depreciation is eliminated against the gross carrying amount of the asset.

The amount of the adjustment of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with the paragraphs 39 and 40 of Ind AS 16.

In this case, the gross carrying amount is restated to ₹ 150 to reflect the fair value and accumulated depreciation is set at zero.

Journal entry

Accumulated Depreciation	Dr.	₹ 80	
To Plant and Machinery (Gross Block)			₹ 80
Plant and Machinery (Gross Block)	Dr.	₹ 30	
To Revaluation Reserve			₹ 30

Depreciation subsequent to revaluation

Since the revalued amount is the revised gross block, the useful life to be considered is the remaining useful life of the asset which results in the same depreciation charge of ₹ 25 per annum as per Option A (₹ 150 / 6 years).

Journal entry

Accumulated Depreciation	Dr.	₹ 25 p.a.	
To Plant and Machinery (Gross Block)			₹ 25 p.a.

5. Paragraph 18 of Ind AS 28 states that, "when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with Ind AS 109. An entity shall make this election separately for each associate or joint venture, at initial recognition of the associate or joint venture."

Paragraph 19 of Ind AS 28 provides that, "'when an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a

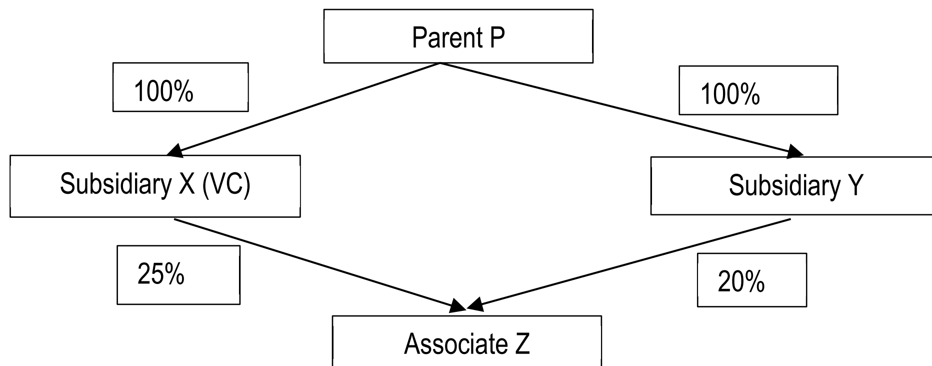
© The Institute of Chartered Accountants of India

mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity *may* elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with Ind AS 109 *regardless of whether the venture capital organisation has significant influence over that portion of the investment.*

If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation".

Therefore, fair value exemption can be applied partially in such cases.

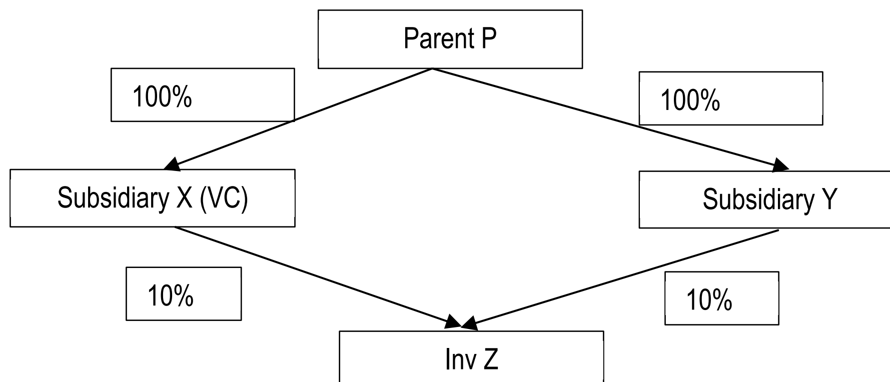
Scenario 1: Where both investments in the associate result in significant influence on a stand-alone basis.



In the present case, in accordance with paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 20% interest held by Y.

Under the partial use of fair value exemption, P may elect to measure the 25% interest held by X at fair value through profit or loss.

Scenario 2: When neither of the investments in the associate results in significant influence on a stand-alone basis, but do provide the parent with significant influence on a combined basis.

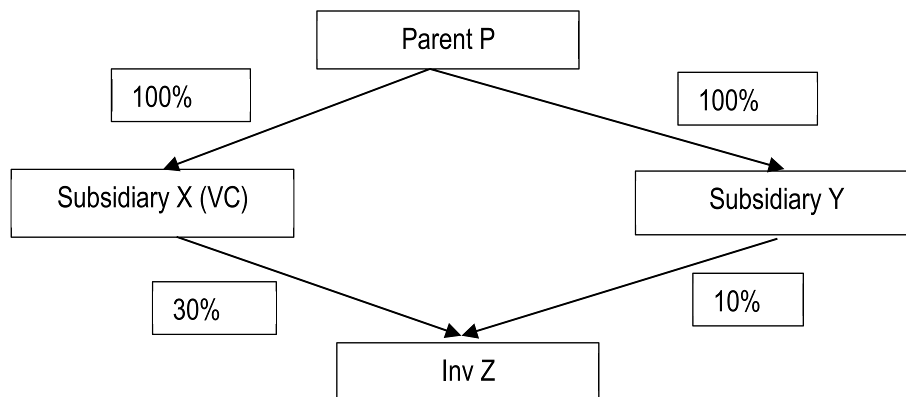


© The Institute of Chartered Accountants of India

In the present case in accordance with the paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 10% interest held by Y, even though Y would not have significant influence on a stand-alone basis.

Under the partial use of fair value exemption, P may elect to measure the 10% interest held by X at fair value through profit or loss.

Scenario 3: When one of the investments in the associate results in significant influence on a stand-alone basis and the other investment in the associate does not result in significant influence on a stand-alone basis



In the present case, in accordance with paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 10% interest held by Y, even though Y would not have significant influence on a stand-alone basis.

Under the partial use of fair value exemption, the P may elect to measure the 30% interest held by X at fair value through profit or loss.

6. Ind AS 37 *"Provisions, Contingent Liabilities and Contingent Assets"* defines an onerous contract as "a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it".

Paragraph 68 of Ind AS 37 states that "the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it".

In the instant case, cost of fulfilling the contract is ₹ 0.5 million (₹ 2.5 million – ₹ 2 million) and cost of exiting from the contract by paying penalty is ₹ 0.25 million.

In accordance with the above reproduced paragraph, it is an onerous contract as cost of meeting the contract exceeds the economic benefits.

Therefore, the provision should be recognised at the best estimate of the unavoidable cost, which is lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it, i.e., at ₹ 0.25 million (lower of ₹ 0.25 million and ₹ 0.5 million).

© The Institute of Chartered Accountants of India

7. With regard to quantitative thresholds to determine reportable segment relevant in context of instant case, paragraph 13(b) of Ind AS 108 may be noted which provides as follows:

"The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss."

In compliance with Ind AS 108, the segment profit/loss of respective segment will be compared with the greater of the following:

(i) All segments in profit, i.e., A, B and E – Total profit ₹ 8,280 crores.

(ii) All segments in loss, i.e., C and D – Total loss ₹ 6,800 crores.

Greater of the above – ₹ 8,280 crores.

Based on the above, reportable segments will be determined as follows:

Segment	Profit/(Loss) (₹ in crore)	As absolute % of ₹ 8,280 crore	Reportable segment
A	780	9%	No
B	1,500	18%	Yes
C	(2,300)	28%	Yes
D	(4,500)	54%	Yes
E	6,000	72%	Yes
Total	**1,480**		

Hence B, C, D, E are reportable segments.

8. Paragraph 20 of Ind AS 111 states that "a joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities incurred jointly;

(c) its revenue from the sale of its share of the output arising from the joint operation;

(d) its share of the revenue from the sale of the output by the joint operation; and

(e) its expenses, including its share of any expenses incurred jointly."

The rights and obligations, as specified in the contractual arrangement, that an entity has with respect to the assets, liabilities, revenue and expenses relating to a joint operation might differ from its ownership interest in the joint operation. Thus a joint operator needs to recognise its interest in the assets, liabilities, revenue and expenses of the joint

© The Institute of Chartered Accountants of India

operation on the basis (bases) specified in the contractual arrangement, rather than in proportion of its ownership interest in the joint operation.

Thus, AB Limited would record the following in its financial statements, to account for its rights to the assets of PQR and its obligations for the liabilities of PQR.

	Rs. in crore
Assets	
Cash	20
Building 1*	240
Building 2	100
Liabilities	
Debt owned to XYZ (third party)**	240
Employees benefit plan obligation	50

* Since AB Limited has the rights to all of Building No. 1, it records the amount in its entirety.

** AB Limited has obligation for the debt owed by PQR to XYZ in its entirety.

9. Carrying amount of asset on 31st March 20X6 = ₹ 6,60,000

Calculation of Value in Use:

Year ended	Cash flow ₹	Discount factor @ 9%	Amount ₹
31st March, 20X7	2,76,000	0.9174	2,53,202
31st March, 20X8	1,92,000	0.8417	1,61,606
31st March, 20X9	1,20,000	0.7722	92,664
31st March, 20Y0	1,14,000	0.7084	80,758
		Total (Value in Use)	**5,88,230**

Calculation of Recoverable amount:

Particulars	Amount (₹)
Value in use	5,88,230
Fair value less costs of disposal (6,00,000 – 96,000)	5,04,000
Recoverable amount (Higher of value in use and fair value less costs of disposal)	5,88,230

© The Institute of Chartered Accountants of India

Calculation of Impairment loss:

Particulars	Amount (₹)
Carrying amount	6,60,000
Less: Recoverable amount	(5,88,230)
Impairment loss	71,770

Calculation of Revised carrying amount:

Particulars	Amount (₹)
Carrying amount	6,60,000
Less: Impairment loss	(71,770)
Revised carrying amount	5,88,230

Calculation of Revised Depreciation:

Revised carrying amount – Residual value

Remaining life = (5,88,230 - 0) / 4 = ₹ 1,47,058 per annum

Set off of Impairment loss:

The impairment loss of ₹ 71,770 must first be set off against any revaluation surplus in relation to the same asset. Therefore, the revaluation surplus of ₹ 36,000 is eliminated against impairment loss, and the remainder of the impairment loss ₹ 35,770 (₹ 71,770 – ₹ 36,000) is charged to profit and loss.

Treatment of Government compensation:

Any compensation by government would be accounted for as such when it becomes receivable. At this time, the government has only stated that it may reimburse the company and therefore credit should not be taken for any potential government receipt.

10. The preference shares provide the holder with the right to receive a predetermined amount of annual dividend out of profits of the company, together with a fixed amount on redemption.

Whilst the legal form is equity, the shares are in substance debt. The fixed level of dividend is interest and the redemption amount is equivalent to the repayment of a loan.

Under Ind AS 32 'Financial Instruments: Presentation' these instruments should be classified as financial liabilities because there is a contractual obligation to deliver cash. The preference shares should be accounted for at amortised cost using the effective interest rate of 18%.

Year	1 April, 20X5 ₹	Interest @18% ₹	Paid at 4% ₹	31 March, 20X6 ₹
20X5-20X6	480,000	86,400	(19,200)	547,200

© The Institute of Chartered Accountants of India

Accordingly, the closing balance of Preference shares at year end i.e. 31st March, 20X6 would be ₹ 5,47,200.

Accountant has inadvertently debited interest of ₹ 19,200 in the profit and loss. However, the interest of ₹ 86,400 should have been debited to profit and loss as finance charge.

Similarly, amount of ₹ 5,47,200 should be included in borrowings (non-current liabilities) and consequently, Equity should be reduced by ₹ 480,000 proceeds of issue and ₹ 67,200 (86,400 – 19,200) i.e. total by 5,47,200.

Necessary adjusting journal entry to rectify the books of accounts will be:

		₹	₹
Preference share capital (equity) (Balance sheet)	Dr.	4,80,000	
Finance costs (Profit and loss)	Dr.	86,400	
To Equity – Retained earnings (Balance sheet)			19,200
To Preference shares (Long-term Borrowings) (Balance sheet)			5,47,200

11. Ind AS 38 'Intangible Assets' requires an intangible asset to be recognised if, and only if, certain criteria are met. Regulatory approval on 1 June 20X5 was the last criterion to be met, the other criteria have been met as follows:

- Intention to complete the asset is apparent as it is a major project with full support from board
- Finance is available as resources are focused on project
- Costs can be reliably measured
- Benefits are expected to exceed costs – (in 2 years)

Amount of ₹ 15,00,000 (₹ 18,00,000 x 10/12) should be capitalised in the Balance sheet of year ending 20X5-20X6 representing expenditure since 1 June 20X5.

The expenditure incurred prior to 1 June 20X5 which is ₹ 3,00,000 (2/12 x ₹ 18,00,000) should be recognised as an expense, retrospective recognition of expense as an asset is not allowed.

Ind AS 36 'Impairment of assets' requires an intangible asset not yet available for use to be tested for impairment annually.

Cash flow of ₹ 12,00,000 in perpetuity would clearly have a present value in excess of ₹ 12,00,000 and hence there would be no impairment. However, the research director is technically qualified, so impairment tests should be based on her estimate of a four-year remaining life and so present value of the future cost savings of ₹ 9,60,000 should be considered in that case.

© The Institute of Chartered Accountants of India

₹ 9,60,000 is greater than the offer received (fair value less costs to sell) of ₹ 7,80,000 and so ₹ 9,60,000 should be used as the recoverable amount.

So, the carrying amount should be consequently reduced to ₹ 9,60,000.

Calculation of Impairment loss:

Particulars	Amount ₹
Carrying amount (Restated)	15,00,000
Less: Recoverable amount	9,60,000
Impairment loss	5,40,000

Impairment loss of ₹ 5,40,000 is to be recognised in the profit and loss for the year 20X5-20X6.

Necessary adjusting entry to correct books of account will be:

		₹	₹
Operating expenses- Development expenditure	Dr.	3,00,000	
Operating expenses–Impairment loss of intangible assets	Dr.	5,40,000	
To Intangible assets – Development expenditure			8,40,000

12. Reconciliation of Plan assets and Defined benefit obligation

	Plan Assets ₹	Defined benefit obligation ₹
Fair value/present value as at 1st April 20X1	20,40,000	21,25,000
Interest @ 5%	1,02,000	1,06,250
Current service cost		5,10,000
Contributions received	4,25,000	-
Benefits paid	(2,55,000)	(2,55,000)
Return on gain (assets) (balancing figure)	68,000	-
Actuarial Loss (balancing figure)	-	2,33,750
Closing balance as at March 31,20X2	23,80,000	27,20,000

In the Statement of Profit and loss, the following will be recognised:

	₹
Current service cost	5,10,000
Net interest on net defined liability (₹ 1,06,250 – ₹ 1,02,000)	4,250

© The Institute of Chartered Accountants of India

Defined benefit re-measurements recognised in Other Comprehensive Income:

	₹
Loss on defined benefit obligation	(2,33,750)
Gain on plan assets	68,000
	(1,65,750)

In the Balance sheet, the following will be recognised :

	₹
Net defined liability (₹ 27,20,000 – ₹ 23,80,000)	3,40,000

13. Accounting treatment for:

1. First Grant

The first grant for 'Clear River Project' involving research into effects of various chemicals waste from the industrial area in Madhya Pradesh, seems to be unconditional as no details regarding its refund has been mentioned. Even though the research has not been started nor any major steps have been completed by Rainbow Limited to commence the research, yet the grant will be recognised immediately in profit or loss for the year ended 31st March, 20X2.

Alternatively, in case, the grant is conditional as to expenditure on research, the grant will be recognised in the books of Rainbow Limited over the year the expenditure is being incurred.

2. Second Grant

The second grant related to commercial development of a new equipment is a grant related to depreciable asset. As per the information given in the question, the equipment will be available for sale in the market from April, 20X3. Hence, by that time, grant relates to the construction of an asset and should be initially recognised as deferred income.

The deferred income should be recognised as income on a systematic and rational basis over the asset's useful life.

The entity should recognise a liability on the balance sheet for the years ending 31st March, 20X2 and 31st March, 20X3. Once the equipment starts being used in the manufacturing process, the deferred grant income of ₹ 100,000 should be recognised over the asset's useful life to compensate for depreciation costs.

Alternatively, as per Ind AS 20, Rainbow Limited would also be permitted to offset the deferred income of ₹ 100,000 against the cost of the equipment as on 1st April, 20X3.

© The Institute of Chartered Accountants of India

3. **For flood related compensation**

Rainbow Limited will be able to submit an application form only after 31st May, 20X2 ie in the year 20X2-20X3. Although flood happened in September, 20X1 and loss was incurred due to flood related to the year 20X1-20X2, the entity should recognise the income from the government grant in the year when the application form related to it is submitted and approved by the government for compensation.

Since, in the year 20X1-20X2, the application form could not be submitted due to adoption of financials with respect to sales figure before flood occurred, Rainbow Limited should not recognise the grant income as it has not become receivable as on 31st March,20X2.

14. As per paragraph 4(a) of Ind AS 110, an entity that is a parent shall present consolidated financial statements. This Ind AS applies to all entities, except as follows:

A parent need not present consolidated financial statements if it meets all the following conditions:

(i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

(ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(iv) its ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this Ind AS.

In accordance with the above, it may be noted that as per paragraph 4(a)(i) above, a parent need not present consolidated financial statements if it is a:

— wholly-owned subsidiary; or

— is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements.

Although GD Limited is a partly-owned subsidiary of G Limited, it is the wholly-owned subsidiary of Gamma Limited (and therefore satisfies the condition 4(a)(i) of Ind AS 110 without regard to the relationship with its immediate owners, i.e. G Limited and D Limited). Thus, GD Limited being the wholly owned subsidiary fulfils the conditions as mentioned

© The Institute of Chartered Accountants of India

under paragraph 4(a)(i) and is not required to inform its other owner D Limited of its intention not to prepare the consolidated financial statements.

Thus, in accordance with the above, GD Limited may take the exemption given under paragraph 4(a) of Ind AS 110 from presentation of consolidated financial statements.

In Alternative Scenario, where both G Limited and D Limited are owned by an individual Mr. X, then GD Limited is ultimately wholly in control of Mr. X (i.e., an individual) and hence it cannot be considered as a wholly owned subsidiary of an entity.

This is because Ind AS 110 makes use of the term 'entity' and the word 'entity' includes a company as well as any other form of entity. Since, Mr. X is an 'individual' and not an 'entity', therefore, GD Limited cannot be considered as wholly owned subsidiary of an entity.

Therefore, in the given case, GD Limited is a partially-owned subsidiary of another entity. Accordingly, in order to avail the exemption under paragraph 4(a), its other owner, D Limited should be informed about and do not object to GD Limited not presenting consolidated financial statements. Further, for the purpose of consolidation of G Limited and D Limited, GD Limited will be required to provide relevant financial information as per Ind AS.

15. Calculation of the liability and equity components on 6% Convertible debentures:

Present value of principal payable at the end of 4th year (₹ 1,80,000 thousand x 0.74)

= ₹ 1,33,200 thousand

Present value of interest payable annually for 4 years (₹ 1,80,000 thousand x 6% x 3.31)

= ₹ 35,748 thousand

Total liability component = ₹ 1,68,948 thousand

Therefore, equity component = ₹ 1,80,000 thousand – ₹ 1,68,948 thousand = ₹ 11,052 thousand

Calculation of finance cost and closing balance of 6% convertible debentures

Year	Opening balance ₹ in '000	Finance cost @ 8% ₹ in '000	Interest paid @ 6% ₹ in '000	Closing balance ₹ in '000
	a	b = a x 8%	c	d = a + b - c
31.3.20X2	1,68,948	13,515.84	10,800	1,71,663.84
31.3.20X3	1,71,663.84	13,733.11	10,800	1,74,596.95

Finance cost of convertible debentures for the year ended 31.3. 20X3 is ₹ **13,733.11 thousand** and closing balance as on 31.3. 20X3 is ₹ **1,74,596.95** thousand.

© The Institute of Chartered Accountants of India

Calculation of Basic EPS **₹ in '000**

Profit for the year	39,000
Less: Dividend on preference shares (80,000 thousand x ₹ 0.05)	(4,000)
Profit attributable to equity shareholders	35,000

Weighted average number of shares = 20,00,00,000 + {5,00,00,000 x (9/12)}

= 23,75,00,000 shares or 2,37,500 thousand shares

Basic EPS = ₹ 35,000 thousand / 2,37,500 thousand shares

= ₹ 0.147

Calculation of Diluted EPS **₹ in '000**

Profit for the year		39,000
Less: Dividend on preference shares (80,000 x 0.05)		(4,000)
		35,000
Add: Finance cost (as given in the above table)	13,733.11	
Less: Tax @ 25%	(3,433.28)	10,299.83
		45,299.83

Weighted average number of shares = 20,00,00,000 + {5,00,00,000 x (9/12)} + 10,00,00,000

= 33,75,00,000 shares or 3,37,500 thousand shares

Diluted EPS = ₹ 45,299.83 thousand / 3,37,500 thousand shares

= ₹ 0.134

16. As per paragraph 41 of Ind AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

Accordingly, the stated issues in question are to dealt as under:

Issue 1

In accordance with para 41, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial

© The Institute of Chartered Accountants of India

statements for the year ended March 31, 20X3, the comparative amounts as at 31 March 20X2 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements, if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period. Accordingly, the entity should present a third balance sheet as at the beginning of the preceding period, i.e., as at 1 April 20X1 in addition to the comparatives for the financial year 20X1-20X2.

Issue 2

In accordance with para 41, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31 March, 20X3, the comparative amounts for the year ended 31 March 20X2 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1 April 20X1). Therefore, the entity is not required to present a third balance sheet.

17. Initial carrying amount of loan in books

Loan amount received	=	60,00,000 FCY
Less: Incremental issue costs	=	2,00,000 FCY
		58,00,000 FCY

Ind AS 21, "The Effect of Changes in Foreign Exchange Rates" states that foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognized.

Loan to be converted in INR	=	58,00,000 FCY x ₹ 2.50/FCY
	=	₹ 1,45,00,000

Therefore, the loan would initially be recorded at ₹ 1,45,00,000.

© The Institute of Chartered Accountants of India

Calculation of amortized cost of loan (in FCY) at the year end:

Period	Opening Financial Liability (FCY) A	Interest @ 12% (FCY) B	Cash Flow (FCY) C	Closing Financial Liability (FCY) A+B-C
20X1-20X2	58,00,000	6,96,000	6,00,000	58,96,000

The finance cost in FCY is 6,96,000

The finance cost would be recorded at an average rate for the period since it accrues over a period of time.

Hence, the finance cost for FY 20X1-20X2 in INR is ₹ 16,84,320 (6,96,000 FCY x ₹ 2.42 / FCY)

The actual payment of interest would be recorded at 6,00,000 x 2.75 = INR 16,50,000

The loan balance is a monetary item so it is translated at the rate of exchange at the reporting date.

So the closing loan balance in INR is 58,96,000 FCY x INR 2.75 / FCY = ₹ 1,62,14,000

The exchange differences that are created by this treatment are recognized in profit and loss.

In this case, the exchange difference is

₹ [1,62,14,000 - (1,45,00,000 + 16,84,320 – 16,50,000)] = ₹ 16,79,680.

This exchange difference is taken to profit and loss.

18. (a) Entity I is likely to provide a price concession and accept an amount less than ₹ 2 million in exchange for the machinery. The consideration is therefore variable. The transaction price in this arrangement is ₹ 1.75 million, as this is the amount which entity I expects to receive after providing the concession and it is not constrained under the variable consideration guidance. Entity I can also conclude that the collectability threshold is met for ₹ 1.75 million and therefore contract exists.

(b) The transaction price is ₹ 90 per container based on entity J's estimate of total sales volume for the year, since the estimated cumulative sales volume of 2.8 million containers would result in a price per container of ₹ 90. Entity J concludes that based on a transaction price of ₹ 90 per container, it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty is resolved. Revenue is therefore recognised at a selling price of ₹ 90 per container as each container is sold. Entity J will recognise a liability for cash received in excess of the transaction price for the first 1 million containers sold at ₹ 100 per container (that is, ₹ 10 per container) until the cumulative sales volume is reached for the next pricing tier and the price is retroactively reduced.

© The Institute of Chartered Accountants of India

For the quarter ended 31st March, 20X8, entity J recognizes revenue of ₹ 63 million (700,000 containers x ₹ 90) and a liability of ₹ 7 million [700,000 containers x (₹ 100 - ₹ 90)].

Entity J will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.

(c) Entity K records sales to the retailer at a transaction price of ₹ 47.50 (₹ 50 less 25% of ₹ 10). The difference between the per unit cash selling price to the retailers and the transaction price is recorded as a liability for cash consideration expected to be paid to the end customer. Entity K will update its estimate of the rebate and the transaction price at each reporting date if estimates of redemption rates change.

(d) The transaction price is ₹ 950, because the expected reimbursement is ₹ 50. The expected payment to the retailer is reflected in the transaction price at contract inception, as that is the amount of consideration to which the manufacturer expects to be entitled after the price protection. The manufacturer will recognise a liability for the difference between the invoice price and the transaction price, as this represents the cash that it expects to refund to the retailer. The manufacturer will update its estimate of expected reimbursement at each reporting date until the uncertainty is resolved.

19. The amount recognized as an expense in each year and as a liability at each year end) is as follows:

Year	*Expense* ₹	*Liability* ₹	Calculation of Liability
31 December 20X5	2,16,000	2,16,000	= 36 x 1,000 x 12 x ½
31 December 20X6	72,000	2,88,000	= 36 x 1,000 x 8
31 December 20X7	1,62,000*	3,90,000	= 30 x 1,000 x 13
31 December 20X8	(30,000)**	0	Liability extinguished

* Expense comprises an increase in the liability of ₹ 102,000 and cash paid to those exercising their SARs of ₹ 60,000 (6 x 1,000 x 10).

** Difference of opening liability (₹ 3,90,000) and actual liability paid [₹ 3,60,000 (30 x 1,000 x 12)] is recognised to Profit and loss ie ₹ 30,000.

Journal Entries

31 December 20X5			
Employee benefits expenses	Dr.	2,16,000	
To Share based payment liability			2,16,000
(Fair value of the SAR recognized)			

© The Institute of Chartered Accountants of India

Particulars		Dr.	Cr.
31 December 20X6			
Employee benefits expenses	Dr.	72,000	
To Share based payment liability			72,000
(Fair value of the SAR re-measured)			
31 December 20X7			
Employee benefits expenses	Dr.	1,62,000	
To Share based payment liability			1,62,000
(Fair value of the SAR recognized)			
Share based payment liability	Dr.	60,000	
To Cash			60,000
(Settlement of SAR)			
31 December 20X8			
Share based payment liability	Dr.	30,000	
To Employee benefits expenses			30,000
(Fair value of the SAR recognized)			
Share based payment liability	Dr.	3,60,000	
To Cash			3,60,000
(Settlement of SAR)			

Note: Last two entries can be combined.

20. Ind AS 32, *'Financial Instruments: Presentation'*, requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of Ind AS 32 would involve separating two portions of equity. The first portion is recognised in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, in accordance with Ind AS 101, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to Ind AS.

In the present case, since the liability is outstanding on the date of transition, Sigma Ltd. will need to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, we will first measure the liability component by discounting the contractually determined stream of future cash flows (interest and principal) to present value by using the discount rate of 10% p.a. (being the market interest rate for similar debentures with no conversion option).

© The Institute of Chartered Accountants of India

	₹
Interest payments p.a. on each debenture	6
Present Value (PV) of interest payment on each debenture for years 1 to 4 (6 x 3.17) (Note 1)	19.02
PV of principal repayment on each debenture (including premium) 110 x 0.68 (Note 2)	74.80
Total liability component on each debenture (A)	93.82
Total equity component per debenture (Balancing figure) (B) = (C) – (A)	6.18
Face value per debenture (C)	100.00
Equity component per debenture	6.18
Total equity component for 30,000 debentures	1,85,400
Total debt amount (30,000 x 93.82)	28,14,600

Thus, on the date of transition, the amount of ₹ 30,00,000 being the amount of debentures will be split as under:

Debt	₹ 28,14,600
Equity	₹ 1,85,400

Notes:

1. 3.17 is annuity factor of present value of Re. 1 at a discount rate of 10% for 4 years.
2. On maturity, ₹ 110 will be paid (₹ 100 as principal payment + ₹ 10 as premium)

© The Institute of Chartered Accountants of India

PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

QUESTIONS

Security Valuation

1. Calculate the value of share from the following information:

Profit after tax of the company	₹ 290 crores
Equity capital of company	₹ 1,300 crores
Par value of share	₹ 40 each
Debt ratio of company (Debt/ Debt + Equity)	27%
Long run growth rate of the company	8%
Beta 0.1; risk free interest rate	8.7%
Market returns	10.3%
Capital expenditure per share	₹ 47
Depreciation per share	₹ 39
Change in Working capital	₹ 3.45 per share

2. M/s Agfa Industries is planning to issue a debenture series on the following terms:

Face value	₹ 100
Term of maturity	10 years
Yearly coupon rate	
Years	
1 – 4	9%
5 – 8	10%
9 – 10	14%

The current market rate on similar debentures is 15 per cent per annum. The Company proposes to price the issue in such a manner that it can yield 16 per cent compounded rate of return to the investors. The Company also proposes to redeem the debentures at 5 per cent premium on maturity. Determine the issue price of the debentures.

Portfolio Management

3. The distribution of return of security 'F' and the market portfolio 'P' is given below:

Probability	Return %	
	F	P
0.30	30	-10

© The Institute of Chartered Accountants of India

0.40	20	20
0.30	0	30

You are required to calculate the expected return of security 'F' and the market portfolio 'P', the covariance between the market portfolio and security and beta for the security.

4. A Portfolio Manager (PM) has the following four stocks in his portfolio:

Security	No. of Shares	Market Price per share (₹)	β
VSL	10,000	50	0.9
CSL	5,000	20	1.0
SML	8,000	25	1.5
APL	2,000	200	1.2

Compute the following:

(i) Portfolio beta.

(ii) If the PM seeks to reduce the beta to 0.8, how much risk free investment should he bring in?

(iii) If the PM seeks to increase the beta to 1.2, how much risk free investment should he bring in?

Mutual Fund

5. On 01-07-2016, Mr. X Invested ₹ 50,000/- at initial offer in Mutual Funds at a face value of ₹ 10 each per unit. On 31-03-2017, a dividend was paid @ 10% and annualized yield was 120%. On 31-03-2018, 20% dividend and capital gain of ₹ 0.60 per unit was given. Mr. X redeemed all his 6271.98 units when his annualized yield was 71.50% over the period of holding. Calculate NAV as on 31-03-2017, 31-03-2018 and 31-03-2019.

For calculations consider a year of 12 months.

Derivatives

6. From the following data for certain stock, find the value of a call option:

Price of stock now	=	₹ 80
Exercise price	=	₹ 75
Standard deviation of continuously compounded annual return	=	0.40
Maturity period	=	6 months
Annual interest rate	=	12%

© The Institute of Chartered Accountants of India

Given

Number of S.D. from Mean, (z)	Area of the left or right (one tail)
0.25	0.4013
0.30	0.3821
0.55	0.2912
0.60	0.2743

$e^{0.12x0.5}$ = 1.062

In 1.0667 = 0.0646

7. On January 1, 2018 an investor has a portfolio of 5 shares as given below:

Security	Price	No. of Shares	Beta
A	349.30	5,000	1.15
B	480.50	7,000	0.40
C	593.52	8,000	0.90
D	734.70	10,000	0.95
E	824.85	2,000	0.85

The cost of capital to the investor is 10.5% per annum.

You are required to calculate:

(i) The beta of his portfolio.

(ii) The theoretical value of the NIFTY futures for February 2018.

(iii) The number of contracts of NIFTY the investor needs to sell to get a full hedge until February for his portfolio if the current value of NIFTY is 5900 and NIFTY futures have a minimum trade lot requirement of 200 units. Assume that the futures are trading at their fair value.

(iv) The number of future contracts the investor should trade if he desires to reduce the beta of his portfolios to 0.6.

No. of days in a year be treated as 365.

Given: In (1.105) = 0.0998 and $e^{(0.015858)}$ = 1.01598

Foreign Exchange Exposure and Risk Management

8. Followings are the spot exchange rates quoted at three different forex markets:

USD/INR	48.30 in Mumbai
GBP/INR	77.52 in London
GBP/USD	1.6231 in New York

© The Institute of Chartered Accountants of India

The arbitrageur has USD 1,00,00,000. Assuming that there are no transaction costs, explain whether there is any arbitrage gain possible from the quoted spot exchange rates.

9. Nitrogen Ltd, a UK company is in the process of negotiating an order amounting to €4 million with a large German retailer on 6 months credit. If successful, this will be the first time that Nitrogen Ltd has exported goods into the highly competitive German market. The following three alternatives are being considered for managing the transaction risk before the order is finalized.

   (i) Invoice the German firm in Sterling using the current exchange rate to calculate the invoice amount.

   (ii) Alternative of invoicing the German firm in € and using a forward foreign exchange contract to hedge the transaction risk.

   (iii) Invoice the German first in € and use sufficient 6 months sterling future contracts (to the nearly whole number) to hedge the transaction risk.

   Following data is available:

Spot Rate	€ 1.1750 - €1.1770/£
6 months forward premium	0.55-0.60 Euro Cents
6 months future contract is currently trading at	€1.1760/£
6 months future contract size is	£62500
Spot rate and 6 months future rate	€1.1785/£

   Required:

   (a) Calculate to the nearest £ the receipt for Nitrogen Ltd, under each of the three proposals.

   (b) In your opinion, which alternative would you consider to be the most appropriate and the reason thereof.

International Financial Management

10. XYZ Ltd., a company based in India, manufactures very high quality modem furniture and sells to a small number of retail outlets in India and Nepal. It is facing tough competition. Recent studies on marketability of products have clearly indicated that the customer is now more interested in variety and choice rather than exclusivity and exceptional quality. Since the cost of quality wood in India is very high, the company is reviewing the proposal for import of woods in bulk from Nepalese supplier.

    The estimate of net Indian (₹) and Nepalese Currency (NC) cash flows in Nominal terms for this proposal is shown below:

© The Institute of Chartered Accountants of India

	Net Cash Flow (in millions)			
Year	0	1	2	3
NC	-25.000	2.600	3.800	4.100
Indian (₹)	0	2.869	4.200	4.600

The following information is relevant:

(i) XYZ Ltd. evaluates all investments by using a discount rate of 9% p.a. All Nepalese customers are invoiced in NC. NC cash flows are converted to Indian (₹) at the forward rate and discounted at the Indian rate.

(ii) Inflation rates in Nepal and India are expected to be 9% and 8% p.a. respectively. The current exchange rate is ₹ 1= NC 1.6

Assuming that you are the finance manager of XYZ Ltd., calculate the net present value (NPV) and modified internal rate of return (MIRR) of the proposal.

You may use following values with respect to discount factor for ₹ 1 @ 9%.

	Present Value	Future Value
Year 1	0.917	1.188
Year 2	0.842	1.090
Year 3	0.772	1

Interest Rate Risk Management

11. A Inc. and B Inc. intend to borrow $200,000 and $200,000 in ¥ respectively for a time horizon of one year. The prevalent interest rates are as follows:

Company	¥ Loan	$ Loan
A Inc	5%	9%
B Inc	8%	10%

The prevalent exchange rate is $1 = ¥120.

They entered in a currency swap under which it is agreed that B Inc will pay A Inc @ 1% over the ¥ Loan interest rate which the later will have to pay as a result of the agreed currency swap whereas A Inc will reimburse interest to B Inc only to the extent of 9%. Keeping the exchange rate invariant, quantify the opportunity gain or loss component of the ultimate outcome, resulting from the designed currency swap.

Corporate Valuation

12. ABC Co. is considering a new sales strategy that will be valid for the next 4 years. They want to know the value of the new strategy. Following information relating to the year which has just ended, is available:

© The Institute of Chartered Accountants of India

Income Statement	₹
Sales	20,000
Gross margin (20%)	4,000
Administration, Selling & distribution expense (10%)	2,000
PBT	2,000
Tax (30%)	600
PAT	1,400
Balance Sheet Information	
Fixed Assets	8,000
Current Assets	4,000
Equity	12,000

If it adopts the new strategy, sales will grow at the rate of 20% per year for three years. The gross margin ratio, Assets turnover ratio, the Capital structure and the income tax rate will remain unchanged.

Depreciation would be at 10% of net fixed assets at the beginning of the year.

The Company's target rate of return is 15%.

Determine the incremental value due to adoption of the strategy.

Mergers, Acquisitions and Corporate Restructuring

13. The following information relating to the acquiring Company Abhiman Ltd. and the target Company Abhishek Ltd. are available. Both the Companies are promoted by Multinational Company, Trident Ltd. The promoter's holding is 50% and 60% respectively in Abhiman Ltd. and Abhishek Ltd.:

	Abhiman Ltd.	Abhishek Ltd.
Share Capital (₹)	200 lakh	100 lakh
Free Reserve and Surplus (₹)	800 lakh	500 lakh
Paid up Value per share (₹)	100	10
Free float Market Capitalisation (₹)	400 lakh	128 lakh
P/E Ratio (times)	10	4

Trident Ltd. is interested to do justice to the shareholders of both the Companies. For the swap ratio weights are assigned to different parameters by the Board of Directors as follows:

Book Value	25%
EPS (Earning per share)	50%

© The Institute of Chartered Accountants of India

Market Price 25%

(a) What is the swap ratio based on above weights?

(b) What is the Book Value, EPS and expected Market price of Abhiman Ltd. after acquisition of Abhishek Ltd. (assuming P.E. ratio of Abhiman Ltd. remains unchanged and all assets and liabilities of Abhishek Ltd. are taken over at book value).

(c) Calculate:

(i) Promoter's revised holding in the Abhiman Ltd.

(ii) Free float market capitalization.

(iii) Also calculate No. of Shares, Earning per Share (EPS) and Book Value (B.V.), if after acquisition of Abhishek Ltd., Abhiman Ltd. decided to :

(a) Issue Bonus shares in the ratio of 1 : 2; and

(b) Split the stock (share) as ₹ 5 each fully paid.

Theoretical Questions

14. (a) How financial goals can be balanced vis-à-vis sustainable growth?

(b) What is Value at Risk? Identify its main features.

(c) Explain the factors affecting economic analysis.

15. (a) Discuss briefly the steps in securitization mechanism.

(b) What are some of the innovative ways to finance a start up?

(c) What is the difference between Management Buy Out and Leveraged Buyout? State the purpose of a leveraged buyout with the help of an example.

SUGGESTED ANSWERS/HINTS

1. No. of Shares = $\frac{₹\ 1,300 \text{ crores}}{₹\ 40}$ = 32.5 Crores

EPS = $\frac{\text{PAT}}{\text{No.of shares}}$

EPS = $\frac{₹\ 290 \text{ crores}}{32.5 \text{ crores}}$ = ₹ 8.923

FCFE = Net income – [(1-b) (capex – dep) + (1-b) (ΔWC)]

FCFE = 8.923 – [(1-0.27) (47-39) + (1-0.27) (3.45)]

= 8.923 – [5.84 + 2.5185] = 0.5645

© The Institute of Chartered Accountants of India

Cost of Equity = $R_f + ß (R_m – R_f)$

= 8.7 + 0.1 (10.3 – 8.7) = 8.86%

$$Po = \frac{FCFE(1+g)}{K_e - g} = \frac{0.5645(1.08)}{0.0886-.08} = \frac{0.60966}{0.0086} = ₹\ 70.89$$

2. The issue price of the debentures will be the sum of present value of interest payments during 10 years of its maturity and present value of redemption value of debenture.

Years	Cash out flow (₹)	PVIF @ 16%	PV
1	9	.862	7.758
2	9	.743	6.687
3	9	.641	5.769
4	9	.552	4.968
5	10	.476	4.76
6	10	.410	4.10
7	10	.354	3.54
8	10	.305	3.05
9	14	.263	3.682
10	14 + 105 = 119	.227	3.178 + 23.835
			71.327

Thus the debentures should be priced at ₹ 71.327

3. Security F

Prob(P)	R_f	PxR_f	Deviations of F ($R_f – ER_f$)	$(Deviation)^2$ of F	$(Deviations)^2$ P_X
0.3	30	9	13	169	50.7
0.4	20	8	3	9	3.6
0.3	0	0	-17	289	86.7
		ER_f=17			Var_f =141

STDEV $\sigma_f = \sqrt{141}$ = 11.87

Market Portfolio, P

R_M %	P_M	Exp. Return R_M x P_M	Dev. of P (R_M-ER_M)	(Dev. of $P)^2$	$(DeV.)^2$ P_M	(Deviation of F) x (Deviation of P)	Dev. of F x Dev. of P) x P
-10	0.3	-3	-24	576	172.8	-312	-93.6

© The Institute of Chartered Accountants of India

20	0.4	8	6	36	14.4	18	7.2
30	0.3	9	16	256	76.8	-272	-81.6
		ER_M=14			Var $_M$=264 σ_M=16.25		=Co Var P_M =- 168

Beta= $\frac{Co\,Var\,P_M}{\sigma^2_M} = \frac{-168}{264} = -.636$

4.

Security	No. of shares (1)	Market Price of Per Share (2)	(1) × (2)	% to total (w)	ß (x)	wx
VSL	10000	50	500000	0.4167	0.9	0.375
CSL	5000	20	100000	0.0833	1	0.083
SML	8000	25	200000	0.1667	1.5	0.250
APL	2000	200	400000	0.3333	1.2	0.400
			1200000	1		1.108

Portfolio beta 1.108

(i) Required Beta 0.8

It should become (0.8 / 1.108) 72.2 % of present portfolio

If ₹ 12,00,000 is 72.20%, the total portfolio should be
₹ 12,00,000 × 100/72.20 or ₹ 16,62,050

Additional investment in zero risk should be (₹ 16,62,050 – ₹ 12,00,000) = ₹ 4,62,050

Revised Portfolio will be

Security	No. of shares (1)	Market Price of Per Share (2)	(1) × (2)	% to total (w)	ß (x)	wx
VSL	10000	50	500000	0.3008	0.9	0.271
CSL	5000	20	100000	0.0602	1	0.060
SML	8000	25	200000	0.1203	1.5	0.180
APL	2000	200	400000	0.2407	1.2	0.289
Risk free asset	46205	10	462050	0.2780	0	0
			1662050	1		0.800

© The Institute of Chartered Accountants of India

(ii) To increase Beta to 1.2

Required beta 1.2

It should become 1.2 / 1.108 108.30% of present beta

If 1200000 is 108.30%, the total portfolio should be

1200000 × 100/108.30 or 1108033 say 1108030

Additional investment should be (-) 91967 i.e. Divest ₹ 91970 of Risk Free Asset

Revised Portfolio will be

Security	No. of shares (1)	Market Price of Per Share (2)	(1) × (2)	% to total (w)	ß (x)	wx
VSL	10000	50	500000	0.4513	0.9	0.406
CSL	5000	20	100000	0.0903	1	0.090
SML	8000	25	200000	0.1805	1.5	0.271
APL	2000	200	400000	0.3610	1.2	0.433
Risk free asset	-9197	10	-91970	-0.0830	0	0
			1108030	1		1.20

Portfolio beta 1.20

5. Yield for 9 months (120% x 9/12) = 90%

Market value of Investments as on 31.03.2017 = ₹ 50,000/- + (₹ 50,000x 90%)= ₹ 95,000/-

Therefore, NAV as on 31.03.2017 = (₹ 95,000 - ₹ 5,000)/5,000 = ₹ 18.00

Since dividend was reinvested by Mr. X, additional units acquired = $\frac{₹\ 5,000}{₹\ 18}$ = 277.78 unit

Therefore, units as on 31.03.2017 = 5,000 + 277.78 = 5,277.78

Alternatively, units as on 31.03.2017 = (₹ 95,000/₹18) = 5,277.78

Dividend as on 31.03.2018 = 5,277.78 x ₹ 10 x 0.2 = ₹10,555.56

Capital Gain (5277.78 x ₹ 0.60) = ₹ 3,166.67

= ₹13,722.23

Let X be the NAV on 31.03.2018, then number of new units reinvested will be ₹13,722.23/X.

Accordingly, 6,271.98 units shall consist of reinvested units and 5277.78 (as on 31.03.2017).

© The Institute of Chartered Accountants of India

Thus, by way of equation it can be shown as follows:

$$6{,}271.98 = \frac{₹\,13{,}722.23}{X} + 5{,}277.78$$

Therefore, NAV as on 31.03.2018 = ₹ 13,722.23/(6,271.98 – 5,277.78) = ₹ 13.80

NAV as on 31.03.2019 = ₹ 50,000 (1+0.715x33/12)/6,271.98 = ₹23.656

6. Applying the Black Scholes Formula,

Value of the Call option now:

The Formula $C = SN(d_1) - Ke^{(-rt)}N(d_2)$

$$d_1 = \frac{\ln(S/K) + (r + \sigma^2/2)t}{\sigma\sqrt{t}}$$

$$d_2 = d_1 - \sigma\sqrt{t}$$

Where,

C = Theoretical call premium

S = Current stock price

t = time until option expiration

K = option striking price

r = risk-free interest rate

N = Cumulative standard normal distribution

e = exponential term

σ = Standard deviation of continuously compounded annual return.

In = natural logarithim

$$d_1 = \frac{\ln(1.0667) + (12\% + 0.08)0.5}{0.40\sqrt{0.5}}$$

$$= \frac{0.0646 + (0.2)0.5}{0.40 \times 0.7071}$$

$$= \frac{0.1646}{0.2828}$$

= 0.5820

d_2 = 0.5820 – 0.2828 = 0.2992

© The Institute of Chartered Accountants of India

$N(d_1)$ = N (0.5820)

$N(d_2)$ = N (0.2992)

Price = $SN(d_1) - Ke^{(-rt)}N(d_2)$

= 80 x $N(d_1)$ – (75/1.062) x $N(d_2)$

Value of option

= 80 $N(d_1)$ - $\frac{75}{1.062} \times N(d_2)$

$N(d_1)$ = N (0.5820) = 0.7197

$N(d_2)$ = N(0.2992) = 0.6176

Price = 80 x 0.7197 – $\frac{75}{1.062} \times 0.6176$

= 57.57 – 70.62 x 0.6176

= 57.57 – 43.61

= ₹13.96

Teaching Notes:

Students may please note following important point:

Values of $N(d_1)$ and $N(d_2)$ have been computed by interpolating the values of areas under respective numbers of SD from Mean (Z) given in the question.

It may also be possible that in question paper areas under Z may be mentioned otherwise e.g. Cumulative Area or Area under Two tails. In such situation the areas of the respective Zs given in the question will be as follows:

Cumulative Area

Number of S.D. from Mean, (z)	Cumulative Area
0.25	0.5987
0.30	0.6179
0.55	0.7088
0.60	0.7257

Two tail area

Number of S.D. from Mean, (z)	Area of the left and right (two tail)
0.25	0.8026
0.30	0.7642

© The Institute of Chartered Accountants of India

0.55	0.5823
0.60	0.5485

7. (i) Calculation of Portfolio Beta

Security	Price of the Stock	No. of shares	Value	Weightage w_i	Beta B_i	Weighted Beta
A	349.30	5,000	17,46,500	0.093	1.15	0.107
B	480.50	7,000	33,63,500	0.178	0.40	0.071
C	593.52	8,000	47,48,160	0.252	0.90	0.227
D	734.70	10,000	73,47,000	0.390	0.95	0.370
E	824.85	2,000	16,49,700	0.087	0.85	0.074
			1,88,54,860			0.849

Portfolio Beta = 0.849

(ii) Calculation of Theoretical Value of Future Contract

Cost of Capital = 10.5% p.a. Accordingly, the Continuously Compounded Rate of Interest ln (1.105) = 0.0998

For February 2013 contract, t= 58/365= 0.1589

Further F= Se^{rt}

F= ₹ 5,900$e^{(0.0998)(0.1589)}$

F= ₹ 5,900$e^{0.015858}$

F= ₹ 5,900X1.01598 = ₹ 5,994.28

Alternatively, it can also be taken as follows:

= ₹ 5900 $e^{0.105 \times 58/365}$

= ₹ 5900 $e^{0.01668}$

= ₹ 5900 x 1.01682 = ₹ 5,999.24

(iii) When total portfolio is to be hedged:

$$= \frac{\text{Value of Spot Position requiring hedging}}{\text{Value of Future Contract}} \times \text{Portfolio Beta}$$

$$= \frac{1,88,54,860}{5994.28 \times 200} \times 0.849$$ = 13.35 contracts say 13 or 14 contracts

© The Institute of Chartered Accountants of India

(iv) When total portfolio beta is to be reduced to 0.6:

Number of Contracts to be sold = $\frac{P(\beta_P - \beta_P^{'})}{F}$

= $\frac{1,88,54,860\,(0.849 - 0.600)}{5994.28 \times 200}$ = 3.92 contracts say 4 contract

8. The arbitrageur can proceed as stated below to realize arbitrage gains.

(i) Buy ₹ from USD 10,000,000 at Mumbai 48.30 × 10,000,000 = ₹483,000,000

(ii) Convert these ₹ to GBP at London $\left(\frac{₹\ 483,000,000}{\text{Rs. } 77.52}\right)$ = GBP 6,230,650.155

(iii) Convert GBP to USD at New York GBP 6,230,650.155 × 1.6231 USD 10,112,968.26

There is net gain of USD 10,112968.26 less USD 10,000,000 i.e. USD 112,968.26

9. (i) Receipt under three proposals

(a) Invoicing in Sterling

Invoicing in £ will produce = $\frac{€\ 4\,\text{million}}{1.1770}$ = £3398471

(b) Use of Forward Contract

Forward Rate = €1.1770+0.0055 = 1.1825

Using Forward Market hedge Sterling receipt would be $\frac{€\ 4\,\text{million}}{1.1825}$ = £ 3382664

(c) Use of Future Contract

The equivalent sterling of the order placed based on future price (€1.1760) = $\frac{€\ 4.00\,\text{million}}{1.1760}$ = £ 3401360

Number of Contracts = $\frac{£3401360}{62,500}$ = 54 Contracts (to the nearest whole number)

Thus, € amount hedged by future contract will be = 54 × £62,500 = £3375000

Buy Future at	€1.1760
Sell Future at	€1.1785
	€0.0025

Total profit on Future Contracts = 54 × £62,500 × €0.0025 = €8438

© The Institute of Chartered Accountants of India

After 6 months

Amount Received	€4000000
Add: Profit on Future Contracts	€ 8438
	€ 4008438

Sterling Receipts

On sale of € at spot = $\frac{€\,4008438}{1.1785}$ = €3401305

(ii) Proposal of option (c) is preferable because the option (a) & (b) produces least receipts**.**

10. Working Notes:

(i) Computation of Forward Rates

End of Year	NC	NC/₹
1	NC1.60 x $\left(\frac{(1+0.09)}{(1+0.08)}\right)$	1.615
2	NC1.615 x $\left(\frac{(1+0.09)}{(1+0.08)}\right)$	1.630
3	NC1.630 x $\left(\frac{(1+0.09)}{(1+0.08)}\right)$	1.645

(ii) NC Cash Flows converted in Indian Rupees

Year	NC (Million)	Conversion Rate	₹ (Million)
0	-25.00	1.600	-15.625
1	2.60	1.615	1.61
2	3.80	1.630	2.33
3	4.10	1.645	2.49

Net Present Value

(₹ Million)

Year	Cash Flow in India	Cash Flow in Nepal	Total	PVF @ 9%	PV
0	---	-15.625	-15.625	1.000	-15.625
1	2.869	1.61	4.479	0.917	4.107

© The Institute of Chartered Accountants of India

2	4.200	2.33	6.53	0.842	5.498
3	4.600	2.49	7.09	0.772	5.473
					-0.547

Modified Internal Rate of Return

	Year			
	0	**1**	**2**	**3**
Cash Flow (₹ Million)	-15.625	4.479	6.53	7.09
Year 1 Cash Inflow reinvested for 2 years (1.188 x 4.479)				5.32
Year 2 Cash Inflow reinvested for 1 years (1.090 x 6.53)				7.12
				19.53

MIRR = $\sqrt[n]{\frac{\text{Terminal Cash Flow}}{\text{Initial Outlay}}} - 1 = \sqrt[3]{\frac{19.53}{15.625}} - 1 = 0.0772$ say 7.72%

11.

Opportunity gain of A Inc under currency swap	**Receipt**	**Payment**	**Net**
Interest to be remitted to B. Inc in \$ 2,00,000x9%=\$18,000 Converted into (\$18,000 x ¥120)		¥21,60,000	
Interest to be received from B. Inc in \$ converted into ¥ (6%x\$2,00,000 x ¥120)	¥14,40,000	-	
Interest payable on ¥ loan	-	¥12,00,000	
	¥14,40,000	¥33,60,000	
Net Payment	¥19,20,000	-	
	¥33,60,000	¥33,60,000	
\$ equivalent paid ¥19,20,000 x(1/¥120)			\$16,000
Interest payable without swap in \$			\$18,000
Opportunity gain in \$			\$ 2,000

Opportunity gain of B Inc under currency swap	**Receipt**	**Payment**	**Net**
Interest to be remitted to A Inc in (\$ 2,00,000 x 6%)		\$12,000	

© The Institute of Chartered Accountants of India

Interest to be received from A. Inc in ¥ converted into $ =¥21,60,000/¥120	$18,000		
Interest payable on $ loan@10%	-	$20,000	
	$18,000	$32,000	
Net Payment	$14,000 $32,000	- $32,000	
¥ equivalent paid $14,000 X ¥120			¥16,80,000
Interest payable without swap in ¥ ($2,00,000X¥120X8%)			¥19,20,000
Opportunity gain in ¥			¥ 2,40,000

Alternative Solution

Cash Flows of A Inc

(i) At the time of exchange of principal amount

Transactions		Cash Flows
Borrowings	$2,00,000 x ¥120	+ ¥240,00,000
Swap		- ¥240,00,000
Swap		+$2,00,000
Net Amount		+$2,00,000

(ii) At the time of exchange of interest amount

Transactions		Cash Flows
Interest to the lender	¥240,00,000X5%	¥12,00,000
Interest Receipt from B Inc.	¥2,00,000X120X6%	¥14,40,000
Net Saving (in $)	¥2,40,000/¥120	$2,000
Interest to B Inc.	$2,00,000X9%	-$18,000
Net Interest Cost		-$16,000

A Inc. used $2,00,000 at the net cost of borrowing of $16,000 i.e. 8%. If it had not opted for swap agreement the borrowing cost would have been 9%. Thus there is saving of 1%.

Cash Flows of B Inc

(i) At the time of exchange of principal amount

Transactions		Cash Flows
Borrowings		+ $2,00,000
Swap		- $2,00,000

© The Institute of Chartered Accountants of India

Swap	$2,00,000X¥120	+¥240,00,000
Net Amount		+¥240,00,000

(ii) At the time of exchange of interest amount

Transactions		Cash Flows
Interest to the lender	$2,00,000X10%	- $20,000
Interest Receipt from A Inc.		+$18,000
Net Saving (in ¥)	-$2,000X¥120	- ¥2,40,000
Interest to A Inc.	$2,00,000X6%X¥120	- ¥14,40,000
Net Interest Cost		- ¥16,80,000

B Inc. used ¥240,00,000 at the net cost of borrowing of ¥16,80,000 i.e. 7%. If it had not opted for swap agreement the borrowing cost would have been 8%. Thus there is saving of 1%.

12.

Projected Balance Sheet				
	Year 1	Year 2	Year 3	Year 4
Fixed Assets (40% of Sales)	9,600	11,520	13,824	13,824
Current Assets (20% of Sales)	4,800	5,760	6,912	6,912
Total Assets	14,400	17,280	20,736	20,736
Equity	14,400	17,280	20,736	20,736

Projected Cash Flows:-

	Year 1	Year 2	Year 3	Year 4
Sales	24,000	28,800	34,560	34,560
PBT (10% of sale)	2,400	2,880	3,456	3,456
PAT (70%)	1,680	2,016	2,419.20	2,419.20
Depreciation	800	960	1,152	1,382
Addition to Fixed Assets	2,400	2,880	3,456	1,382
Increase in Current Assets	800	960	1,152	-
Operating cash flow (FCFF)	(720)	(864)	(1,036.80)	2,419.20

Projected Cash Flows:-

Present value of Projected Cash Flows:-

Cash Flows	*PVF at 15%*	*PV*
-720	0.870	-626.40

© The Institute of Chartered Accountants of India

-864 -1,036.80	0.756 0.658	-653.18 -682.21 -1,961.79

Residual Value - 2419.20/0.15 = 16,128

Present value of Residual value = $16128/(1.15)^3$

= 16128/1.521 = 10603.55

Total shareholders' value = 10,603.55 – 1,961.79 = 8,641.76

Pre strategy value = 1,400 / 0.15 = 9,333.33

∴ Value of strategy = 8,641.76 – 9,333.33 = – 691.57

Conclusion: The strategy is not financially viable.

13. (a) Swap Ratio

	Abhiman Ltd.	**Abhishek Ltd.**
Share Capital	200 Lakh	100 Lakh
Free Reserves	800 Lakh	500 Lakh
Total	1000 Lakh	600 Lakh
No. of Shares	2 Lakh	10 Lakh
Book Value per share	₹ 500	₹ 60
Promoter's holding	50%	60%
Non promoter's holding	50%	40%
Free Float Market Cap. i.e. relating to Public's holding	400 Lakh	128 Lakh
Hence Total market Cap.	800 Lakh	320 Lakh
No. of Shares	2 Lakh	10 Lakh
Market Price	₹ 400	₹ 32
P/E Ratio	10	4
EPS	40	8
Profits (₹ 2 X 40 lakh)	₹ 80 lakh	-
(₹ 8 X 10 lakh)	-	₹ 80 lakh

Calculation of Swap Ratio

Book Value 1 : 0.12 i.e. 0.12 x 25% 0.03

© The Institute of Chartered Accountants of India

EPS	1 : 0.2	0.20 x 50%	0.10
Market Price	1 : 0.08	0.08 x 25%	0.02
		Total	0.15

Swap ratio is for every one share of Abhishek Ltd., to issue 0.15 shares of Abhiman Ltd. Hence total no. of shares to be issued

= 10 Lakh x 0.15 = 1.50 lakh shares

(b) Book Value, EPS & Market Price

Total No of Shares 2 Lakh + 1.5 Lakh = 3.5 Lakh

Total Capital ₹ 200 Lakh + ₹ 150 Lakh = ₹ 350 Lakh

Reserves ₹ 800 Lakh + ₹ 450 Lakh = ₹ 1,250 Lakh

Book Value $\frac{₹\ 350\text{ Lakh} + ₹\ 1{,}250\text{ Lakh}}{3.5\text{ Lakh}}$ = ₹ 457.14 per share

EPS $\frac{\text{Total Profit}}{\text{No. of Share}} = \frac{₹\ 80\text{ Lakh} + ₹\ 80\text{ Lakh}}{3.5\text{ Lakh}} = \frac{₹\ 160\text{ Lakh}}{3.5}$ = ₹ 45.71

Expected Market Price EPS (₹ 45.71) x P/E Ratio (10) = ₹ 457.10

(c) (1) Promoter's holding

Promoter's Revised	Abhiman 50% i.e.	1.00 Lakh shares
Holding	Abhishek 60% i.e.	0.90 Lakh shares
	Total	1.90 Lakh shares

Promoter's % = 1.90/3.50 x 100 = 54.29%

(2) Free Float Market Capitalisation

Free Float Market Capitalisation = (3.5 Lakh – 1.9 Lakh) x ₹ 457.10 = ₹ 731.36 Lakh

(3) (i) & (ii)

Revised Capital	₹ 350 Lakh + ₹ 175 Lakh = ₹ 525 Lakh
No. of shares before Split (F.V ₹ 100)	5.25 Lakh
No. of Shares after Split (F.V. ₹ 5)	5.25 x 20 = 105 Lakh
EPS	160 Lakh / 105 Lakh = 1.523
Book Value	$\frac{\text{Cap. ₹ 525 Lakh + ₹ 1075 Lakh}}{\text{105 Lakh}}$
	= ₹ 15.238 per share

© The Institute of Chartered Accountants of India

14. (a) The concept of sustainable growth can be helpful for planning healthy corporate growth. This concept forces managers to consider the financial consequences of sales increases and to set sales growth goals that are consistent with the operating and financial policies of the firm. Often, a conflict can arise if growth objectives are not consistent with the value of the organization's sustainable growth. Question concerning right distribution of resources may take a difficult shape if we take into consideration the rightness not for the current stakeholders but for the future stakeholders also. To take an illustration, let us refer to fuel industry where resources are limited in quantity and a judicial use of resources is needed to cater to the need of the future customers along with the need of the present customers. One may have noticed the save fuel campaign, a demarketing campaign that deviates from the usual approach of sales growth strategy and preaches for conservation of fuel for their use across generation. This is an example of stable growth strategy adopted by the oil industry as a whole under resource constraints and the long run objective of survival over years. Incremental growth strategy, profit strategy and pause strategy are other variants of stable growth strategy.

Sustainable growth is important to enterprise long-term development. Too fast or too slow growth will go against enterprise growth and development, so financial should play important role in enterprise development, adopt suitable financial policy initiative to make sure enterprise growth speed close to sustainable growth ratio and have sustainable healthy development.

(b) VAR is a measure of risk of investment. Given the normal market condition in a set of period, say, one day it estimates how much an investment might lose. This investment can be a portfolio, capital investment or foreign exchange etc., VAR answers two basic questions -

(i) What is worst case scenario?

(ii) What will be loss?

It was first applied in 1922 in New York Stock Exchange, entered the financial world in 1990s and become world's most widely used measure of financial risk.

Following are main features of VAR

(i) Components of Calculations: VAR calculation is based on following three components:

(a) Time Period

(b) Confidence Level – Generally 95% and 99%

(c) Loss in percentage or in amount

(ii) Statistical Method: It is a type of statistical tool based on Standard Deviation.

© The Institute of Chartered Accountants of India

(iii) Time Horizon: VAR can be applied for different time horizons say one day, one week, one month and so on.

(iv) Probability: Assuming the values are normally attributed, probability of maximum loss can be predicted.

(v) Control Risk: Risk can be controlled by selling limits for maximum loss.

(vi) Z Score: Z Score indicates how many standard Deviations is away from Mean value of a population. When it is multiplied with Standard Deviation it provides VAR.

(c) Some of the factors affecting economic analysis are discussed as under:

(i) Growth Rates of National Income and Related Measures*:* For most purposes, what is important is the difference between the nominal growth rate quoted by GDP and the 'real' growth after taking inflation into account. The estimated growth rate of the economy would be a pointer to the prospects for the industrial sector, and therefore to the returns investors can expect from investment in shares.

(ii) Growth Rates of Industrial Sector*:* This can be further broken down into growth rates of various industries or groups of industries if required. The growth rates in various industries are estimated based on the estimated demand for its products.

(iii) Inflation*:* Inflation is measured in terms of either wholesale prices (the Wholesale Price Index or WPI) or retail prices (Consumer Price Index or CPI). The demand in some industries, particularly the consumer products industries, is significantly influenced by the inflation rate. Therefore, firms in these industries make continuous assessment about inflation rates likely to prevail in the near future so as to fine-tune their pricing, distribution and promotion policies to the anticipated impact of inflation on demand for their products.

(iv) Monsoon: Because of the strong forward and backward linkages, monsoon is of great concern to investors in the stock market too.

15. (a) The various steps in securitization mechanism are discussed as below:

Creation of Pool of Assets

The process of securitization begins with creation of pool of assets by segregation of assets backed by similar type of mortgages in terms of interest rate, risk, maturity and concentration units.

Transfer to SPV

One assets have been pooled, they are transferred to Special Purpose Vehicle (SPV) especially created for this purpose.

© The Institute of Chartered Accountants of India

Sale of Securitized Papers

SPV designs the instruments based on nature of interest, risk, tenure etc. based on pool of assets. These instruments can be Pass Through Security or Pay Through Certificates, (discussed later).

Administration of assets

The administration of assets in subcontracted back to originator which collects principal and interest from underlying assets and transfer it to SPV, which works as a conduct.

Recourse to Originator

Performance of securitized papers depends on the performance of underlying assets and unless specified in case of default they go back to originator from SPV.

Repayment of funds

SPV will repay the funds in form of interest and principal that arises from the assets pooled.

Credit Rating to Instruments

Sometime before the sale of securitized instruments credit rating can be done to assess the risk of the issuer.

(b) Some of the innovative steps to finance a startup are as follows:

(i) **Personal financing.** It may not seem to be innovative but you may be surprised to note that most budding entrepreneurs never thought of saving any money to start a business. This is important because most of the investors will not put money into a deal if they see that you have not contributed any money from your personal sources.

(ii) **Personal credit lines.** One qualifies for personal credit line based on one's personal credit efforts. Credit cards are a good example of this. However, banks are very cautious while granting personal credit lines. They provide this facility only when the business has enough cash flow to repay the line of credit.

(iii) **Family and friends.** These are the people who generally believe in you, without even thinking that your idea works or not. However, the loan obligations to friends and relatives should always be in writing as a promissory note or otherwise.

(iv) **Peer-to-peer lending.** In this process group of people come together and lend money to each other. Peer to peer to lending has been there for many years. Many small and ethnic business groups having similar faith or interest generally support each other in their start up endeavors.

© The Institute of Chartered Accountants of India

(v) **Crowdfunding**. Crowdfunding is the use of small amounts of capital from a large number of individuals to finance a new business initiative. Crowdfunding makes use of the easy accessibility of vast networks of people through social media and crowdfunding websites to bring investors and entrepreneurs together.

(vi) **Microloans.** Microloans are small loans that are given by individuals at a lower interest to a new business ventures. These loans can be issued by a single individual or aggregated across a number of individuals who each contribute a portion of the total amount.

(vii) **Vendor financing.** Vendor financing is the form of financing in which a company lends money to one of its customers so that he can buy products from the company itself. Vendor financing also takes place when many manufacturers and distributors are convinced to defer payment until the goods are sold. This means extending the payment terms to a longer period for e.g. 30 days payment period can be extended to 45 days or 60 days. However, this depends on one's credit worthiness and payment of more money.

(viii) **Purchase order financing.** The most common scaling problem faced by startups is the inability to find a large new order. The reason is that they don't have the necessary cash to produce and deliver the product. Purchase order financing companies often advance the required funds directly to the supplier. This allows the transaction to complete and profit to flow up to the new business.

(ix) **Factoring accounts receivables.** In this method, a facility is given to the seller who has sold the good on credit to fund his receivables till the amount is fully received. So, when the goods are sold on credit, and the credit period (i.e. the date upto which payment shall be made) is for example 6 months, factor will pay most of the sold amount up front and rest of the amount later. Therefore, in this way, a startup can meet his day to day expenses.

(c) The difference between Management Buy Outs and Leveraged Buy Outs has been discussed as below:

Management Buy Outs

Buyouts initiated by the management team of a company are known as a management buyout. In this type of acquisition, the company is bought by its own management team.

MBOs are considered as a useful strategy for exiting those divisions that does not form part of the core business of the entity.

Leveraged Buyout (LBO)

An acquisition of a company or a division of another company which is financed entirely or partially (50% or more) using borrowed funds is termed as a leveraged

© The Institute of Chartered Accountants of India

buyout. The target company no longer remains public after the leveraged buyout; hence the transaction is also known as going private. The deal is usually secured by the acquired firm's physical assets.

The intention behind an LBO transaction is to improve the operational efficiency of a firm and increase the volume of its sales, thereby increasing the cash flow of the firm. This extra cash flow generated will be used to pay back the debt in LBO transaction. After an, LBO the target entity is managed by private investors, which makes it easier to have a close control of its operational activities. The LBOs do not stay permanent. Once the LBO is successful in increasing its profit margin and improving its operational efficiency and the debt is paid back, it will go public again. Companies that are in a leading market position with proven demand for product, have a strong management team, strong relationships with key customers and suppliers and steady growth are likely to become the target for LBOs. In India the first LBO took place in the year 2000 when Tata Tea acquired Tetley in the United Kingdom. The deal value was ₹ 2135 crores out of which almost 77% was financed by the company using debt. The intention behind this deal was to get direct access to Tetley's international market. The largest LBO deal in terms of deal value (7.6 Billion) by an Indian company is the buyout of Corus by Tata Steel.

© The Institute of Chartered Accountants of India

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

PART – I ACADEMIC UPDATE

(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority)

Chapter 7: Audit Committee and Corporate Governance

As per Stock and Exchange Board of India circular no. CIR/CFD/CMD1/114/2019 dated 18th October, 2019 on resignation of statutory auditors from listed entities and their material subsidiaries:

1. Listed companies are required to make timely disclosures to investors in the securities market for enabling them to take informed investment decisions.
2. Under Sub-clause (2) of Clause A in Part C of Schedule II under Regulation 18(3) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("SEBI LODR Regulations"), the Audit Committee of a listed entity, inter alia, has to make recommendations for the appointment, remuneration and terms of appointment of auditors of a listed entity. Under Sub-clause (7), the Audit Committee is also responsible for reviewing and monitoring the independence and performance of auditors and the effectiveness of the audit process.
3. Further, Sub-clause (7A) inserted under Clause A in Part A of Schedule III under Regulation 30(2) of SEBI LODR Regulations requires detailed reasons to be disclosed by the listed entities to the stock exchanges in case of resignation of the auditor of a listed entity as soon as possible but not later than twenty-four hours of receipt of such reasons from the auditor.
4. Regulation 36(5) of the SEBI LODR Regulations lays down certain disclosures to be made part of the notice to the shareholders for an AGM, where the statutory auditors are proposed to be appointed/re-appointed, including their terms of appointment.
5. Resignation of an auditor of a listed entity / its material subsidiary before completion of the audit of the financial results for the year due to reasons such as pre-occupation may seriously hamper investor confidence and deny them access to reliable information for taking timely investment decisions.
6. In light of the above, the conditions to be complied with upon resignation of the statutory auditor of a listed entity/material subsidiary w.r.t. limited review / audit report as per SEBI LODR Regulations, are as under:

   A. All listed entities/material subsidiaries shall ensure compliance with the following conditions while appointing/re-appointing an auditor:

   (i) If the auditor resigns within 45 days from the end of a quarter of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit

© The Institute of Chartered Accountants of India

report for such quarter.

(ii) If the auditor resigns after 45 days from the end of a quarter of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for such quarter as well as the next quarter.

(iii) Notwithstanding the above, if the auditor has signed the limited review/ audit report for the first three quarters of a financial year, then the auditor shall, before such resignation, issue the limited review/ audit report for the last quarter of such financial year as well as the audit report for such financial year.

B. Other conditions relating to resignation shall include:

(i) Reporting of concerns with respect to the listed entity/its material subsidiary to the Audit Committee:

a. In case of any concern with the management of the listed entity/material subsidiary such as non-availability of information I non-cooperation by the management which may hamper the audit process, the auditor shall approach the Chairman of the Audit Committee of the listed entity and the Audit Committee shall receive such concern directly and immediately without specifically waiting for the quarterly Audit Committee meetings.

b. In case the auditor proposes to resign, all concerns with respect to the proposed resignation, along with relevant documents shall be brought to the notice of the Audit Committee. In cases where the proposed resignation is due to non-receipt of information I explanation from the company, the auditor shall inform the Audit Committee of the details of information I explanation sought and not provided by the management, as applicable.

c. On receipt of such information from the auditor relating to the proposal to resign as mentioned above, the Audit Committee I board of directors, as the case may be, shall deliberate on the matter and communicate its views to the management and the auditor.

(ii) Disclaimer in case of non-receipt of information: In case the listed entity/ its material subsidiary does not provide information required by the auditor, to that extent, the auditor shall provide an appropriate disclaimer in the audit report, which may be in accordance with the Standards of Auditing as specified by ICAI/ NFRA.

The listed entity/ material subsidiary shall ensure that the conditions as mentioned in 6(A) and 6(B) above are included in the terms of appointment of the statutory auditor at the time of appointing/re-appointing the auditor. In case the auditor has already been appointed, the terms of appointment shall be suitably modified to give effect to 6(A) and 6(B) above.

© The Institute of Chartered Accountants of India

The practicing company secretary shall certify compliance by a listed entity with 6(A) and 6(B) above in the annual secretarial compliance report issued in terms of SEBI Circular no. CIR/CFD/CMD1/27/2019 dated February 08, 2019.

C. Obligations of the listed entity and its material subsidiary:

(i) Format of information to be obtained from the statutory auditor upon resignation: Upon resignation, the listed entity/ its material subsidiary shall obtain information from the Auditor in the format as specified in Annexure A to this Circular. The listed entity shall ensure disclosure of the same under Sub-clause (7A) of Clause A in Part A of Schedule III under Regulation 30(2) of SEBI LODR Regulations.

(ii) Co-operation by listed entity and its material subsidiary: During the period from when the auditor proposes to resign till the auditor submits the report for such quarter I financial year as specified above, the listed entity and its material subsidiaries shall continue to provide all such documents/information as may be necessary for the audit I limited review.

(iii) Disclosure of Audit Committee's views to the Stock Exchanges: Upon resignation of the auditor, the Audit Committee shall deliberate upon all the concerns raised by the auditor with respect to its resignation as soon as possible, but not later than the date of the next Audit Committee meeting and communicate its views to the management. The listed entity shall ensure the disclosure of the Audit Committee's views to the stock exchanges as soon as possible but not later than twenty-four hours after the date of such Audit Committee meeting.

7. In case an entity is not mandated to have an Audit Committee, then the board of directors of the entity shall ensure compliance of this circular.

8. The Stock Exchanges are advised to bring the provisions of this circular to the notice of all listed entities and their material subsidiaries and also disseminate it on their websites.

9. In case the auditor is rendered disqualified due to operation of any condition mentioned in Section 141 of the Companies Act, 2013, then the provisions of this Circular shall not apply.

10. The Circular is issued in exercise of the powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992 read with regulations 18(3), 30(2) and 36(5) of the SEBI LODR Regulations and shall be in addition to the provisions of Companies Act, 2013. For more details visit: https://www.sebi.gov.in/legal/circulars/oct-2019/resignation-of-statutory-auditors-from-listed-entities-and-their-material-subsidiaries_44703.html

Chapter 18: Professional Ethics

Joining/Association with "Networks" by Members in Practice

It is hereby clarified that associations with "Network" as a medium of referral of professional work is permissible only if the Network is registered with the Institute, comprising only of

© The Institute of Chartered Accountants of India

Chartered Accountants/ Chartered Accountant Firms, and governed by the Institute' s Network Guidelines, which may be accessed at https://resource.cdn.icai.org/24427announ14280.pdf

Members" attention is also drawn towards following provisions of Chartered Accountants Act, 1949 (hereinafter referred to as the "Act") :

Clause (2) of Part I of First Schedule to the Act

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the Fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Explanation — In this item, "partner" includes a person residing outside India with whom a chartered accountant in practice has entered into partnership which is not in contravention of item (4) of this Part;

Clause (3) of Part I of First Schedule to the Act

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute:

Provided that nothing herein contained shall be construed as prohibiting a member from entering into profit sharing or other similar arrangements, including receiving any share commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in item (2) of this Part;

Clause (5) of Part I of First Schedule to the Act

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he secures, either through the services of a person who is not an employee of such Chartered Accountant or who is not his partner or by means which are not open to a chartered accountant, any professional business.

Provided that nothing herein contained shall be construed as prohibiting any arrangement permitted in terms of items (2), (3) and (4) of this Part;

Clause (6) of Part I of First Schedule to the Act

A Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means:

Provided that nothing herein contained shall be construed as preventing or prohibiting —

(i) any chartered accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or

© The Institute of Chartered Accountants of India

(ii) a member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence;

In view of the above provisions, it is not permissible for members in practice to join Networks (by whatever name called) other than the Networks registered with the Institute.

Members may note that joining such Networks as mentioned above may result in noncompliance of the above stated provisions of the Act resulting in disciplinary proceedings in accordance with the provisions of the Act.

A -Meaning of Network & Network Firm –

Network - A larger structure (a) That is aimed at co-operation; and (b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

Network Firm – "Network Firm" means a firm or Entity that belongs to a Network.

B - Concept of Network

1. To enhance their ability to provide professional services, firms frequently form larger structures with other firms and entities. Whether these larger structures create a network depends on the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct. For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, a larger structure might be such that it is aimed at co-operation and the firms share a common brand name, a common system of quality control, or significant professional resources and consequently is deemed to be a network.
2. The judgment as to whether the larger structure is a network shall be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgment shall be applied consistently throughout the network.
3. Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure, it is deemed to be a network. However, the sharing of immaterial costs does not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals, or training courses, this would not in itself create a network.

   Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not in itself create a network.
4. Where the larger structure is aimed at cooperation and the entities within the structure share common ownership, control or management, it is deemed to be a network. This could be achieved by contract or other means.

© The Institute of Chartered Accountants of India

5. Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is deemed to be a network. For this purpose, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.
6. Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is deemed to be a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not deemed to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision.
7. Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is deemed to be a network. A common brand name includes common initials or a common name. A firm is deemed to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name, when a partner of the firm signs an audit report.
8. Even though a firm does not belong to a network and does not use a common brand name as part of its firm name, it may give the appearance that it belongs to a network if it makes reference in its stationery or promotional materials to being a member of an association of firms.

   Accordingly, if care is not taken in how a firm describes such memberships, a perception may be created that the firm belongs to a network.
9. Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is deemed to be a network. Professional resources include:
   - Common systems that enable firms to exchange information such as client data, billing and time records;
   - Partners and staff;
   - Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements;
   - Audit methodology or audit manuals; and
   - Training courses and facilities.
10. The determination of whether the professional resources shared are significant, and therefore the firms are network firms, shall be made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be significant. The same applies to a common training endeavor. Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical

© The Institute of Chartered Accountants of India

department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

C- Forms of the Network: The different forms of Network can be as under:-

1. A network can be constituted as a mutual entity which will act as a facilitator for the constituents of the Network. In such a case the Network itself will not carry out any professional practice.
2. A network can be constituted as a partnership firm subject to the condition that the total number of partners does not exceed twenty.
3. A network can be constituted as a Limited Liability Partnership subject to the provision of the Chartered Accountant Act and Rules and such other laws as may be applicable.
4. A network can be constituted as company subject to the guidelines prescribed by Institute for corporate form of practice and formation of management consultancy services company.
5. Network Firms shall consist of sole Practitioner/proprietor, partnership or any such entity of professional accountants as may be permitted by the Act
6. A firm is allowed to join only one network.
7. Firms having common partners shall join only one Network.

D- Approval of Name of Network amongst firms registered with Institute:

1. The Network may have distinct name which should be approved by the Institute. To distinguish a "Network" from a "firm" of Chartered Accountants, the words "& Affiliates" shall be used after the name of the network and the words "& Co." / "& Associates" shall not be used. The prescribed format of application for approval of Name for Network is at Form 'A' (enclosed). Illustrative examples of names of Network: -
   (a) If the Network is a Mutual Entity or Partnership Firm: AB & Affiliates
   (b) If the Network is a LLP: AB Affiliates LLP
   (c) If the Network is a Limited Company: AB Affiliates P. Ltd/Limited
2. Provisions of Regulation 190 of the Chartered Accountants Regulations, 1988 shall be applicable to the name of Network. However, even if a name is approved and subsequently it is found that the same is undesirable then, the said name may be withdrawn at any time by the Institute. The Institute shall reject any undesirable name and the provisions in respect of names of companies as prescribed in the Companies Act, 1956 shall be applicable in spirit.
3. The Institute shall approve or reject the name of the Network and intimate the same to the Network at its address mentioned in Form 'A' within a period which shall not be later than 30 days from the date of receipt of the said Form.

© The Institute of Chartered Accountants of India

4. Mere approval of the name of the Network shall not entitle the Network to carry on practice in its own name.

E- Registration of Network with entities in India

1. After the name of a Network is approved as per provision under Guideline 5, the Institute same shall reserve such name for a period of three (3) months from the date of approval.
2. The Network shall get itself registered with the Institute by applying in Form B within the period of 3 months, failing which the name assigned shall stand cancelled on the expiry of the said period.
3. Registration of Network with Institute is mandatory.
4. If different Indian firms are networked with a common Multinational Accounting Firm, they shall be considered as a part of network.

F- Listing of Network with entities outside India

1. The duly authorized representative(s) of the Indian Member firm (s)/Member constituting the Network with entities outside India shall file a declaration with the Institute in Form 'D' for Listing of such Network within 30 days from the date of entering into the Network arrangement.
2. Proprietary/individual members, partnership firms as well as members in LLP or any such other entity of members as may be permitted by the Act, shall be permitted to join such network with entities outside India provided that the proprietary/individual members, partnership firms as well as members in LLP or any such other entity of members are allowed to join only one network and firms having common partners shall join only one such network.

G- Change in constitution of registered Network: In case of change in the constitution of registered Network on account of any entry into or exit from the Network, the network shall communicate the same to the Institute by filing Form 'C' within a period of thirty (30) days from the date of change in the constitution.

H - Ethical Compliance: Once the relationship of network arises, it will be necessary for such a network to comply with all applicable ethical requirements prescribed by the Institute from time to time in general and the following requirements in particular: -

1. If one firm of the network is the statutory auditor of an entity then the associate [including the networked firm(s)] or the said firm directly/indirectly shall not accept the internal audit or book-keeping or such other professional assignments which are prohibited for the statutory auditor firm.
2. The guidelines of ceiling on Non-audit fees is applicable in relation to a Network as follows: i) For a Network firm who is doing statutory audit (including its associate concern and/or firm(s) having common partnership), it shall be the same as mentioned in the said

© The Institute of Chartered Accountants of India

notification; and ii) For other firms of the same Network collectively, it shall be 3 times of the fee payable for carrying out the statutory audit of the same undertaking/company.

3. In those cases where rotation of firms is prescribed by any regulatory authority, no member firm of the network can accept appointment as an auditor in place of any member firm of the network which is retiring.
4. The Network may advertise the Network to the extent permitted by the Advertisement Guidelines issued by Institute. The firms constituting the network are permitted to use the words "Network Firms" on their professional stationery.
5. The constituent member firms of a Network and the Network shall comply with all the Ethical Standards prescribed by the Council from time to time.

I - Consent of Client: The effect of registration of network with Institute will be deemed to be a public notice of the network and therefore consent of client will be deemed to be obtained.

J - Framework of Internal Byelaws of Network: To streamline the networking, a network shall formulate operational bye-laws. Bye-laws may contain the following clauses on which the affiliates of the network may enter into a written agreement among themselves:

(i) Appointment of a Managing Committee, from among the managing partners of the member firms of the network and the terms and conditions under which it should function. The minimum and maximum number of members of the Managing Committee shall also be agreed upon.

(ii) Administration of the network

(iii) Contribution of membership fees to meet the cost of the administration of the network.

(iv) Identifying a partner of any of the member firms of the network to be responsible for the assignment (engagement partner)

(v) Dispute settlement procedures through arbitration and conciliation

(vi) Development of training materials for members of the network

(vii) Issue of News-letters for staff and clients

(viii) Development of softwares for different types of assignments

(ix) Development and maintenance of data bases relevant for different types of assignments

(x) Library

(xi) Appointment of a technical director to whom references can be made

(xii) Determining the methodology for drawing resources from each member firm

(xiii) Determining compensation to member firms for resources to be drawn from them

(xiv) Peer review of the member firms These clauses are illustrative.

© The Institute of Chartered Accountants of India

K - Repeal and Saving: The erstwhile "Rules/Guidelines of Network" issued by the Institute stands repealed from the date of commencement of these Guidelines.

Provided that notwithstanding such repeal, anything done or any action taken or purported to have been done or taken in respect of the erstwhile Rules/Guidelines prior to the date of applicability of these Guidelines shall be deemed to have been done or taken under the corresponding provisions of these Guidelines.

Note: Students are also advised to refer RTP of Paper 1 Financial Reporting (for AS, Ind AS and other updates) and Paper 4 Part A -Corporate Laws (for academic updates relating to Company Law).

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

PART A: MULTIPLE CHOICE QUESTIONS

Integrated Case Scenario 1.

PQR Ltd., is one of the leading companies in the cement manufacturing industry. Right from its incorporation, it has been a subsidiary of GDP Ltd. The total shareholding of GDP Ltd includes the following:

- The Government of Puducherry and Government of Delhi each hold 19% of the paid-up share capital,
- The Government Gujarat's share is 13.5%.

On 27th August 2019, Mr. JJ, the auditor of PQR Ltd. had resigned from his post, citing personal reasons. He had forgotten to inform about his resignation to the concerned authorities. The casual vacancy which was created by the outgoing auditor was filled up with the appointment of FDI & Co. Chartered Accountants as statutory auditors of PQR Ltd. However, few shareholders of the company raised certain objections, which was later settled without any problems. As a part of the terms and conditions of appointment as auditors, FDI & Co. agreed to do the following:

- Charge fees at 5% of the paid-up capital plus 0.1% of net profit of the company (however Mr. JJ had agreed to charge only ₹ 45,000/-),
- Select and recruit personnel, conduct training programmes for and on behalf of PQR Ltd.

The company was having an annual turnover of ₹ 200 crores, and hence it was also liable to tax audit under section 44 AB of Income Tax Act, 1961.

During the current financial year 2019-20, PQR Ltd. had changed its method of accounting compared to the previous financial year (2018-19) and had reported a closing stock of raw material amounting to ₹ 2 lakhs only as on 31st March 2020. Also, the company had borrowed

© The Institute of Chartered Accountants of India

a sum of ₹ 10 crores equally from two public sector banks and two Non-Banking Financial Companies. It had also repaid few deposits amounting to ₹ 75 lakhs to the deposit holders.

As far as FDI & Co. Chartered accountants are concerned, Mr. F, who is one of the partners of the firm (*NOTE*- Mr. F does not sign the financials of PQR Ltd.) had borrowed a sum of ₹ 3.89 lakhs from GDP Ltd. He had also purchased goods worth ₹ 1.09 lakhs from the company. Both the sum borrowed and the cost of the goods bought are not yet paid by Mr. F. Another partner of the firm, Mr. I, who is also responsible for signing the financials statements of PQR Ltd. was also engaged in the teaching profession during his free time.

Upon hearing about the efficient services provided by FDI & Co. Chartered accountants, they were approached by XYZ Cooperative Society to act as their statutory auditor for the upcoming financial years. The firm agreed to the offer and had the following options in mind with respect to the fees to be charged from them:

(i) To charge fees as percentage of Net Profits, or

(ii) To charge fees of ₹ 101/-.

Question No.: (1-5)

1. To whom should have Mr. JJ informed about his resignation? What could be the possible consequence for his non-compliance?

   (a) He should have informed the registrar and PQR Ltd. As a consequence of his failure, he is liable to a penalty not exceeding ₹ 5 lakhs.

   (b) He should have informed the registrar alone. As a consequence of his failure, he is liable to a penalty not less than ₹ 50,000/-.

   (c) He should have informed the registrar and FDI & Co. As a consequence of his failure, he is liable to a fine of ₹ 500 per day for each day of failure.

   (d) He should have informed the registrar & comptroller and auditor general. As a consequence of his failure, he is liable to a fine of ₹ 45,000/-.

2. With respect to the acts carried out by Mr. F, the partner of the audit firm, what can you infer about the appointment of FDI & Co. as auditors of PQR Ltd.?

   (a) It is valid since the indebtedness is within prescribed limits.

   (b) It is not valid since the indebtedness exceeds prescribed limit of ₹ 1 lakhs.

   (c) It is valid since Mr. F is not signing the financials of PQR Ltd.

   (d) It is valid since the indebtedness is not with PQR Ltd.

3. Which among the below are permitted as per Chartered Accounts Act, 1949?

   (i) Charge fees at 5% of the paid-up capital plus 0.1% of net profit of the company.

   (ii) Select and recruit personnel, conduct training programmes for and on behalf of PQR Ltd.

© The Institute of Chartered Accountants of India

(iii) Mr. I, one of the partners who is responsible to sign the financials of PQR Ltd. was into teaching profession.

(a) (i) & (ii)

(b) (iii) only

(c) (ii) & (iii)

(d) (i), (ii) & (iii)

4. With respect to the fees to be charged for its new assignment, which option can be opted by FDI & Co.?

(i) To charge fees as percentage of Net Profits, or

(ii) To charge fees of ₹ 101/-.

(a) (i) Only.

(b) (ii) Only.

(c) Either (i) or (ii).

(d) Neither (i) nor (ii).

5. Among the below transactions which were undertaken by PQR Ltd., which needs to be reported by the auditors under fiscal laws?

(i) ₹ 10 crores loan taken, which is exceeding the limit specified u/s 269 SS of Income Tax Act.

(ii) Changed its method of accounting from the previous financial year.

(iii) Repayment of deposits of ₹ 75 lakhs, which is exceeding limit specified u/s 269 T of Income Tax Act.

(iv) Reporting of Closing stock of raw material worth ₹ 2 lakhs only.

(a) (i), (iii) & (iv).

(b) (ii) & (iv).

(c) (i) & (iii).

(d) (i), (ii), (iii) & (iv).

Integrated Case Scenario 2.

CA & Co. Chartered Accountants have been appointed as the auditors of ZXC company. The company has obtained a license from the Central Government for itself to promote the sport of hockey in the rural areas of India. The company's average annual profit was estimated to be around ₹ 50 lakhs. This profit would not be distributed as dividend to the shareholders, however, it would be applied towards its objective of promoting sports in the country. During the course of audit for the financial year 2019-20, the following observations with respect to the company were made by the auditors:

© The Institute of Chartered Accountants of India

- The company was not maintaining proper records with respect to the fixed assets maintained by it. The value of fixed assets of the company amounts to ₹ 1.50 crores approximately.
- Physical verification for the same was not carried out at regular intervals. The last physical verification was conducted on 31st July 2018.

As a result of the above observations, the auditors decided to report the same in the Companies (Auditors Report) Order 2016. However, the management of the company was against the decision of the auditors and insisted that the observations need not be reported. After several discussions between the auditors and the management, CA & Co. decided not to report the issues.

CA & Co. Chartered Accountants, were also acting as auditors for another company, LS Ltd. and KD Bank Ltd. During the course of audit of LS Ltd, there was a difference of opinion between the management and the auditors as to which among the following are the areas which the auditor should take into account to determine "Key Audit Matter" as per SA 701:

(i) The effect on audit of significant transactions that took place in the financial year.

(ii) Areas of high risk as assessed and reported by management's expert.

(iii) Significant auditor judgement relating to areas in the financials that involved significant management judgement

During the audit of KD Bank Ltd., the auditors and the management had a certain difference of opinion as to the amount and the items which needs to be disclosed under the head of contingent liabilities. However, apart from that, the auditors had observed the following:

- 59 agricultural loan accounts (guaranteed by Government of Delhi) amounting to ₹ 29 lakhs were overdue for more than two years.
- 73 (guaranteed by Government of India) agricultural loan accounts amounting to ₹ 25 lakhs were overdue for more than two years.
- 6 corporate loans accounts (guaranteed three each by Government of India and Government of Delhi) amounting to ₹ 25 lakhs for each company were overdue for more than three and a half months.

On hearing about the efficient services provided by CA & Co. Chartered Accountants, they were offered the following new assignments:

- A GST assessing officer approached for conduct of special audit under section 66 of CGST Act for a company named MD Ltd. which was having an annual turnover of ₹ 1 crore. He had requested for the special audit as per the opinion that the company had not availed input tax credit within normal limits.

© The Institute of Chartered Accountants of India

- Offer to provide incorporation services to RS General Insurance Ltd. which was proposed to be set up with a paid-up share capital of ₹ 113 crores, of which preliminary expenses of ₹ 17 crores were included.

The audit firm after taking into consideration all the facts and figures with respect to its new assignments, decided not to undertake both of them.

Question No: (6-10)

6. Is the decision of CA & Co. of not reporting the issues of ZXC in CARO 2016 justified? If so, under what reason?
   (a) No. CARO 2016 is applicable to ZXC and hence the same has to be reported under clause (i) of CARO.
   (b) Yes. CARO 2016 is not applicable to ZXC and hence the same need not to be reported.
   (c) No. As per SA 240, the auditor has to maintain professional skepticism when it comes to issues in the area of fixed assets and hence the same has to be reported.
   (d) Yes. As per SA 320, the auditor after taking into account the materiality of the issue, he may either choose to report or not report about the same.
7. What is the total amount of loans that should be classified as NPA by KD Bank?
   (a) ₹ 79 lakhs.
   (b) ₹ 100 lakhs.
   (c) ₹ 204 lakhs.
   (d) ₹ 104 lakhs.
8. Which among the following has to be reported by the auditor as contingent liability of KD Bank Ltd.?
   (a) Guarantee given by KD Bank on behalf of constituent located in Myanmar.
   (b) A percentage of the total bills purchased by KD Bank.
   (c) Claims against the bank acknowledged as debt.
   (d) Unpaid salary of ₹ 5 lakhs to five staffs of KD Bank Ltd., who are currently undergoing a court trail.
9. What could be the possible reason for not accepting the special audit under section 66 of CGST Act?
   (a) Such audit is applicable only if the turnover of the company exceeds ₹ 2 crores.
   (b) Such audits need to be conducted by cost accountants.
   (c) Such audit has to be called upon by assistant commissioner.

© The Institute of Chartered Accountants of India

(d) Such audit has to be called upon by the central government.

10. Whether CA & Co. are justified for not accepting the incorporation services for RS General Insurance Ltd.? If so, as to what is the reason?

    (a) Yes. The incorporation services for an insurance company should be done by the auditor appointed by the comptroller and auditor general of India.

    (b) Yes. The insurance company should have a minimum paid up share capital of ₹ 100 crores which shall exclude the preliminary expenses.

    (c) No. The insurance company should have a minimum paid up share capital of ₹ 100 crores which also includes the preliminary expenses.

    (d) Yes. The incorporation services for an insurance company should be done by the auditor appointed by the Insurance Regulatory and Development Authority.

PART B : DESCRIPTIVE QUESTIONS

Standards on Auditing, Statements and Guidance Notes

11. (a) Your firm has been appointed as the statutory auditors of AGM Private Limited for the financial year 2018-19. While verification of company's trade receivables as on 31st March 2019, accountant of AGM Ltd. has requested you, not to send balance confirmations to a particular group of trade receivables since the said balances are under dispute and the matter is pending in the Court. As a Statutory Auditor, how would you deal in this situation?

    (b) RIM Private Ltd is engaged in the business of manufacturing of water bottles and is experiencing significant increase in turnover year on year. During the financial year ended 31 March 2019, the company carried out a detailed physical verification of its inventory and property, plant and equipment.

    You are the auditor of RIM Private Ltd. The inventory as at the end of the year was ₹ 2.25 crores. Due to unavoidable circumstances, you could not be present at the time of annual physical verification. Under the above circumstances how would you ensure that the physical verification conducted by the management was in order?

    (c) Mr. PM, a practising Chartered Accountant, has been appointed as an auditor of Truth Pvt. Ltd. What factors would influence the amount of working papers required to be maintained for the purpose of his audit?

Risk Assessment and Internal Control

12. (a) Navjeevan Hospital is a multi-speciality hospital which has been facing a lot of pilferage and troubles regarding their inventory maintenance and control. On investigation into the matter it was found that the person in charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. According to you, which basis system of control has been violated? Also list down the other general conditions pertaining to such system which

© The Institute of Chartered Accountants of India

needs to be maintained and checked by the management.

(b) During the course of his audit, the auditor noticed material weaknesses in the internal control system and he wishes to communicate the same to the management. You are required to elucidate the important points the auditor should keep in the mind while drafting the letter of weaknesses in internal control system.

The Company Audit & Audit Report

13. (a) The Balance Sheet of G Ltd. as at 31st March, 19 is as under. Comment on the presentation in terms of Schedule III.

Heading	Note No.	31st March, 19	31st March, 18
Equity & Liabilities			
Share Capital	1	XXX	XXX
Reserves & Surplus	2	0	0
Employee stock option outstanding	3	XXX	XXX
Share application money refundable	4	XXX	XXX
Non-Current Liabilities		XXX	XXX
Deferred tax liability (Arising from Indian Income Tax)	5	XXX	XXX
Current Liabilities			
Trade Payables	6	XXX	XXX
Total		XXXX	XXXX
Assets			
Non-Current Assets			
Fixed Assets-Tangible	7	XXX	XXX
CWIP (including capital advances)	8	XXX	XXX
Current Assets			
Trade Receivables	9	XXX	XXX
Deferred Tax Asset (Arising from Indian Income Tax)	10	XXX	XXX
Debit balance of Statement of Profit and Loss		XXX	XXX
Total		XXXX	XXXX

(b) “When the auditor modifies the audit opinion, the auditor shall use the heading “Qualified Opinion,” “Adverse Opinion,” or “Disclaimer of Opinion,” as appropriate, for

© The Institute of Chartered Accountants of India

the Opinion section." As an expert you are required to brief the special considerations required for expressing:

(i) Qualified Opinion;

(ii) Adverse Opinion and

(iii) Disclaimer of Opinion.

(c) The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

(i) Circumstances beyond the control of the entity;

(ii) Circumstances relating to the nature or timing of the auditor's work; or

(iii) Limitations imposed by management.

Explain with the help of examples.

Audit of Banks & Insurance Company

14 (a) In course of audit of Good Samaritan Bank as at 31st March, 2019 you observed the following:

(1) In a particular account there was no recovery in the past 18 months. The bank has not applied the NPA norms as well as income recognition norms to this particular account. When queried the bank management replied that this account was guaranteed by the central government and hence these norms were not applicable. The bank has not invoked the guarantee. Please respond. Would your answer be different if the advance is guaranteed by a State Government?

(2) The bank's advance portfolio comprised of significant loans against Life Insurance Policies. Write suitable audit program to verify these advances.

(b) Amrapali & Co., Chartered Accountants are the Auditors of Natural Care General Insurance Company Limited. As on March 31, 2019 the Management made a provision for claims outstanding. Enumerate the steps to be taken by the Auditor while verifying the "Claims Provision".

Audit under Fiscal Laws

15. (a) ABC Printing Press, a proprietary concern, made a turnover of above ₹ 1.03 crore for the year ended 31.03.2019. The Management explained its auditor Mr. Z, that it undertakes different job work orders from various customers. The raw materials required for each job are dissimilar. It purchases the raw materials as per specification/ requirements of each customer and there is hardly any balance of raw materials remaining in the stock except pending work-in-progress at the year end. Because of variety and complexity of materials, it is impossible to maintain a stock-register. Give your comments.

© The Institute of Chartered Accountants of India

(b) PQR Ltd is a textile company with aggregate turnover exceeding ₹ 2 crores. XYZ & Associates is a Chartered Accountant firm which has been appointed for GST audit of PQR Ltd. Mr Sandhu, Chartered Accountant from XYZ & Associates, observes on 23 July 2019 that PQR Ltd has not filed its GSTR 3B for the month of July & its GSTR-1 return is also not complied with. What should Mr Sandhu advise the client before conducting GST audit of PQR Ltd.

Audit of Public Sector Undertakings

16. (a) XYZ & Co., a CA. firm was appointed by C&AG to conduct comprehensive audit of ABC Public undertaking. C&AG advised to cover areas such as investment decisions, project formulation, organisational effectiveness, capacity utilisation, management of equipment, plant and machinery, production performance, use of materials, productivity of labour, idle capacity, costs and prices, materials management, sales and credit control, budgetary and internal control systems, etc. Discuss stating the issues examined in comprehensive audit.

(b) A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action." Briefly discuss the issues addressed by Performance Audits conducted in accordance with the guidelines issued by C&AG.

Internal Audit, Management and Operational Audit

17. Mr. Anand is appointed as statutory auditor of XYZ Ltd. XYZ Ltd is required to appoint internal auditor as per statutory provisions given in the Companies Act, 2013 and appointed Mr. Bhola as its internal auditor. The external auditor Mr. Anand asked internal auditor to provide direct assistance to him regarding evaluating significant accounting estimates by the management and assessing the risk of material misstatements.

(a) Discuss whether Mr. Anand, statutory auditor, can ask direct assistance from Mr. Bhola, internal auditor as stated above in view of Standards on Auditing.

(b) Will your answer be different, if Mr. Anand ask direct assistance from Mr. Bhola, internal auditor with respect to external confirmation requests and evaluation of the results of external confirmation procedures?

Due Diligence, Investigation and Forensic Audit

18. ABC nationalised bank received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. In this connection, the General Manager, who is in-charge of advances, approaches you to conduct a thorough investigation of this limited company and submit a confidential report based on which he will decide whether to sanction this loan or not.

Decide the points you will cover in your investigation before submitting your report to the General Manager.

© The Institute of Chartered Accountants of India

Professional Ethics

19. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

    (a) OPAQ & Associates, a firm of Chartered Accountants responded to a tender issued exclusively for Chartered Accountants by an organisation in the area of tax audit. However no minimum fee was prescribed in the tender document.

    (b) Agarwal Pvt Ltd. approached CA. Prem, a Chartered Accountant in practice, for debt recovery services. CA Prem accepted the work and insisted for fees to be based on 2% of the debt recovered.

    (c) ABZ & Co., a firm of Chartered Accountants, develops a website "abz.com". The colour chosen for the website was a very bright green and the web-site was to run on a "push" technology where the names of the partners of the firm and the major clients were to be displayed on the web-site without any disclosure obligation from any regulator.

    (d) Mr. P and Mr. Q are running a firm of Chartered Accountants in the name of PQ & Co. On 23.05.2019, they included the name of Mr. R, a practicing Chartered Accountant, without his knowledge, as a partner while submitting an application for empanelment as auditor for branches of a public sector bank, to the Institute. However, they added Mr. R as a partner to their firm offering a share of 25% of the profits, on 25.05.2019.

20. Write a short note on the following:

    (a) Scope of peer review.

    (b) "Mandatory Review" areas of the audit committee.

    (c) Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III

    (d) Understanding and documenting automated environment

SUGGESTED ANSWERS/HINTS

PART A : ANSWERS TO MULTIPLE QUESTIONS

1. (d)

2. (a)

3. (c)

4. (c)

5. (b)

© The Institute of Chartered Accountants of India

6. (b)

7. (d)

8. (a)

9. (c)

10. (b)

PART B

11. (a) **SA 505 "External Confirmations"**, establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. If the management refuses to allow the auditor to a send a confirmation request, the auditor shall:

(i) Inquire as to Management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness,

(ii) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures, and

(iii) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those in charge of governance and also determine its implication for the audit and his opinion.

(b) As per **SA 501 "Audit Evidence – Additional Considerations for Specific Items",** the auditor should perform audit procedures, designed to obtain sufficient appropriate audit evidence during his attendance at physical inventory counting. SA 501 is additional guidance to that contained in SA 500, "Audit Evidence", with respect to certain specific financial statement amounts and other disclosures.

If the auditor is unable to be present at the physical inventory count on the date planned due to unforeseen circumstances, the auditor should take or observe some physical counts on an alternative date and where necessary, perform alternative audit procedures to assess whether the changes in inventory between the date of physical count and the period end date are correctly recorded. The auditor would also verify the procedure adopted, treatment given for the discrepancies noticed during the physical count. The auditor would also ensure that appropriate cut off procedures were followed by the management. He should also get management's written representation on (a) the completeness of information provided regarding the inventory, and (b) assurance with regard to adherence to laid down procedures for physical inventory count.

© The Institute of Chartered Accountants of India

By following the above procedure, it will be ensured that the physical verification conducted by the management was in order.

(c) **Factors Influencing the amount of Working Papers:** As per SA 230 "Audit Documentation", which refers to the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached, the amount of audit working papers depend on factors such as-

(i) The size and complexity of the entity.

(ii) The nature of the audit procedures to be performed.

(iii) The identified risks of material misstatement.

(iv) The significance of the audit evidence obtained.

(v) The nature and extent of exceptions identified.

(vi) The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.

(vii) The audit methodology and tools used.

(viii) Timely preparation of Audit Documentation.

12. (a) Basic system of Control: Internal Checks and Internal Audit are important constituents of Accounting Controls. Internal check system implies organization of the overall system of book-keeping and arrangement of Staff duties in such a way that no one person can carry through a transaction and record every aspect thereof.

In the given case of Navjeevan Hospital, the person-in-charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. Thus, one of the basic system of control i.e. internal check which includes segregation of duties or maker and checker has been violated where transaction processing are allocated to different persons in such a manner that no one person can carry through the completion of a transaction from start to finish or the work of one person is made complimentary to the work of another person.

The general condition pertaining to the internal check system may be summarized as under-

(i) No single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.

(ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.

(iii) Every member of the staff should be encouraged to go on leave at least once a year.

© The Institute of Chartered Accountants of India

(iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.

(v) There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.

(vi) Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.

(vii) Budgetary control should be exercised and wide deviations observed should be reconciled.

(viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.

(ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.

(x) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.

(b) Important Points to be kept in Mind While Drafting Letter of Weakness: As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control -

(i) A description of the deficiencies and an explanation of their potential effects; and

(ii) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

(1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.

(2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.

(3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.

© The Institute of Chartered Accountants of India

(4) The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

13. (a) Following Errors are noticed in presentation as per Schedule III:

(i) Share Capital and Reserve & Surplus are to be reflected under the heading "Shareholders' funds", which is not shown while preparing the balance sheet. Although it is a part of Equity and Liabilities, yet it must be shown under head "shareholders' funds". The heading "Shareholders' funds" is missing in the balance sheet given in the question.

(ii) Reserve & Surplus is showing zero balance, which is not correct in the given case. Debit balance of statement of Profit & Loss should be shown as a negative figure under the head 'Surplus'. The balance of 'Reserves and Surplus', after adjusting negative balance of surplus shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

(iii) Schedule III requires that Employee Stock Option outstanding should be disclosed under the heading "Reserves and Surplus".

(iv) Share application money refundable shall be shown under the sub-heading "Other Current Liabilities". As this is refundable and not pending for allotment, hence it is not a part of equity.

(v) Deferred Tax Liability has been correctly shown under Non-Current Liabilities. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.

(vi) Under the main heading of Non-Current Assets, Property, Plant and Equipment are further classified as under:

(a) Tangible assets

(b) Intangible assets

(c) Capital work in Progress

(d) Intangible assets under development.

Keeping in view the above, the CWIP shall be shown under Property, Plant and Equipment as Capital Work in Progress. The amount of Capital advances included in CWIP shall be disclosed under the sub-heading "Long term loans and advances" under the heading Non-Current Assets.

Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, the words "Fixed assets" shall be substituted with the words "Property, Plant and Equipment".

(e) Deferred Tax Asset shall be shown under Non-Current Asset. It should be the

© The Institute of Chartered Accountants of India

net balance of Deferred Tax Asset after adjusting the balance of deferred tax liability if the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and it relates to the same governing tax laws.

(f) Subsequent to the notification of Ministry of Corporate Affairs dated October 11, 2018 under Section 467(1) of the Companies Act, 2013, Trade Payables should be disclosed as follows:-

(A) total outstanding dues of micro enterprises and small enterprises; and

(B) total outstanding dues of creditors other than micro enterprises and small enterprises."

(b) (i) Special consideration required for expressing Qualified Opinion: When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section:

(1) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) […] in accordance with [the applicable financial reporting framework]; or

(2) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion.

(ii) Special consideration needed for expressing Adverse Opinion: When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:

(1) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) […] in accordance with [the applicable financial reporting framework]; or

(2) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

(iii) Special consideration is required for expressing Disclaimer of Opinion: When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

© The Institute of Chartered Accountants of India

(1) State that the auditor does not express an opinion on the accompanying financial statements;

(2) State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and

(3) Amend the statement required in SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

(c) The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

(i) Circumstances beyond the control of the entity;

(ii) Circumstances relating to the nature or timing of the auditor's work; or

(iii) Limitations imposed by management.

An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.

Examples of circumstances beyond the control of the entity include when:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

Examples of circumstances relating to the nature or timing of the auditor's work include when:

- The entity is required to use the equity method of accounting for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
- The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.
- The auditor determines that performing substantive procedures alone is not

© The Institute of Chartered Accountants of India

sufficient, but the entity's controls are not effective.

Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include when:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

14. (a) (1) Government Guaranteed Advance: If a government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance should not be taken to income unless interest is realized. However, for purpose of asset classification, credit facility backed by Central Government Guarantee, though overdue, can be treated as NPA only when the Central Government repudiates its guarantee, when invoked.

Since the bank has not revoked the guarantee, the question of repudiation does not arise. Hence the bank is correct to the extent of not applying the NPA norms for provisioning purpose. But this exemption is not available in respect of income recognition norms. Hence the income to the extent not recovered should be reversed.

The situation would be different if the advance is guaranteed by State Government because this exception is not applicable for State Government Guaranteed advances, where advance is to be considered NPA if it remains overdue for more than 90 days.

In case the bank has not invoked the Central Government Guarantee though the amount is overdue for long, the reasoning for the same should be taken and duly reported in LFAR.

(2) The Audit Programme to Verify Advances against Life Insurance Policies is as under-

(i) The auditor should inspect the policies and see whether they are assigned to the bank and whether such assignment has been registered with the insurer.

(ii) The auditor should also examine whether premium has been paid on the policies and whether they are in force.

(iii) Certificate regarding surrender value obtained from the insurer should be examined.

(iv) The auditor should particularly see that if such surrender value is subject to payment of certain premium, the amount of such premium has been deducted from the surrender value.

© The Institute of Chartered Accountants of India

(b) **Verification of "Claims Provision" in the Case of a General Insurance Company**: The outstanding liability at the year-end is determined at the divisions/branches where the liability originates for outstanding claims. Thereafter, based on the total consolidated figure for all the divisions/branches, the Head Office considers a further provision in respect of outstanding claims. The auditor should satisfy himself that the estimated liability provided for by the management is adequate with reference to the relevant claim files/dockets, keeping in view the following:

(i) that provision has been made for all unsettled claims as at the year-end on the basis of claims lodged/communicated by the parties against the company. The date of loss (and not the date of communication thereof) is important for recording/ recognizing the claim as attributable to a particular year.

(ii) that provision has been made for only such claims for which the company is legally liable, considering particularly, (a) that the risk was covered by the policy, if in force, and the claims arose during the currency of the policy; and (b) that claim did not arise during the period the company was not supposed to cover the risk.

(iii) that the provision made is normally not in excess of the amount insured except in some categories of claims where matters may be sub-judice in legal proceedings which will determine the quantum of claim, the amount of provision should also include survey fee and other direct expenses.

(iv) that in determining the amount of provision, events after the balance sheet date have been considered.

(v) that the claims status reports recommended to be prepared by the Divisional Manager on large claims outstanding at the year-end have been reviewed with the contents of relevant files or dockets for determining excess/short provisions.

(vi) that in determining the amount of provision, the 'average clause' has been applied in case of under-insurance by parties.

(vii) that the provision made is net of payments made 'on account' to the parties wherever such payments have been booked to claims.

(viii) that in case of co-insurance arrangements, the company has made provisions only in respect of its own share of anticipated liability.

(ix) that wherever an unduly long time has elapsed after the filing of the claim and there has been no further communication and no litigation or arbitration dispute is involved, the reasons for carrying the provision have been ascertained.

(x) that wherever legal advice has been sought or the claim is under litigation, the provisions is made according to the legal advisor's view and differences, if any, are explained.

(xi) that in the case of amounts purely in the nature of deposits with courts or other

© The Institute of Chartered Accountants of India

authorities, adequate provision is made and deposits are stated separately as assets and provisions are not made net of such deposits.

(xii) that no contingent liability is carried in respect of any claim intimated in respect of policies issued.

(xiii) that the claims are provided for net of estimated salvage, wherever applicable.

(xiv) that intimation of loss is received within a reasonable time and reasons for undue delay in intimation are looked into.

(xv) that provisions have been retained as at the year-end in respect of guarantees given by company to various Courts for claims under litigation.

(xvi) that due provision has been made in respect of claims lodged at any office of the company other than the one from where the policy was taken, e.g., a vehicle insured at Mumbai having met with an accident at Chennai necessitating claim intimation at one of the offices of the company at Chennai.

In cases of material differences in the liability estimated by the management and that which ought to be provided in the opinion of the auditor, the same must be brought out in the auditor's report after obtaining further information or explanation from the management.

15. (a) Non-maintenance of stock register: The explanation of the entity for the use of varieties of raw materials for different jobs undertaken may be valid. But the auditor needs to verify the specified job-orders received and the different raw materials purchased for each job separately. The use of different papers (quality, quantity and size) ink, colour etc. may be examined. If possible, the auditor may also enquire with the other similar printers in the locality to ensure the prevailing custom. At the same time, he has to report and certify under clause 35(b) and clause 11(b) of Form 3CD read with the Rule 6G(2) of the Income-tax Act, 1961, about the details of stock and account books (including stock register) maintained. He must verify the closing stock of raw materials, work-in-progress and finished goods of the concern, at least on the date of its balance sheet. In case the said details are not properly maintained, he has to specifically mention the same with reasons for non-maintenance of stock register by the entity.

(b) The auditor should advise the company to file all the GSTR-3B, GSTR-1 and annual returns before conducting GST audit so that auditor can validate and verify the returns filed by the company, verification of ITC claimed, verification of output GST liability discharged by the company and for collation of return workings and reconciliations. Auditor needs to have a comprehensive picture of -

(i) Understanding of the back-up of monthly returns as well as annual return and understanding of reports generated by the GSTN portal as well as internal records of the company.

© The Institute of Chartered Accountants of India

(ii) Understanding of the eligibility of Input Tax Credit (ITC) availed i.e. whether ITC availed by the company is creditable or not and understanding of reversal of ITC undertaken or applicable (if any).

(iii) Understanding of the taxability of outward supplies and transactions covered under Reverse Charge Mechanism and other miscellaneous/ specific transactions and understanding of the positions taken on various transactions by the company.

16 (a) Issues examined in Comprehensive Audit: Some of the issues examined in comprehensive audit are-

(i) How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases and, if so, what are these and whether there is evidence of extravagance or unnecessary expenditure?

(ii) Have the accepted production or operational outputs been achieved? Has there been under utilisation of installed capacity or shortfall in performance and, if so, what has caused it?

(iii) Has the planned rate of return been achieved?

(iv) Are the systems of project formulation and execution sound? Are there inadequacies? What has been the effect on the gestation period and capital cost?

(v) Are cost control measures adequate and are there inefficiencies, wastages in raw materials consumption, etc.?

(vi) Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores and spares?

(vii) Does the enterprise have research and development programmes? What has been the performance in adopting new processes, technologies, improving profits and in reducing costs through technological progress?

(viii) If the enterprise has an adequate system of repairs and maintenance?

(ix) Are procedures effective and economical?

(x) Is there any poor or insufficient or inefficient project planning?

(b) According to the guidelines issued by the C&AG, Performance Audits usually address the issues of:

(i) Economy - It is minimising the cost of resources used for an activity, having regard to appropriate quantity, quality and at the best price.

Judging economy implies forming an opinion on the resources (**e.g. human, financial and material)** deployed. This requires assessing whether the given resources have been used economically and acquired in due time, in appropriate quantity and quality at the best price.

© The Institute of Chartered Accountants of India

(ii) **Efficiency** - It is the input-output ratio. In the case of public spending, efficiency is achieved when the output is maximised at the minimum of inputs, or input is minimised for any given quantity and quality of output.

Auditing efficiency embraces aspects such as whether:

(a) sound procurement practices are followed;

(b) resources are properly protected and maintained;

(c) human, financial and other resources are efficiently used;

(d) optimum amount of resources (staff, equipment, and facilities) are used in producing or delivering the appropriate quantity and quality of goods or services in a timely manner;

(e) public sector programmes, entities and activities are efficiently managed, regulated, organised and executed;

(f) efficient operating procedures are used; and

(g) the objectives of public sector programmes are met cost-effectively.

(iii) **Effectiveness -** It is the extent to which objectives are achieved and the relationship between the intended impact and the actual impact of an activity.

In auditing effectiveness, performance audit may, for instance:

(a) assess whether the objectives of and the means provided (legal, financial, etc.) for a new or ongoing public sector programme are proper, consistent, suitable or relevant to the policy;

(b) determine the extent to which a program achieves a desired level of program results;

(c) assess and establish with evidence whether the observed direct or indirect social and economic impacts of a policy are due to the policy or to other causes;

(d) identify factors inhibiting satisfactory performance or goal-fulfilment;

(e) assess whether the programme complements, duplicates, overlaps or counteracts other related programmes;

(f) assess the effectiveness of the program and/or of individual program components;

(g) determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;

(h) assess the adequacy of the management control system for measuring, monitoring and reporting a programme's effectiveness;

(i) assess compliance with laws and regulations applicable to the program; and

© The Institute of Chartered Accountants of India

(j) identify ways of making programmes work more effectively.

17. (a) Direct Assistance from Internal Auditor: As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that Involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

Significant judgments include the following:

- Assessing the risks of material misstatement;
- Evaluating the sufficiency of tests performed;
- Evaluating the appropriateness of management's use of the going concern assumption;
- Evaluating significant accounting estimates; and
- Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

In view of above, Mr. Anand cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

(b) Direct Assistance from Internal Auditor in case of External Confirmation Procedures: SA 610 "Using the Work of Internal Auditor", provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned.

Further, in accordance with SA 505, "External Confirmation" the external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

18. Investigation on Behalf of the Bank for Advances: A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan. On these considerations, the investigating accountant, in the course of his enquiry, should attempt to collect information on the under mentioned points:

(i) The purpose for which the loan is required and the manner in which the borrower proposes to invest the amount of the loan.

© The Institute of Chartered Accountants of India

(ii) The schedule of repayment of loan submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case. Institutional lenders now-a-days rely more for payment of loans on the reliability of annual profits and loss on the values of assets mortgaged to them.

(iii) The financial standing and reputation for business integrity enjoyed by directors and officers of the company.

(iv) Whether the company is authorised by the Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.

(v) The history of growth and development of the company and its performance during the past 5 years.

(vi) How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period of loan.

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant should take the under-mentioned steps:

(a) Prepare a condensed income statement from the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.

(b) Compute the under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:

(i) Sales to Average Inventories held.

(ii) Sales to Fixed Assets.

(iii) Equity to Fixed Assets.

(iv) Current Assets to Current Liabilities.

(v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.

(vi) Equity to Long Term Loans.

(vii) Sales to Book Debts.

(viii) Return on Capital Employed.

© The Institute of Chartered Accountants of India

(c) Enter in a separate part of the statement the break-up of annual sales product-wise to show their trend.

Steps involved in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank- The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below:

(1) Fixed assets - A full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.

(2) Inventory - The value of different types of inventories held (raw materials, work-in-progress and finished goods) and the basis on which these have been valued.

Details as regards the nature and composition of finished goods should be disclosed. Slow-moving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in important items of inventory subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered.

If any inventory has been pledged as a security for a loan the amount of loan should be disclosed.

(3) Trade Receivables, including bills receivable - Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them.

Further, the total amount outstanding at the close of the period should be segregated as follows:

(i) debts due in respect of which the period of credit has not expired;

(ii) debts due within six months; and

(iii) debts due but not recovered for over six months.

If any debts are due from directors or other officers or employees of the company, the particulars thereof should be stated. Amounts due from subsidiary and affiliated concerns, as well as those considered abnormal should be disclosed. The recoveries out of various debts subsequent to the date of the

© The Institute of Chartered Accountants of India

Balance sheet should be stated.

(4) Investments - The schedule of investments should be prepared. It should disclose the date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.

(5) Secured Loans - Debentures and other loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re-payment of a liability should be disclosed.

(6) Provision of Taxation - The previous years up to which taxes have been assessed should be ascertained. If provision for taxes not assessed appears in be inadequate, the fact should be stated along with the extent of the shortfall.

(7) Other Liabilities - It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade payables should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.

(8) Insurance - A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance-cover appears to be adequate, having regard to the value of assets.

(9) Contingent Liabilities - By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced those of machinery suppliers and the legal adviser, for example, the investigating accountant should ascertain particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.

(10) The impact on economic position of the company by economic, political and social changes those are likely to take place during the period of loan.

Finally, the investigating accountant should ascertain whether any application for loan to another bank or any other party has been made. If so, the result thereof should be examined.

19. (a) Responding to Tenders: Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 lays down guidelines for responding to tenders, etc. It states that a member may respond to tenders or enquiries issued by various users of

© The Institute of Chartered Accountants of India

professional services or organizations from time to time and secure professional work as a consequence.

However, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for Chartered Accountants, such as audit and attestation services. Though, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

In the instant case, OPAQ & Associates responded to a tender of tax audit which is exclusively reserved for Chartered Accountants even though no minimum fee was prescribed in the tender document.

Therefore, OPAQ & Associates shall be held guilty of professional conduct for responding to such tender in view of above-mentioned guideline.

(b) **Charging of Fees based on Percentage:** Clause (10) of Part I to First Schedule to the Chartered Accountants Act, 1949 prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him.

However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949. The Council of the Institute has framed Regulation 192 which exempts debt recovery services where fees may be based on a percentage of the debt recovered.

In the given case, CA. Prem has insisted for fees to be based on percentage of the debt recovered (which is exempted under Regulation 192). Hence, CA. Prem will not be held guilty for professional misconduct.

(c) **Posting of Particulars on Website:** The Council of the Institute had approved posting of particulars on website by Chartered Accountants in practice under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949 subject to the prescribed guidelines. The relevant guidelines in the context of the website hosted by ABZ & Co. are:

- No restriction on the colours used in the website;
- The websites are run on a “pull” technology and not a “push” technology
- Names of clients and fees charged not to be given.

  However, disclosure of names of clients and/or fees charged, on the website is permissible only where it is required by a regulator, whether or not constituted under a statute, in India or outside India, provided that such disclosure is only to the extent of requirement of the regulator. Where such disclosure of names of clients and/or fees charged is made on the website, the member/ firm shall ensure that it is mentioned on the website [in italics], below such disclosure

© The Institute of Chartered Accountants of India

itself, that "This disclosure is in terms of the requirement of [name of the regulator] having jurisdiction in [name of the country/area where such regulator has jurisdiction] vide [Rule/ Directive etc. under which the disclosure is required by the Regulator].

In view of the above, ABZ & Co. would have no restriction on the colours used in the website but failed to satisfy the other two guidelines. Thus, the firm would be liable for professional misconduct since it would amount to soliciting work by advertisement.

(d) Submitting Wrong Information to the Institute: As per Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false.

In the instant case, Mr. P and Mr. Q, partners of PQ & Co., included the name of Mr. R, another Chartered Accountant, as partner in their firm, without his knowledge, in their application for empanelment as auditor of branches of Public Sector Banks submitted to the Institute. However, such a member was not a partner of the said firm as on the date of application submitted. Here, Mr. P and Mr. Q have submitted wrong information to the Institute.

Therefore, Mr. P and Mr. Q, both, would be held guilty of professional misconduct under Clause (3) of Part II of the Second Schedule to the Chartered Accountants Act, 1949.

20. (a) Scope of Peer Review: The Statement on Peer Review lays down the scope of review to be conducted as under:

The Peer Review process shall apply to all the assurance services provided by a Practice Unit.

1. Once a Practice Unit is selected for Review, its assurance engagement records pertaining to the Peer Review Period shall be subjected to Review.
2. The Review shall cover:
   - (i) Compliance with Technical, Professional and Ethical Standards:
   - (ii) Quality of reporting.
   - (iii) Systems and procedures for carrying out assurance services.
   - (iv) Training programmes for staff (including articled and audit assistants) concerned with assurance functions, including availability of appropriate infrastructure.
   - (v) Compliance with directions and/or guidelines issued by the Council to the

© The Institute of Chartered Accountants of India

Members, including Fees to be charged, Number of audits undertaken, register for Assurance Engagements conducted during the year and such other related records.

(vi) Compliance with directions and/or guidelines issued by the Council in relation to article assistants and/or audit assistants, including attendance register, work diaries, stipend payments, and such other related records.

(b) Mandatory Review Areas of the Audit Committee: The Audit Committee shall mandatorily review the following information as per LODR Regulations-

(i) Management discussion and analysis of financial condition and results of operations;

(ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;

(iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;

(iv) Internal audit reports relating to internal control weaknesses; and

(v) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

(vi) Statement of deviations: (a) quarterly statement of deviations including report of monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

(c) Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III –The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

(i) NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II. Additionally, NBFCs are required to classify items of the balance sheet into financial and non-financial whereas other companies are required to classify the items into current and non-current.

(ii) An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 per cent of the revenue from operations or ₹10 lakhs, whichever is higher.

(iii) NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member.

© The Institute of Chartered Accountants of India

NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of as part of the notes.

(d) Understanding and Documenting Automated Environment: Understanding of the automated environment of a company is required as per SA 315. The auditor's understanding of the automated environment should include the following:

- The applications that are being used by the company;
- Details of the IT infrastructure components for each of the application;
- The organisation structure and governance;
- The policies, procedures and processes followed;
- IT risks and controls.

The auditor is required to document the understanding of a company's automated environment as per SA 230.

© The Institute of Chartered Accountants of India

PAPER 4: CORPORATE AND ECONOMIC LAWS

PART – I: RELEVANT AMENDMENTS APPLICABLE FOR MAY 2020 EXAMINATION

Applicability of Relevant Amendments/ Circulars/ Notifications/ Regulations etc.

For May 2020 examinations for Paper 4: Corporate and Economic Laws, the significant amendments made in the respective subject for the period 1st May 2019 to 31st October, 2019 are relevant and applicable for said examinations.

Students are advised to refer study material of August 2019 edition with these applicable amendments.

Relevant amendments: Here are given relevant amendments arranged chapter wise.

PART I: CORPORATE LAWS

SECTION A: COMPANY LAW

Companies (Amendment) Act, 2019: On July 31, 2019, the Ministry of Corporate Affairs introduced the Companies (Amendment) Act, 2019. The Amendment considers changes brought in by the Companies (Amendment) Ordinance, 2018, the Companies (Amendment) Ordinance Act, 2019 and the Companies (Amendment) Second Ordinance, 2019 to further amend the Companies Act, 2013.

The Amendment has reinforced the 2018 Ordinance and 2019 Ordinances, and all provisions are deemed to have come into force from November 2, 2018 except some sections which have come into force on August 15, 2019.

CHAPTER 1: APPOINTMENT AND QUALIFICATION OF DIRECTORS

Enforcement of the *Companies (Appointment and Qualification of Directors) Third Amendment Rules, 2019* via G.S.R. 528(E) dated 25th July, 2019

The Central Government makes the *Companies (Appointment and Qualification of Directors) Third Amendment Rules, 2019* to amend *Companies (Appointment and Qualification of Directors) Rules, 2014.*

In Companies (Appointment and Qualification of Directors) Rules, 2014, in rule 12A,-

(i) for the words **"who has been allotted"**, the words **"who holds"** shall be substituted;

(ii) for the words, letters and figures "submit e-form DIR-3-KYC to the Central Government on or before 30th June of immediate next financial year", the words, letters and figures "submit e-form DIR-3-KYC for the said financial year to the Central Government on or before 30th September of immediate next financial year" shall be substituted;

(iii) after the proviso, the **following provisos** shall be inserted, namely:-

"Provided further that where an individual who has already submitted e-form DIR-3 KYC in relation to any previous financial year, submits web-form DIR-3 KYC-WEB through the web

© The Institute of Chartered Accountants of India

service in relation to any subsequent financial year it shall be deemed to be compliance of the provisions of this rule for the said financial year:

Provided also that in case an individual desires to update his personal mobile number or the e-mail address, as the case may be, he shall update the same by submitting e-form DIR-3 KYC only.

Provided also that fee for filing e-form DIR-3 KYC or web-form DIR-3 KYC-WEB through the web service, as the case may be, shall be payable as provided in *Companies (Registration Offices and Fees) Rules, 2014.”*.

CHAPTER 3: MEETING OF BOARD AND ITS POWERS

Enforcement of the *Companies (Meetings of Board and its Powers) Amendment Rules, 2019* dated 11th October, 2019

The Central Government makes the *Companies (Meetings of Board and its Powers) Amendment Rules, 2019* to amend the *Companies (Meetings of Board and its Powers) Rules, 2014*.

In the *Companies (Meetings of Board and its Powers) Rules, 2014*, in **rule 11**, in sub-rule (2), for the words "business of financing of companies", the words "business of financing industrial enterprises" shall be substituted.

CHAPTER 4: INSPECTION, INQUIRY AND INVESTIGATION

Amendments through the Companies (Amendment) Act, 2019

Relevant Section	Amendment	Date of Enforcement
Amendment of Section 212	(a) in **sub-section (*8*),** for the words “If the Director, Additional Director or Assistant Director”, the words “If any officer not below the rank of Assistant Director” shall be substituted; (b) in **sub-section (*9*),** for the portion beginning with the words “The Director” and ending with the word, brackets and figure “sub-section (*8*)”, the words, brackets and figure “The officer authorised under sub-section (*8*) shall, immediately after arrest of such person under such sub-section” shall be substituted; (c) in **sub-section (10),—** (i) for the words “Judicial Magistrate”, the words “Special Court or Judicial Magistrate” shall be substituted; (ii) in the proviso, for the words “Magistrate’s court”, the words “Special Court or Magistrate’s court” shall be substituted;	**15th August, 2019**

© The Institute of Chartered Accountants of India

	(d) after **sub-section (*14*),** the following sub-section shall be inserted, namely:— "(*14A*) Where the report under sub-section (*11*) or sub-section (*12*) states that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property or cash and also for holding such director, key managerial personnel, other officer or any other person liable personally without any limitation of liability."	

CHAPTER 5: COMPROMISES, ARRANGEMENTS AND AMALGAMATIONS

Clarification under Section 232(6) of the Companies Act, 2013

A clarification has been issued by the MCA on 21st August, 2019 regarding section 232(6). According to the clarification,

(a) The provision of section 232(6) of the Act enables the companies in question to choose and state in the scheme an 'appointed date'. This date may be a specific calendar date or may be tied to the occurrence of an event such as grant of license by a competent authority or fulfilment of any preconditions agreed upon by the parties, or meeting any other requirement as agreed upon between the parties, etc., which are relevant to the scheme.

(b) The 'appointed date' identified under the scheme shall also be deemed to be the 'acquisition date' and date of transfer of control for the purpose of conforming to accounting standards (including Ind-AS 103 Business Combinations).

(c) Where the 'appointed date' is chosen as a specific calendar date, it may precede the date of filing of the application for scheme of merger/amalgamation in NCLT. However, if the 'appointed date' is significantly ante-dated beyond a year from the date of filing, the justification for the same would have to be specifically brought out in the scheme and it should not be against public interest.

(d) The scheme may identify the 'appointed date' based on the occurrence of a trigger event which is key to the proposed scheme and agreed upon by the parties to the scheme. This event would have to be indicated in the scheme itself upon occurrence of which the scheme would become effective. However, in case of such event based date being a date subsequent to the date of filing the order with the Registrar under section 232(5), the company shall file an intimation of the same with the Registrar within 30 days of such scheme coming into force.

© The Institute of Chartered Accountants of India

CHAPTER 6: PREVENTION OF OPPRESSION AND MISMANAGEMENT

1. Amendments through the Companies (Amendment) Act, 2019

Relevant Section	Amendment	Date of Enforcement
Amendment of Section 241	(a) **in sub-section (*2*),** the following proviso shall be inserted, namely:— "Provided that the applications under this sub-section, in respect of such company or class of companies, as may be prescribed, shall be made before the Principal Bench of the Tribunal which shall be dealt with by such Bench."; (b) after **sub-section (*2*),** the following sub-sections shall be inserted, namely:— **"(*3*)** Where in the opinion of the Central Government there exist circumstances suggesting that–– (a) any person concerned in the conduct and management of the affairs of a company is or has been in connection therewith guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law or of breach of trust; (b) the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices; (c) a company is or has been conducted and managed by such person in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or (d) the business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest, the Central Government	**15th August, 2019**

© The Institute of Chartered Accountants of India

	may initiate a case against such person and refer the same to the Tribunal with a request that the Tribunal may inquire into the case and record a decision as to whether or not such person is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company. **(4)** The person against whom a case is referred to the Tribunal under sub-section (*3*), shall be joined as a respondent to the application. **(5)** Every application under sub-section (*3*)–– (a) shall contain a concise statement of such circumstances and materials as the Central Government may consider necessary for the purposes of the inquiry; and (b) shall be signed and verified in the manner laid down in the Code of Civil Procedure, 1908, for the signature and verification of a plaint in a suit by the Central Government.”.	
Amendment of Section 242	after **sub-section (*4*),** the following sub-section shall be inserted, namely:–– **“(*4A*)** At the conclusion of the hearing of the case in respect of sub-section (*3*) of section 241, the Tribunal shall record its decision stating therein specifically as to whether or not the respondent is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.”.	**15th August, 2019**
Amendment of Section 243	(a) after **sub-section (*1*),** the following sub-sections shall be inserted, namely:— **“(*1A*)**The person who is not a fit and proper person pursuant to sub-section (*4A*) of section 242 shall not hold the office of a director or any other office connected with the conduct and management of the affairs of any company for a period of five years from the date of the said decision:	**15th August, 2019**

© The Institute of Chartered Accountants of India

	Provided that the Central Government may, with the leave of the Tribunal, permit such person to hold any such office before the expiry of the said period of five years. (*1B*) Notwithstanding anything contained in any other provision of this Act, or any other law for the time being in force, or any contract, memorandum or articles, on the removal of a person from the office of a director or any other office connected with the conduct and management of the affairs of the company, that person shall not be entitled to, or be paid, any compensation for the loss or termination of office."; (b) in **sub-section (2),** after the word, brackets and figure "sub-section (*1*)", the words, brackets, figure and letter "or sub-section (*1A*)" shall be inserted.	

2. Enforcement of the *National Company Law Tribunal (Second Amendment) Rules, 2019* vide Notification G.S.R. 351(E) dated 8th May, 2019

The Central Government makes *the National Company Law Tribunal (Second Amendment) Rules, 2019* to amend the *National Company Law Tribunal Rules, 2016.*

In *National Company Law Tribunal Rules, 2016*,

in **rule 84**, after **sub-rule (2)**, the following sub-rules shall be inserted, namely: –

"(3) In case of a company having a share capital, the requisite number of member or members to file an application under sub-section (1) of section 245 shall be -

(i) (a) at least five per cent. of the total number of members of the company; or

(b) one hundred members of the company,

whichever is less; or

(ii) (a) member or members holding not less than five per cent. of the issued share capital of the company, in case of an unlisted company;

(b) member or members holding not less than two per cent. of the issued share capital of the company, in case of a listed company.

(4) The requisite number of depositor or depositors to file an application under sub-section (1) of section 245 shall be -

(i) (a) at least five per cent. of the total number of depositors of the company; or

(b) one hundred depositors of the company,

© The Institute of Chartered Accountants of India

whichever is less; or

(ii) depositor or depositors to whom the company owes five per cent. of total deposits of the company."

CHAPTER 7: WINDING UP

Amendments through the Companies (Amendment) Act, 2019

Relevant sections	**Amendment**	**Date of Enforcement**
Amendment of Section 272	in **sub-section (*3*),** for the words, brackets and letter "or clause (*e*) of that sub-section", the words "of that section" shall be substituted.	**15th August, 2019**

CHAPTER 10: MISCELLANEOUS PROVISIONS

1. **Amendment in Section 406**: Section 406 has been substituted by the Companies (Amendment) Act, 2017, with effect from **15th August, 2019**

   Section 406: (1) In this section, "Nidhi" or "Mutual Benefit Society" means a company which the Central Government may, by notification in the Official Gazette, declare to be a Nidhi or Mutual Benefit Society, as the case may be.

   (2) The Central Government may, by notification in the Official Gazette, direct that any of the provisions of this Act specified in the notification—

   (a) shall not apply to any Nidhi or Mutual Benefit Society; or

   (b) shall apply to any Nidhi or Mutual Benefit Society with such exceptions, modifications and adaptations as may be specified in the notification.

   (3) A copy of every notification proposed to be issued under sub-section (2), shall be laid in draft before each House of Parliament, while it is in session, for a total period of thirty days, and if, both Houses agree in disapproving the issue of notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses.

   (4) In reckoning any such period of thirty days as is referred to in sub-section (3), no account shall be taken of any period during which the House referred to in sub-section (3) is prorogued or adjourned for more than four consecutive days.

   (5) The copies of every notification issued under this section shall, as soon as may be after it has been issued, be laid before each House of Parliament.

2. **Enforcement of the *Nidhi (Amendment) Rules, 2019* via G.S.R. 467(E) dated 15th August, 2019**

   The Central Government makes *the Nidhi (Amendment) Rules, 2019* to amend *Nidhi Rules, 2014.*

© The Institute of Chartered Accountants of India

In the *Nidhi rules, 2014* (hereinafter referred to as "said rules"):

1. in **rule 2**, after clause (c), the following clause shall be inserted, namely:-

   "(d) every company declared as Nidhi or Mutual Benefit Society under sub-section (1) of section 406 of the Act".

2. in **rule 3,** after clause (d), the following clause shall be inserted, namely:-

   '(da) "*Nidhi*" means a company which has been incorporated as a *Nidhi* with the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit, and which complies with the rules made by the Central Government for regulation of such class of companies.'.

3. In the said rules, **after rule 3**, the following rule shall be inserted, namely:-

   "3A. Declaration of Nidhis.– The Central Government, on receipt of application (in Form NDH-4 along with fee thereon) of a public company for declaring it as Nidhi and on being satisfied that the company meets the requirements under these rules, shall notify the company as a Nidhi in the Official Gazette:

   Provided that a Nidhi incorporated under the Act on or after the commencement of the Nidhi (Amendment) Rules, 2019 shall file Form NDH-4 within sixty days from the date of expiry of:-

   (a) one year from the date of its incorporation; or

   (b) the period up to which extension of time has been granted by the Regional Director under sub-rule (3) of rule 5:

   Provided further that nothing in the first proviso shall prevent a Nidhi from filing Form NDH-4 before the period referred therein:

   Provided also that that in case a company does not comply with the requirements of this rule, it shall not be allowed to file Form No. SH-7 (Notice to Registrar of any alteration of share capital) and Form PAS-3 (Return of Allotment).".

4. In the said rules, **in rule 4, -**

   (i) in sub-rule (1), the words, "to be incorporated under the Act" shall be omitted;

   (ii) in sub-rule (5), the words "Company incorporated as a" shall be omitted.

5. In the said rules, **in rule 5**, –

   (i) in sub-rule (1), for the words "from the commencement of these rules", the words "from the date of its incorporation" shall be substituted;

   (ii) in sub-rule (3), before the Explanation, the following proviso shall be inserted, namely:-

   "Provided that the Regional Director may extend the period upto one year from the date of receipt of application".

© The Institute of Chartered Accountants of India

(iii) in sub-rule (4), after the words, brackets and figure "contained in sub-rule (1)", the words, brackets and figures "and gets itself declared under sub-section (1) of section 406" shall be inserted.

6. In the said rules, in **rule 7,** in sub-rule (1), after the words "shall issue" the words "fully paid up" shall be inserted.

7. In the said rules, in **rule 12,**–

   (i) in sub-rule (1) after clause (b), the following clause shall be inserted namely:-

   "(ba) The date of declaration or notification as Nidhi";";

   (ii) in sub-rule (2), in clause (a), for the words "Registrar of Companies", the words "Bench of the National Company Law Tribunal" shall be substituted.

8. In the said rules, in **rule 23**, in sub-rule (2),-

   (i) for the words "concerned Regional Director", the words, "Central Government" shall be substituted;

   (ii) for the words "such Regional Director", the words, "Central Government" shall be substituted;

   (iii) in the proviso, for the words "Regional Director", the words, "Central Government" shall be substituted.

9. In the said rules, **after rule 23**, the following rules shall be inserted, namely:-

   23A. Compliance with rule 3A by certain Nidhis:- Every company referred to in clause (b) of rule 2 and every Nidhi incorporated under the Act, before the commencement of *Nidhi (Amendment) Rules, 2019*, shall also get itself declared as such in accordance with rule 3A within a period of one year from the date of its incorporation or within a period of six months from the date of commencement of *Nidhi (Amendment) Rules, 2019*, whichever is later:

   Provided that in case a company does not comply with the requirements of this rule, it shall not be allowed to file Form No. SH-7 (Notice to Registrar of any alteration of share capital) and Form PAS-3 (Return of Allotment).

   23B. Companies declared as Nidhis under previous company law to file Form NDH-4:- Every company referred in clause (a) of rule 2 shall file Form NDH-4 alongwith fees as per the *Companies (Registration Offices and Fees) Rules, 2014* for updating its status:

   Provided that no fees shall be charged under this rule for filing Form NDH-4, in case it is filed within six month of the commencement of *Nidhi (Amendment) Rules, 2019*:

   Provided further that, in case a company does not comply with the requirements of this rule, it shall not be allowed to file Form No. SH-7 (Notice to Registrar of any alteration of share capital) and Form PAS-3 (Return of Allotment).

© The Institute of Chartered Accountants of India

PART II: ECONOMIC LAWS

CHAPTER 1: THE FOREIGN EXCHANGE AND MANAGEMENT ACT, 1999

I Amendment in Section 6 of the Foreign Exchange Management Act, 1999 vide Finance Act, 2015 w.e.f. 15.10.2019.

Amended section with the changes marked in bold, is as follows:

(1) Subject to the provisions of sub-section (2), any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction.

(2) The Reserve Bank may, in consultation with the Central Government, specify—

(a) any class or classes of capital account transactions, involving debt instruments, which are permissible;

(b) the limit up to which foreign exchange shall be admissible for such transactions;

(c) any conditions which may be placed on such transactions:

[Provided that the Reserve Bank or the Central Government shall not impose any restrictions on the drawal of foreign exchange for payment due on account of amortisation of loans or for depreciation of direct investments in the ordinary course of business.

(2A) The Central Government may, in consultation with the Reserve Bank, prescribe—

(a) any class or classes of capital account transactions, not involving debt instruments, which are permissible;

(b) the limit up to which foreign exchange shall be admissible for such transactions; and

(c) any conditions which may be placed on such transactions.

(3) [***]

(4) A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

(5) A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

(6) Without prejudice to the provisions of this section, the Reserve Bank may, by regulation, prohibit, restrict, or regulate establishment in India of a branch, office or

© The Institute of Chartered Accountants of India

other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.

(7) For the purposes of this section, the term "debt instruments" shall mean, such instruments as may be determined by the Central Government in consultation with the Reserve Bank.

II. Amendments in External Commercial Borrowings

Vide FED Master Direction No.5/2018-19, amendments have been made in the Transactions on account of External Commercial Borrowings (ECB) . Here is the updated master direction –external commercial borrowings.

Within the contours of the Regulations, Reserve Bank of India also issues directions to Authorised Persons under Section 11 of the Foreign Exchange Management Act (FEMA), 1999. These directions lay down the modalities as to how the foreign exchange business has to be conducted by the Authorised Persons with their customers/constituents with a view to implementing the regulations framed.

Index

Para. No.	Particulars
	External Commercial Borrowings Framework
2	Introduction
2.1	External Commercial Borrowings Framework
2.2	Limit and leverage
3	Issuance of Guarantee, etc. by Indian banks and Financial Institutions
4	Parking of ECB proceeds
4.1	Parking of ECB proceeds abroad
4.2	Parking of ECB proceeds domestically
5	Procedure of raising ECB
6	Reporting Requirements
6.1	Loan Registration Number
6.2	Changes in terms and conditions of ECB
6.3	Monthly reporting of actual transactions
6.4	Late Submission Fee for delay in reporting
6.5	Standard Operating Procedure for Untraceable Entities

© The Institute of Chartered Accountants of India

7	Powers delegated to AD Category I banks to deal with ECB cases
7.1	Change of the AD Category I bank
7.2	Cancellation of LRN
7.3	Refinancing of existing ECB
7.4	Conversion of ECB into equity
7.5	Security for raising ECB
7.6	Additional Requirements
8	Special Dispensations under the ECB framework
8.1	ECB facility for Oil Marketing Companies
8.2	ECB facility for Start-ups
9	Borrowing by Entities under Investigation
10	ECB by entities under restructuring/ ECB facility for refinancing stressed assets
11	Dissemination of information
12	Compliance with the guidelines

2. **Introduction:** External Commercial Borrowings are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. The parameters given below apply in totality and not on a standalone basis.

   2.1. ECB Framework: The framework for raising loans through ECB (hereinafter referred to as the ECB Framework) comprises the following two options:

Sr.No.	Parameters	FCY denominated ECB	INR denominated ECB
i	Currency of borrowing	Any freely convertible Foreign Currency	Indian Rupee (INR)
ii	Forms of ECB	Loans including bank loans; floating/ fixed rate notes/ bonds/ debentures (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; [1]FCCBs;	Loans including bank loans; floating/ fixed rate notes/bonds/ debentures/ preference shares (other than fully and compulsorily convertible instruments); Trade

[1] FCCB – Foreign Currency Convertible Bond

© The Institute of Chartered Accountants of India

		[2]FCEBs and Financial Lease.	credits beyond 3 years; and Financial Lease. Also, plain vanilla Rupee denominated bonds issued overseas, which can be either placed privately or listed on exchanges as per host country regulations.
iii	Eligible borrowers	All entities eligible to receive [3]FDI. Further, the following entities are also eligible to raise ECB: i. Port Trusts; ii. Units in SEZ; iii. SIDBI; and iv. EXIM Bank of India.	a) All entities eligible to raise [4]FCY ECB; and Registered entities engaged in micro-finance activities, viz., registered Not for Profit companies, registered societies/trusts/ cooperatives and Non-Government Organisations.
iv	Recognised lenders	The lender should be resident of [5]FATF or [6]IOSCO compliant country, including on transfer of ECB. However, a) Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognised lenders; b) Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad; and c) Foreign branches / subsidiaries of Indian banks are permitted as recognised lenders only for FCY ECB (except FCCBs and FCEBs).	

[2] FCEB – Foreign Currency Exchangeable Bond
[3] FDI – Foreign Direct Investment
[4] FCY – Foreign Currency
[5] FATF – Financial Action Task Force
[6] IOSCO – International Organization of Securities Commission

© The Institute of Chartered Accountants of India

<table>
<tr><td></td><td></td><td>Foreign branches / subsidiaries of Indian banks, subject to applicable prudential norms, can participate as arrangers/underwriters/market-makers/traders for Rupee denominated Bonds issued overseas. However, underwriting by foreign branches/subsidiaries of Indian banks for issuances by Indian banks will not be allowed.</td></tr>
<tr><td>V</td><td>Minimum Average Maturity Period (MAMP)</td><td>MAMP for ECB will be 3 years. Call and put options, if any, shall not be exercisable prior to completion of minimum average maturity. However, for the specific categories mentioned below, the MAMP will be as prescribed therein:
<table>
<tr><th>Sr.No.</th><th>Category</th><th>MAMP</th></tr>
<tr><td>(a)</td><td>ECB raised by manufacturing companies up to USD 50 million or its equivalent per financial year.</td><td>1 year</td></tr>
<tr><td>(b)</td><td>ECB raised from foreign equity holder for working capital purposes, general corporate purposes or for repayment of Rupee loans</td><td>5 years</td></tr>
<tr><td>[7](c)</td><td>ECB raised for
(i) working capital purposes or general corporate purposes
(ii) on-lending by NBFCs for working capital purposes or general corporate purposes</td><td>10 years</td></tr>
<tr><td>(d)</td><td>ECB raised for
(i) repayment of Rupee loans availed domestically for capital expenditure
(ii) on-lending by NBFCs for the same purpose</td><td>7 years</td></tr>
<tr><td>(e)</td><td>ECB raised for
(i) repayment of Rupee loans availed domestically for</td><td>10 years</td></tr>
</table>
</td></tr>
</table>

[7] Inserted vide A.P.(DIR Series) Circular No. 04 dated July 30, 2019.

© The Institute of Chartered Accountants of India

		purposes other than capital expenditure (ii) on-lending by NBFCs for the same purpose
		for the categories mentioned at (b) to (e) – (i) ECB cannot be raised from foreign branches / subsidiaries of Indian banks (ii) the prescribed MAMP will have to be strictly complied with under all circumstances.
vi	All-in-cost ceiling per annum	Benchmark rate plus 450 bps spread.
vii	Other costs	Prepayment charge/ Penal interest, if any, for default or breach of covenants, should not be more than 2 per cent over and above the
		contracted rate of interest on the outstanding principal amount and will be outside the all-in-cost ceiling.
Viii	End-uses (Negative list)	The negative list, for which the ECB proceeds cannot be utilised, would include the following: a) Real estate activities. b) Investment in capital market. c) Equity investment. d) [8]Working capital purposes, except in case of ECB mentioned at v(b) and v(c) above. e) General corporate purposes, except in case of ECB mentioned at v(b) and v(c) above. f) Repayment of Rupee loans, except in case of ECB mentioned at v(d) and v(e) above. g) On-lending to entities for the above activities, except in case of ECB raised by NBFCs as given at v(c), v(d) and v(e) above.

[8] Substituted vide A.P.(DIR Series) Circular No. 04 dated July 30, 2019. Prior to substitution it read as below:
a) Working capital purposes except from foreign equity holder.
b) General corporate purposes except from foreign equity holder.
c) Repayment of Rupee loans except from foreign equity holder.
d) On-lending to entities for the above activities.

© The Institute of Chartered Accountants of India

ix	Exchange rate	Change of currency of FCY ECB into INR ECB can be at the exchange rate prevailing on the date of the agreement for such change between the parties concerned or at an exchange rate, which is less than the rate prevailing on the date of the agreement, if consented to by the ECB lender.	For conversion to Rupee, the exchange rate shall be the rate prevailing on the date of settlement.
x	Hedging provision	The entities raising ECB are required to follow the guidelines for hedging issued, if any, by the concerned sectoral or prudential regulator in respect of foreign currency exposure. Infrastructure space companies shall have a Board approved risk management policy. Further, such companies are required to mandatorily hedge 70 per cent of their ECB exposure in case the average maturity of the ECB is less than 5 years. The designated AD Category-I bank shall verify that 70 per cent hedging requirement is complied with during the currency of the ECB and report the position to RBI through Form ECB 2. The following operational aspects with respect to hedging should be ensured:	Overseas investors are eligible to hedge their exposure in Rupee through permitted derivative products with AD Category I banks in India. The investors can also access the domestic market through branches / subsidiaries of Indian banks abroad or branches of foreign banks with Indian presence on a back to back basis.

© The Institute of Chartered Accountants of India

		a. Coverage: The ECB borrower will be required to cover the principal as well as the coupon through financial hedges. The financial hedge for all exposures on account of ECB should start from the time of each such exposure (i.e. the day the liability is created in the books of the borrower). **b. Tenor and rollover:** A minimum tenor of one year for the financial hedge would be required with periodic rollover, duly ensuring that the exposure on account of ECB is not unhedged at any point during the currency of the ECB. **c. Natural Hedge:** Natural hedge, in lieu of financial hedge, will be considered only to the extent of offsetting projected cash flows / revenues in matching currency, net of all other projected outflows. For this purpose, an ECB may be considered naturally hedged if the offsetting exposure	

		has the maturity/cash flow within the same accounting any other arrangements/ structures, where revenues are indexed to foreign currency will not be considered as a natural hedge.	
xi	Change of currency of borrowing	Change of currency of ECB from one freely convertible foreign currency to any other freely convertible foreign currency as well as to INR is freely permitted.	Change of currency from INR to any freely convertible foreign currency is not permitted.

Note: The ECB framework is not applicable in respect of investments in Non-Convertible Debentures in India made by Registered Foreign Portfolio Investors. [9]Lending and borrowing under the ECB framework by Indian banks and their branches/subsidiaries outside India will be subject to prudential guidelines issued by the Department of Banking Regulation of the Reserve Bank. Further, other entities raising ECB are required to follow the guidelines issued, if any, by the concerned sectoral or prudential regulator.

2.2. Limit and leverage: Under the aforesaid framework, all eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year under the automatic route. Further, in case of FCY denominated ECB raised from direct foreign equity holder, ECB liability-equity ratio for ECB raised under the automatic route cannot exceed 7:1. However, this ratio will not be applicable if the outstanding amount of all ECB, including the proposed one, is up to USD 5 million or its equivalent. Further, the borrowing entities will also be governed by the guidelines on debt equity ratio, issued, if any, by the sectoral or prudential regulator concerned.

3. Issuance of Guarantee, etc. by Indian banks and Financial Institutions: Issuance of any type of guarantee by Indian banks, All India Financial Institutions and NBFCs relating to ECB is not permitted. Further, financial intermediaries (viz., Indian banks, All India Financial Institutions, or NBFCs) shall not invest in FCCBs/ FCEBs in any manner whatsoever.

[9] Inserted vide A.P. (DIR Series) Circular No. 17 dated January 16, 2019.

© The Institute of Chartered Accountants of India

4. **Parking of ECB proceeds:** ECB proceeds are permitted to be parked abroad as well as domestically in the manner given below:

   4.1 **Parking of ECB proceeds abroad**: ECB proceeds meant only for foreign currency expenditure can be parked abroad pending utilisation. Till utilisation, these funds can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/Fitch IBCA or Aa3 by Moody's; (b) Treasury bills and other monetary instruments of one-year maturity having minimum rating as indicated above and (c) deposits with foreign branches/subsidiaries of Indian banks abroad.

   4.2 **Parking of ECB proceeds domestically:** ECB proceeds meant for Rupee expenditure should be repatriated immediately for credit to their Rupee accounts with AD Category I banks in India. ECB borrowers are also allowed to park ECB proceeds in term deposits with AD Category I banks in India for a maximum period of 12 months cumulatively. These term deposits should be kept in unencumbered position.

5. **Procedure of raising ECB:** All ECB can be raised under the automatic route if they conform to the parameters prescribed under this framework. For approval route cases, the borrowers may approach the RBI with an application in prescribed format (Form ECB) for examination through their AD Category I bank. Such cases shall be considered keeping in view the overall guidelines, macroeconomic situation and merits of the specific proposals. ECB proposals received in the Reserve Bank above certain threshold limit (refixed from time to time) would be placed before the Empowered Committee set up by the Reserve Bank. The Empowered Committee will have external as well as internal members and the Reserve Bank will take a final decision in the cases taking into account recommendation of the Empowered Committee. Entities desirous to raise ECB under the automatic route may approach an AD Category I bank with their proposal along with duly filled in Form ECB.

6. **Reporting Requirements:** Borrowings under ECB Framework are subject to following reporting requirements apart from any other specific reporting required under the framework:

   6.1 **Loan Registration Number (LRN):** Any draw-down in respect of an ECB should happen only after obtaining the LRN from the Reserve Bank. To obtain the LRN, borrowers are required to submit duly certified Form ECB, which also contains terms and conditions of the ECB, in duplicate to the designated AD Category I bank. In turn, the AD Category I bank will forward one copy to the Director, Reserve Bank of India, Department of Statistics and Information Management, External Commercial Borrowings Division, Bandra-Kurla Complex, Mumbai – 400 051 (Contact numbers 022-26572513 and 022-26573612). Copies of loan agreement for raising ECB are not required to be submitted to the Reserve Bank.

© The Institute of Chartered Accountants of India

6.2 Changes in terms and conditions of ECB: Changes in ECB parameters in consonance with the ECB norms, including reduced repayment by mutual agreement between the lender and borrower, should be reported to the [10]DSIM through revised Form ECB at the earliest, in any case not later than 7 days from the changes effected. While submitting revised Form ECB the changes should be specifically mentioned in the communication.

6.3 Monthly Reporting of actual transactions: The borrowers are required to report actual ECB transactions through Form ECB 2 Return through the AD Category I bank on monthly basis so as to reach DSIM within seven working days from the close of month to which it relates.

Changes, if any, in ECB parameters should also be incorporated in Form ECB 2 Return.

6.4 Late Submission Fee (LSF) for delay in reporting:

6.4.1 Any borrower, who is otherwise in compliance of ECB guidelines, can regularise the delay in reporting of drawdown of ECB proceeds before obtaining [11]LRN or delay in submission of Form ECB 2 returns, by payment of late submission fees as detailed in the following matrix:

Sr. No.	Type of Return /Form	Period of delay	Applicable LSF
1	Form ECB 2	Up to 30 calendar days from due date of submission	INR 5,000
2	Form ECB 2/Form ECB	Up to three years from due date of submission/date of drawdown	INR 50,000 per year
3	Form ECB 2/Form ECB	Beyond three years from due date of submission/date of drawdown	INR 100,000 per year

6.4.2 The borrower, through its AD bank, may pay the LSF by way of demand draft in favour of "Reserve Bank of India" or any other mode specified by the Reserve Bank. Such payment should be accompanied with the requisite return(s). Form ECB and Form ECB 2 returns reporting contraventions will be treated separately. Non-payment of LSF will be treated as contravention of reporting provision and shall be subject to compounding or adjudication as provided in FEMA 1999 or regulations/rules framed thereunder.

6.5 Standard Operating Procedure (SOP) for Untraceable Entities: The following SOP has to be followed by designated AD Category-I banks in case of untraceable entities who are found to be in contravention of reporting provisions

[10] DISM – Department of Statistics and Information Management

[11] LRN – Loan Registration Number

© The Institute of Chartered Accountants of India

for ECB by failing to submit prescribed return(s) under the ECB framework, either physically or electronically, for past eight quarters or more.

i. Definition: Any borrower who has raised ECB will be treated as 'untraceable entity', if entity/auditor(s)/director(s)/ promoter(s) of entity are not reachable/responsive/reply in negative over email/letters/phone for a period of not less than two quarters with documented communication/ reminders numbering 6 or more and it fulfills both of the following conditions:

a) Entity not found to be operative at the registered office address as per records available with the AD Bank or not found to be operative during the visit by the officials of the AD Bank or any other agencies authorised by the AD bank for the purpose;

b) Entities have not submitted Statutory Auditor's Certificate for last two years or more;

ii. Action: The followings actions are to be undertaken in respect of 'untraceable entities':

a) File Revised Form ECB, if required, and last Form ECB 2 Return without certification from company with 'UNTRACEABLE ENTITY' written in bold on top. The outstanding amount will be treated as written-off from external debt liability of the country but may be retained by the lender in its books for recovery through judicial/ non-judicial means;

b) No fresh ECB application by the entity should be examined/processed by the AD bank;

c) Directorate of Enforcement should be informed whenever any entity is designated 'UNTRACEABLE ENTITY'; and

d) No inward remittance or debt servicing will be permitted under auto route.

7. Powers delegated to AD Category I banks to deal with ECB cases: The designated AD Category I banks can approve any requests from the borrowers for changes in respect of ECB, except for FCCBs/FCEBs, duly ensuring that the changed conditions, including change in name of borrower/lender, transfer of ECB and any other parameters, comply with extant ECB norms and are with the consent of lender(s). Further, the following can also be undertaken under the automatic route:

7.1 Change of the AD Category I bank: AD Category I bank can be changed subject to obtaining no objection certificate from the existing AD Category I bank.

7.2 Cancellation of LRN: The designated AD Category I banks may directly approach DSIM for cancellation of LRN for ECB contracted, subject to ensuring that no draw down against the said LRN has taken place and the monthly ECB-2 returns till date in respect of the allotted LRN have been submitted to DSIM.

© The Institute of Chartered Accountants of India

7.3 **Refinancing of existing ECB:** Refinancing of existing ECB by fresh ECB provided the outstanding maturity of the original borrowing (weighted outstanding maturity in case of multiple borrowings) is not reduced and all-in-cost of fresh ECB is lower than the all-in-cost (weighted average cost in case of multiple borrowings) of existing ECB. Further, refinancing of ECB raised under the previous ECB frameworks may also be permitted, subject to additionally ensuring that the borrower is eligible to raise ECB under the extant framework. Raising of fresh ECB to part refinance the existing ECB is also permitted subject to same conditions. Indian banks are permitted to participate in refinancing of existing ECB, only for highly rated corporates (AAA) and for Maharatna/ Navratna public sector undertakings.

7.4 **Conversion of ECB into equity:** Conversion of ECB, including those which are matured but unpaid, into equity is permitted subject to the following conditions:

(i) The activity of the borrowing company is covered under the automatic route for FDI or Government approval is received, wherever applicable, for foreign equity participation as per extant FDI policy.

(ii) The conversion, which should be with the lender's consent and without any additional cost, should not result in contravention of eligibility and breach of applicable sector cap on the foreign equity holding under FDI policy;

(iii) Applicable pricing guidelines for shares are complied with; iv. In case of partial or full conversion of ECB into equity, the reporting to the Reserve Bank will be as under:

(a) For partial conversion, the converted portion is to be reported in Form FC-GPR prescribed for reporting of FDI flows, while monthly reporting to DSIM in Form ECB 2 Return will be with suitable remarks, viz., "ECB partially converted to equity".

(b) For full conversion, the entire portion is to be reported in Form FC-GPR, while reporting to DSIM in Form ECB 2 Return should be done with remarks "ECB fully converted to equity". Subsequent filing of Form ECB 2 Return is not required.

(c) For conversion of ECB into equity in phases, reporting through Form FC-GPR and Form ECB 2 Return will also be in phases.

(iv) If the borrower concerned has availed of other credit facilities from the Indian banking system, including foreign branches/subsidiaries of Indian banks, the applicable prudential guidelines issued by the Department of Banking Regulation of Reserve Bank, including guidelines on restructuring are complied with;

© The Institute of Chartered Accountants of India

(v) Consent of other lenders, if any, to the same borrower is available or atleast information regarding conversions is exchanged with other lenders of the borrower.

(vi) For conversion of ECB dues into equity, the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion or any lesser rate can be applied with a mutual agreement with the ECB lender. It may be noted that the fair value of the equity shares to be issued shall be worked out with reference to the date of conversion only.

7.5. Security for raising ECB: AD Category I banks are permitted to allow creation/cancellation of charge on immovable assets, movable assets, financial securities and issue of corporate and/or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised/ raised by the borrower, subject to satisfying themselves that:

(i) the underlying ECB is in compliance with the extant ECB guidelines,

(ii) there exists a security clause in the Loan Agreement requiring the ECB borrower to create/cancel charge, in favour of overseas lender/security trustee, on immovable assets/movable assets/financial securities/issuance of corporate and/or personal guarantee, and

(iii) No objection certificate, as applicable, from the existing lenders in India has been obtained in case of creation of charge.

Once the aforesaid stipulations are met, the AD Category I bank may permit creation of charge on immovable assets, movable assets, financial securities and issue of corporate and/or personal guarantees, during the currency of the ECB with security co-terminating with underlying ECB, subject to the following:

(i) Creation of Charge on Immovable Assets: The arrangement shall be subject to the following:

(a) Such security shall be subject to provisions contained in the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2017, as amended from time to time.

(b) The permission should not be construed as a permission to acquire immovable asset (property) in India, by the overseas lender/ security trustee.

(c) In the event of enforcement / invocation of the charge, the immovable asset/ property will have to be sold only to a person resident in India and the sale proceeds shall be repatriated to liquidate the outstanding ECB.

(ii) Creation of Charge on Movable Assets: In the event of enforcement/ invocation of the charge, the claim of the lender, whether the lender takes over the movable asset or otherwise, will be restricted to the outstanding claim

© The Institute of Chartered Accountants of India

against the ECB. Encumbered movable assets may also be taken out of the country subject to getting 'No Objection Certificate' from domestic lender/s, if any.

(iii) Creation of Charge over Financial Securities: The arrangements may be permitted subject to the following:

(a) Pledge of shares of the borrowing company held by the promoters as well as in domestic associate companies of the borrower is permitted. Pledge on other financial securities, viz. bonds and debentures, Government Securities, Government Savings Certificates, deposit receipts of securities and units of the Unit Trust of India or of any mutual funds, standing in the name of ECB borrower/promoter, is also permitted.

(b) In addition, security interest over all current and future loan assets and all current assets including cash and cash equivalents, including Rupee accounts of the borrower with ADs in India, standing in the name of the borrower/promoter, can be used as security for ECB. The Rupee accounts of the borrower/promoter can also be in the form of escrow arrangement or debt service reserve account.

(c) In case of invocation of pledge, transfer of financial securities shall be in accordance with the extant FDI/FII policy including provisions relating to sectoral cap and pricing as applicable read with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017, as amended from time to time.

(iv) Issue of Corporate or Personal Guarantee: The arrangement shall be subject to the following:

(a) A copy of Board Resolution for the issue of corporate guarantee for the company issuing such guarantee, specifying name of the officials authorised to execute such guarantees on behalf of the company or in individual capacity should be obtained.

(b) Specific requests from individuals to issue personal guarantee indicating details of the ECB should be obtained.

(c) Such security shall be subject to provisions contained in the Foreign Exchange Management (Guarantees) Regulations, 2000, as amended from time to time.

(d) ECB can be credit enhanced / guaranteed / insured by overseas party/ parties only if it/ they fulfil/s the criteria of recognised lender under extant ECB guidelines.

7.6. Additional Requirements: While exercising the delegated powers, the AD Category I banks should ensure that:

© The Institute of Chartered Accountants of India

i. The changes permitted are in conformity with the applicable ceilings / guidelines and the ECB continues to be in compliance with applicable guidelines. It should also be ensured that if the ECB borrower has availed of credit facilities from the Indian banking system, including foreign branches/subsidiaries of Indian banks, any extension of tenure of ECB (whether matured or not) shall be subject to applicable prudential guidelines issued by Department of Banking Regulation of Reserve Bank including guidelines on restructuring.

ii. The changes in the terms and conditions of ECB allowed by the ADs under the powers delegated and / or changes approved by the Reserve Bank should be reported to the DSIM as given at paragraph 6.2 above. Further, these changes should also get reflected in the Form ECB 2 returns appropriately.

8. Special Dispensations under the ECB framework:

8.1 ECB facility for Oil Marketing Companies: Notwithstanding the provisions contained in paragraph 2.1 (viii), 2.1 (x) and 2.2 above, Public Sector Oil Marketing Companies (OMCs) can raise ECB for working capital purposes with minimum average maturity period of 3 years from all recognised lenders under the automatic route without mandatory hedging and individual limit requirements. The overall ceiling for such ECB shall be USD 10 billion or equivalent. However, OMCs should have a Board approved forex mark to market procedure and prudent risk management policy, for such ECB. All other provisions under the ECB framework will be applicable to such ECB.

8.2 ECB facility for Startups: AD Category-I banks are permitted to allow Startups to raise ECB under the automatic route as per the following framework:

(i) Eligibility: An entity recognised as a Startup by the Central Government as on date of raising ECB.

(ii) Maturity: Minimum average maturity period will be 3 years.

(iii) Recognised lender: Lender / investor shall be a resident of a FATF compliant country. However, foreign branches/subsidiaries of Indian banks and overseas entity in which Indian entity has made overseas direct investment as per the extant Overseas Direct Investment Policy will not be considered as recognised lenders under this framework.

(iv) Forms: The borrowing can be in form of loans or non-convertible, optionally convertible or partially convertible preference shares.

(v) Currency: The borrowing should be denominated in any freely convertible currency or in Indian Rupees (INR) or a combination thereof. In case of borrowing in INR, the nonresident lender, should mobilise INR through swaps/outright sale undertaken through an AD Category-I bank in India.

© The Institute of Chartered Accountants of India

(vi) **Amount:** The borrowing per Startup will be limited to USD 3 million or equivalent per financial year either in INR or any convertible foreign currency or a combination of both.

(vii) **All-in-cost:** Shall be mutually agreed between the borrower and the lender.

(viii) **End uses:** For any expenditure in connection with the business of the borrower.

(ix) **Conversion into equity:** Conversion into equity is freely permitted subject to Regulations applicable for foreign investment in Startups.

(x) **Security:** The choice of security to be provided to the lender is left to the borrowing entity. Security can be in the nature of movable, immovable, intangible assets (including patents, intellectual property rights), financial securities, etc. and shall comply with foreign direct investment / foreign portfolio investment / or any other norms applicable for foreign lenders / entities holding such securities. Further, issuance of corporate or personal guarantee is allowed. Guarantee issued by a nonresident(s) is allowed only if such parties qualify as lender under ECB for Startups. However, issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by Indian banks, all India Financial Institutions and NBFCs is not permitted.

(xi) **Hedging:** The overseas lender, in case of INR denominated ECB, will be eligible to hedge its INR exposure through permitted derivative products with AD Category – I banks in India. The lender can also access the domestic market through branches/ subsidiaries of Indian banks abroad or branches of foreign bank with Indian presence on a back to back basis.

Note: Startups raising ECB in foreign currency, whether having natural hedge or not, are exposed to currency risk due to exchange rate movements and hence are advised to ensure that they have an appropriate risk management policy to manage potential risk arising out of ECB.

(xii) **Conversion rate:** In case of borrowing in INR, the foreign currency - INR conversion will be at the market rate as on the date of agreement.

(xiii) **Other Provisions:** Other provisions like parking of ECB proceeds, reporting arrangements, powers delegated to AD banks, borrowing by entities under investigation, conversion of ECB into equity will be as included in the ECB framework. However, provisions on leverage ratio and ECB liability: Equity ratio will not be applicable. Further, the Start-ups as defined above [8.2. (i)] as well as other start-ups which do not comply with the aforesaid definition but are eligible to receive FDI, can also raise ECB under the general ECB route/framework.

9. **Borrowing by Entities under Investigation:** All entities against which investigation / adjudication / appeal by the law enforcing agencies for violation of any of the

© The Institute of Chartered Accountants of India

provisions of the Regulations under FEMA pending, may raise ECB as per the applicable norms, if they are otherwise eligible, notwithstanding the pending investigations / adjudications / appeals, without prejudice to the outcome of such investigations / adjudications / appeals. The borrowing entity shall inform about pendency of such investigation / adjudication / appeal to the AD Category-I bank / RBI as the case may be. Accordingly, in case of all applications where the borrowing entity has indicated about the pending investigations / adjudications / appeals, the AD Category I Banks / Reserve Bank while approving the proposal shall intimate the agencies concerned by endorsing a copy of the approval letter.

10. ECB by entities under restructuring/ ECB facility for refinancing stressed assets:

10.1 An entity which is under a restructuring scheme/ corporate insolvency resolution process can raise ECB only if specifically permitted under the resolution plan.

10.2 [12]Eligible corporate borrowers who have availed Rupee loans domestically for capital expenditure in manufacturing and infrastructure sector and which have been classified as SMA-2 or NPA can avail ECB for repayment of these loans under any one time settlement with lenders. Lender banks are also permitted to sell, through assignment, such loans to eligible ECB lenders, provided, the resultant external commercial borrowing complies with all-in-cost, minimum average maturity period and other relevant norms of the ECB framework. Foreign branches/ overseas subsidiaries of Indian banks are not eligible to lend for the above purposes. The applicable MAMP will have to be strictly complied with under all circumstances.

10.3 Eligible borrowers under the ECB framework, who are participating in the Corporate Insolvency Resolution Process under Insolvency and Bankruptcy Code, 2016 as resolution applicants, can raise ECB from all recognised lenders, except foreign branches/subsidiaries of Indian banks, for repayment of Rupee term loans of the target company. Such ECB will be considered under the approval route, procedure of which is given at paragraph No. 5 above.

11. Dissemination of information: For providing greater transparency, information with regard to the name of the borrower, amount, purpose and maturity of ECB under both Automatic and Approval routes are put on the RBI's website, on a monthly basis, with a lag of one month to which it relates.

12. Compliance with the guidelines: The primary responsibility for ensuring that the borrowing is in compliance with the applicable guidelines is that of the borrower concerned. Any contravention of the applicable provisions of ECB guidelines will invite penal action under the FEMA. The designated AD Category I bank is also expected to ensure compliance with applicable ECB guidelines by their constituents.

[12] Inserted vide A.P.(DIR Series) Circular No. 04 dated July 30, 2019.

© The Institute of Chartered Accountants of India

CHAPTER 3: PREVENTION OF MONEY LAUNDERING ACT, 2002

I Amendment in section 8 vide Finance Act, 2019, w.r.e.f. 20-3-2019.

Sub-section (3) dealing with the computation of period of attachment/ retention of property / record seized / frozen during investigation, is amended as follows:

(3) Where the Adjudicating Authority decides that any property is involved in money-laundering, he shall, by an order in writing, confirm the attachment of the property made under section 5(1) or retention of property or record seized or frozen under section 17 or section 18 and record a finding to that effect, whereupon such attachment or retention or freezing of the seized or frozen property or record shall—

(*a*) continue during investigation for a period not **exceeding three hundred and sixty-five days** or the pendency of the proceedings relating to any offence under this Act before a court or under the corresponding law of any other country, before the competent court of criminal jurisdiction outside India, as the case may be; and

(*b*) become final after an order of confiscation is passed under sub-section (5) or sub-section (7) of section 8 or section 58B or sub-section (2A) of section 60 by the Special Court.

Explanation.—For the purposes of computing the period of three hundred and sixty-five days under clause (a), the period during which the investigation is stayed by any court under any law for the time being in force shall be excluded.

II Insertion of section 11A vide the Aadhaar and Other Laws (Amendment) Act, 2019, w.e.f. 25-7-2019

Verification of identity by reporting entity.

11A.(1) Every reporting entity shall verify the identity of its clients and the beneficial owner, by—

(a) authentication under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016) if the reporting entity is a banking company; or

(b) offline verification under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016); or

(c) use of passport issued under section 4 of the Passports Act, 1967 (15 of 1967); or

(d) use of any other officially valid document or modes of identification as may be notified by the Central Government in this behalf:

Provided that the Central Government may, if satisfied that a reporting entity other than banking company, complies with such standards of privacy and security under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and

© The Institute of Chartered Accountants of India

Services) Act, 2016 (18 of 2016), and it is necessary and expedient to do so, by notification, permit such entity to perform authentication under clause (a):

Provided further that no notification under the first proviso shall be issued without consultation with the Unique Identification Authority of India established under sub-section (1) of section 11 of the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016) and the appropriate regulator.

(2) If any reporting entity performs authentication under clause (a) of sub-section (1), to verify the identity of its client or the beneficial owner it shall make the other modes of identification under clauses (b), (c) and (d) of sub-section (1) also available to such client or the beneficial owner.

(3) The use of modes of identification under sub-section (1) shall be a voluntary choice of every client or beneficial owner who is sought to be identified and no client or beneficial owner shall be denied services for not having an Aadhaar number.

(4) If, for identification of a client or beneficial owner, authentication or offline verification under clause (a) or clause (b) of sub-section (1) is used, neither his core biometric information nor his Aadhaar number shall be stored.

(5) Nothing in this section shall prevent the Central Government from notifying additional safeguards on any reporting entity in respect of verification of the identity of its client or beneficial owner.

Explanation.—The expressions "Aadhaar number" and "core biometric information" shall have the same meanings as are respectively assigned to them in clauses (a) and (j) of section 2 of the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016).]

III Amendment in section 12 vide Aadhaar and Other Laws (Amendment) Act, 2019, w.e.f. 25-7-2019

Clause (c) & (d) of section 12(1) have been omitted by the Aadhaar and Other Laws (Amendment) Act, 2019, w.e.f. **25-7-2019**.

Prior to their omission, clauses (*c*) and (*d*) read as under:

"(*c*) verify the identity of its clients in such manner and subject to such conditions, as may be prescribed;

(*d*) identify the beneficial owner, if any, of such of its clients, as may be prescribed;"

CHAPTER 4: FOREIGN CONTRIBUTION REGULATION ACT, 2010

Foreign Contribution (Regulation) (Second Amendment) Rules, 2019

Vide notification no. **G.S.R. 659(E),** dated 16th September, 2019, Central Government hereby enacts the *Foreign Contribution (Regulation) (Second Amendment) Rules, 2019*, further to amend the *Foreign Contribution (Regulation) Rules, 2011*.

© The Institute of Chartered Accountants of India

In the Foreign Contribution (Regulation) Rules, 2011, —

(i) **in rule 6A**, for the words "rupees twenty-five thousand", the words "one lakh rupees" shall be substituted;

(ii) **in rule 7,** in sub-rule (4), for the words "sixty days", the words "one month" shall be substituted;

(iii) **in rule 12**, in sub-rule (2), after the prescribed form (i.e., FC- 3C) the words and letters "with an affidavit executed by each office bearer and key functionary and member in Performa 'AA' appended to these rules" shall be inserted;

CHAPTER 5: ARBITRATION AND CONCILIATION ACT, 1996

In section 1 which deals with the Short title, extent and commencement, provisio is omitted by the Jammu and Kashmir Reorganisation Act, 2019, dated 9-8-2019, w.e.f. **31-10-2019**, Prior to its omission read as under:

"Provided that Parts I, III and IV shall extent to the State of Jammu and Kashmir only insofar as they relate to international Commercial arbitration or, as the case may be, international Commercial Conciliation."

CHAPTER 6: INSOLVENCY AND BANKRUPTCY CODE, 2016

The Insolvency and Bankruptcy Code (Amendment) Act, 2019

Ministry of Corporate Affairs vide Notification S.O. 2953(E) dated 16th August, 2019, in exercise of the powers conferred by sub-section (2) of section 1 of **the Insolvency and Bankruptcy Code (Amendment) Act, 2019**, the Central Government hereby appoints the date of publication of this notification in the Official Gazette as the date on which the provisions of the said Act shall come into force.

Following are the relevant amendments:

(i) In **section 5(26)** pertaining to the definition "resolution plan", following explanation is added.

"Explanation.—For the removal of doubts, it is hereby clarified that a resolution plan may include provisions for the restructuring of the corporate debtor, including by way of merger, amalgamation and demerger;"

(ii) **In section 7(4)** of the Code, following proviso shall be inserted:

"Provided that if the Adjudicating Authority has not ascertained the existence of default and passed an order under sub-section (5) within such time, it shall record its reasons in writing for the same."

(iii) **In section 12** which deals with the Time-limit for completion of insolvency resolution process. – Following provisos have been added after the proviso to section 3:

"Provided further that the corporate insolvency resolution process shall mandatorily be completed within a period of three hundred and thirty days from the insolvency

© The Institute of Chartered Accountants of India

commencement date, including any extension of the period of corporate insolvency resolution process granted under this section and the time taken in legal proceedings in relation to such resolution process of the corporate debtor:

Provided also that where the insolvency resolution process of a corporate debtor is pending and has not been completed within the period referred to in the second proviso, such resolution process shall be completed within a period of ninety days from the date of commencement of the Insolvency and Bankruptcy Code (Amendment) Act, 2019".

(iv) In **section 25A** after sub-section 3, following sub-section shall be added:

"(3A) Notwithstanding anything to the contrary contained in sub-section (3), the authorised representative under sub-section (6A) of section 21 shall cast his vote on behalf of all the financial creditors he represents in accordance with the decision taken by a vote of more than fifty per cent, of the voting share of the financial creditors he represents, who have cast their vote:

Provided that for a vote to be cast in respect of an application under section 12 A, the authorised representative shall cast his vote in accordance with the provisions of sub-section (3)."

(v) **In section 30(2)(b),** the following shall be substituted :

(b) provides for the payment of debts of operational creditors in such manner as may be specified by the Board which shall not be less than—

(i) the amount to be paid to such creditors in the event of a liquidation of the corporate debtor under section 53; or

(ii) the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority in sub-section (1) of section 53,

whichever is higher, and provides for the payment of debts of financial creditors, who do not vote in favour of the resolution plan, in such manner as may be specified by the Board, which shall not be less than the amount to be paid to such creditors in accordance with sub-section (7) of section 53 in the event of a liquidation of the corporate debtor.

Explanation 1.—For the removal of doubts, it is hereby clarified that a distribution in accordance with the provisions of this clause shall be fair and equitable to such creditors.

Explanation 2.—For the purposes of this clause, it is hereby declared that on and from the date of commencement of the Insolvency and Bankruptcy Code (Amendment) Act, 2019, the provisions of this clause shall also apply to the corporate insolvency resolution process of a corporate debtor—

© The Institute of Chartered Accountants of India

(i) where a resolution plan has not been approved or rejected by the Adjudicating Authority;

(ii) where an appeal has been preferred under section 61 or section 62 or such an appeal is not time barred under any provision of law for the time being in force; or

(iii) where a legal proceeding has been initiated in any court against the decision of the Adjudicating Authority in respect of a resolution plan;"

(vi) **In section 31(1)** of the Code, after the words "members, creditors," the following words shall be inserted:

"including the Central Government, any State Government or any local authority to whom a debt in respect of the payment of dues arising under any law for the time being in force, such as authorities to whom statutory dues are owed,"

(vii) In **section 33(2),** following explanation shall be added:

"Explanation.—For the purposes of this sub-section, it is hereby declared that the committee of creditors may take the decision to liquidate the corporate debtor, any time after its constitution under sub-section (7) of section 21 and before the confirmation of the resolution plan, including at any time before the preparation of the information memorandum."

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

Integrated Case Scenario/ Multiple Choice Questions

1. Lagus Transport Services Limited (LTSL) is operating in logistics and public transport domain. The company has pan-India presence. As per its Articles of Association, the company can appoint a maximum of 15 directors and all of them shall be rotational directors. Presently, the company has a strength of 14 directors, of which 9 are executive directors and the remaining 5 are non-executive directors. As on 31st March, 2018, its paid-up share capital was ₹ 8.42 crore; the turnover was ₹ 84 crore; and it had, in the aggregate, outstanding loans, debentures and deposits to the tune of ₹ 42 crore.

   In the Annual General Meeting (AGM), held on 20th August, 2018, Anil, Badal, Chanchal and Damodar were appointed as directors in place of Mohan, Navin, Om and Prasad by passing a single resolution with simple majority. It is to be noted that earlier, a motion authorising the appointment of Anil, Badal, Chanchal and Damodar by a single resolution was passed in the meeting and not a single vote was cast against such motion.

   As on 31st March, 2019, the turnover of the company increased to ₹ 120.52 crore but the aggregate of outstanding loans, debentures and deposits reduced to ₹ 40 crore. The paid-

© The Institute of Chartered Accountants of India

up share capital was the same as earlier. Due to the increased turnover there arose the requirement of appointing two independent directors.

Since the company was required to appoint two independent directors, the total strength of the Board with such appointments would go up to 16 directors from the present 14 whereas according to the Articles, the company can have a maximum of 15 directors. Accordingly, the Articles were altered and the total strength was increased to 20 directors.

After altering the Articles, the company proceeded to appoint four independent directors instead of the mandatorily required two since it was felt that such step would strengthen the corporate governance to the maximum extent. The independent directors were - Mrs. Eekam, who is considered 'influencer' on supply chain management and has a lot of expertise in the logistics field; Mrs. Prajna who is a marketing expert; Mrs. Ruchita, who is MBA (Finance and Accounting) from IIM, Ahmedabad; and Mr. Amit, who is skilled in developing customised software. Subsequent to the above developments, the time to hold Annual General Meeting (AGM) approached and it was held on 12th August, 2019, at the registered office of the company at Mumbai.

Multiple Choice Questions (MCQs)

1. In this case scenario, Anil, Badal, Chanchal and Damodar were appointed as directors by passing a single resolution at the AGM. Is such appointment valid?

   (a) The appointment of Anil, Badal, Chanchal and Damodar by a single resolution is valid because beforehand, a motion authorising their appointment by a single resolution was passed in the meeting and not a single vote was cast against such motion.

   (b) The appointment of Anil, Badal, Chanchal and Damodar by a single resolution is not valid because passing of resolution by simple majority indicates that it was not passed unanimously.

   (c) The appointment of Anil, Badal, Chanchal and Damodar by a single resolution with simple majority is not valid because such resolution is required to be passed as a special resolution.

   (d) The appointment of Anil, Badal, Chanchal and Damodar by a single resolution is not valid because in no case more than one director can be appointed by passing a single resolution.

2. In the given case scenario, according to the Articles all the directors are rotational. Had this been not the case, how many directors were required to retire at the AGM which was held on 20th August, 2018?

   (a) Five directors

   (b) Four directors

   (c) Three directors

© The Institute of Chartered Accountants of India

(d) Two directors

3. In the given case scenario, if it is presumed that as on 31st March, 2019, the turnover of the company is ₹ 87.00 crore and the paid-up share capital is ₹ 12.00 crore, would the company be still mandatorily required to appoint two independent directors?

   (a) There is no need to appoint two independent directors since the aggregate of turnover and paid-up share capital has not crossed the threshold of ₹ 100 crore.

   (b) Instead of appointing two independent directors, the company is required to appoint only one independent director since the aggregate of turnover and paid-up share capital is above ₹ 90 crore but less than ₹ 100 crore.

   (c) The company is required to appoint minimum two independent directors since the paid-up share capital is ₹ 12 crore.

   (d) The company is required to appoint only one independent director since the paid-up share capital is below ₹ 15 crore.

4. According to the case scenario, the company altered its Articles of Association so as to increase the total strength of directors up to 20 from the present 15 directors. Which of the following options is applicable in such a case of alteration:

   (a) The articles were altered by passing an ordinary resolution.

   (b) The articles were altered by passing an ordinary resolution followed by approval sought from the jurisdictional Registrar of Companies.

   (c) The articles were altered by passing a Board Resolution with more than seventy-five percent majority.

   (d) The articles were altered by passing a special resolution.

5. As on 12th August, 2019, when the AGM of LTSL was held, the total strength of directors reached to 18 due to the appointment of four independent directors. When all the directors are rotational, how many directors shall get retired at this AGM?

   (a) Six directors

   (b) Five directors

   (c) Four directors

   (d) Two directors

2. Ali Baba Limited is a listed company incorporated under the provisions of Company Law having its registered office at Andhra Pradesh. Mrs. Smart is a Managing Director of Ali Baba Limited since its incorporation. She was first director and one of the promoters of the company. She has vast experience of managing the company in very efficient manner.

   Ali Baba Ltd. is a holding company of PM Limited with a Fira Private Limited as a subsidiary to PM Limited.

© The Institute of Chartered Accountants of India

Following are the details pertaining to the incorporation of the related entities and its capital structure:

S. No.	Particulars	Ali Baba Limited	PM Limited	Fira Private Limited
1.	Date of Incorporation	17/09/1985	06/09/1988	28/09/1989
2.	Place of Registered Office	Andhra Pradesh	Delhi	Hyderabad
3.	Authorised Share Capital	₹ 100,00,00,000/-	₹ 20,00,00,000/-	₹10,00, 00,000/-
4.	Paid Up Share Capital	₹ 99,00,00,000/-	₹ 10,00,00,000/-	₹ 10,00,00,000/-

Under the guidance of Mrs. Smart, Ali Baba Limited acquired shareholding in PM Limited and thus resulting it into a subsidiary company of Ali Baba Limited. Now the Board of Directors of Ali Baba Limited wishes to nominate Mrs. Smart for the position of Managing Director in PM Limited and also to appoint her as Whole Time Director(WTO) in Fira Private Limited, which is a wholly owned subsidiary (WOS) of PM Limited.

Therefore, the Board of Directors of PM Limited passed a Board Resolution through resolution by circulation to appoint Mrs. Smart as Managing Director of the company. Subsequently, the Board of Directors of Fira Private Limited passed the Board Resolution at Board Meeting, wherein all directors present in the meeting approved the resolution for appointing her as Whole Time Director of the company and then subsequent to unanimous Board approval, Fira Private Limited also conducted the general meeting for getting approval of shareholders and passed the ordinary resolution to appoint her as Whole Time Director in the company.

Further, for appointment of Mrs. Smart, PM Limited and Fira Private Limited had complied with Schedule V of the Companies Act, 2013 as a result respective companies did not take any approval from Central Government for her appointment as Managing Director and Whole Time Director respectively.

Based on the above provided information and in the light of applicable provisions of the Companies Act, 2013, read with Schedule V of the Act, you are asked to advice on the following Multiple Choice Questions:

1. State on the validity of the appointment of Mrs. Smart as Managing Director in PM Limited in terms of the provisions of the Companies Act, 2013?

   (a) Invalid, as no such appointment was made or approved by resolution passed at the board meeting with the consent of all the directors present at the meeting and supported by general meeting's ordinary resolution under section 196.

   (b) Valid as whole time KMP shall hold office in its subsidiary at the same time.

   (c) Valid with further approval of the Central Government

   (d) Invalid because a person cannot hold more than one office as Managing Director

© The Institute of Chartered Accountants of India

2. Whether Mrs. Smart appointment as Whole Time Director in Fira Private Limited is valid as per provisions of the Companies Act, 2013?
   (a) No, because being Fira Private Limited is private company so rule 8 & 8A of Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014, not applicable
   (b) Yes, as per section 2(71) it is deemed as public Co.
   (c) Yes, on further approval of Central Government
   (d) No, because of restriction under section 203(3) on appointment in more than one company.
3. What will be legal position as to the appointment of Mrs. Smart as Managing Director in PM Limited, if Ali Baba Limited is a Government Company?
   (a) Invalid due to non-compliance of section 203
   (b) Valid in light of the provisions 203(4A)
   (c) Valid with approval of central government
   (d) Invalid because a person cannot hold office of Managing Director in more than 1 company.
4. What is the status of Fira Private Limited for the purpose of the applicability of the Companies Act, 2013, if Ali Baba Limited is a Government Company?
   (a) Private Company
   (b) Public Company
   (c) Government Company
   (d) Associate Company
5. Whether appointment of Mrs. Smart as Whole Time Director in Fira Private Limited is legally acceptable, if Ali Baba Limited is a Government Company?
   (a) No, because being Fira Private Limited is private company so rule 8 & 8A of Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014, not applicable
   (b) Yes, because section 203 is not applicable on Government Companies
   (c) Yes, with further approval Central Government
   (d) No, because of restriction under section 203(3)

3. In case of Topica Sugar Mills Limited, necessary arrangements are in place for conducting of Board Meetings through the means of video conferencing, a facility which Vaibhav and Yukta, the two directors out of six intend to utilize by participating in such meetings through

© The Institute of Chartered Accountants of India

it. During which part of the year they should intimate the company about their participation in Board Meetings through video conferencing?

(a) At the beginning of the Financial Year

(b) At the beginning of the Calendar Year

(c) On 1st day of any month falling in the Financial Year

(d) Before the Board Meeting.

4. Blue Rose Agri-Products Limited, which is *inter-alia* listed on National Stock Exchange, has called an extra-ordinary general meeting (EGM) of the shareholders on 29th January, 2019 at its Head Office in New Delhi to seek approval in respect of certain matters. It so happened that the company received a notice on 25th January, 2019 from the requisite number of small shareholders who proposed appointment of Shivank as their director but it refused to entertain the notice as the same was served quite late. Advise the latest date by which the small shareholders must have given the notice for the appointment of Shivank so that it was not refused by the company.

(a) The notice should have been served latest by 24th January, 2019.

(b) The notice should have been served latest by 15th January, 2019.

(c) The notice should have been served latest by 22nd January, 2019.

(d) The notice should have been served latest by 19th January, 2019.

5. The IRP appointed for M Ltd. is seeking your views on the constitution of the Committee of creditors of M Ltd. M Ltd. does not have any financial debt other than loan obtained from Mr. A, son of Mr. B, the managing director of M Ltd. Considering the above, identify the appropriate constitution of the committee of creditors out of the following:

(a) Mr. A, 18 largest operational creditors, 1 representative of all workmen

(b) 18 largest operational creditors, 1 representative of workmen and 1 representative of employees.

(c) Only Mr. A since he is the only financial creditor

(d) 18 largest operational creditors, 1 representative of workmen and 1 representative of employees and the resolution professional.

6. Which of the following terms are not included within arrangements entered into by the Central Government with another country, in relation to reciprocal arrangements under PMLA, 2002?

(a) Enforcement of the provisions of PMLA, 2002

(b) Prevention of offence in India under the corresponding PMLA law in force in the other country

(c) Exchange the history of person if it is wilful offender under the PMLA on annual basis.

© The Institute of Chartered Accountants of India

(d) Exchange information to prevent any offence under PMLA, 2002.

7. Mr. V, brother of Mr. R, is a resident of Singapore and he owns an immovable property in Chennai which he inherited from his father, who was a resident of India, Can Mr. V continue to hold the property?

   (a) No, he cannot hold transfer or invest In India, since he is resident outside India.

   (b) Yes, he can continue to hold in India, since he is person of India Origin and the property is located in India

   (c) Yes, he can continue to hold the property, since this was inherited from a person who was resident in India.

   (d) Yes, he can continue to hold the property, since his brother (Mr. R) uses the property whenever he travels to Chennai.

8. Which among the following is legally acceptable permissible source for funding overseas direct investment :

   (a) Proceeds of External Commercial Borrowings

   (b) Proceeds of Real estate business

   (c) Proceeds of Banking business

   (d) Proceeds of foreign currency funds raised through other than ADR / GDR issues

Descriptive Questions

9. Aster limited (a listed company) deals in business of trading of raw materials to the manufacturer of the garments. The company was running in losses for past two years. The Board of the company appointed Mr. C with good experience in cost management to overcome the said situation, as whole time director. He was of 70 years on the date of his appointment i.e. 18.12.2019.

   Following were the relevant extracts from latest audited financial statements (as on 31st March, 2019);

   (a) Authorised Share capital is ₹ 390 crore, out of which paid up share capital was ₹ 215 crore; company was in process of FPO, hence had balance of ₹ 15 crore in share application money account.

   (b) Balance of reserve and surplus was ₹ 170 crore, out of which ₹ 150 crore was general reserve and ₹ 20 crore was on accounts of revaluation reserve.

   (c) Outstanding amount for long term loans was ₹ 200 crore

   (d) Company had investment of ₹ 40 crore at book value; due to economic slowdown same is not liquid investment

   (e) Accumulated losses were of ₹ 10 crore.

© The Institute of Chartered Accountants of India

In the light of the given facts and figures, evaluate the given situations in terms of the relevant provisions of the Companies Act, 2013-

(i) Validity of appointment of Mr. C, as managerial person in office of whole time director in Aster Limited.

(ii) Compute the Effective Capital of Aster Limited for payment of Managerial Remuneration.

(iii) Since Aster Ltd. was running in losses, state the maximum amount of remuneration to be paid on yearly basis to each Managerial Person.

10. Fame Ltd. filed an application to the registrar for removal of the name of company from the register of companies after passing special resolution. On the complaint of certain members, Registrar came to know that already an application is pending before the Tribunal for the sanctioning of a compromise or arrangement proposal. The application was filed by the Fame Ltd. two months before the filing of this application to the Registrar.

    Determine the given situations in the lights of the given facts as per the Companies Act, 2013:

    (i) Legality of filing an application by Fame Ltd. Before the Registrar.

    (ii) Consequences if Fame Ltd. files an application in the above given situation.

    (iii) In case Registrar notifies Fame Ltd as dissolved under section 248 in compliances to the required provisions, what remedy will be available to the aggrieved party?

11. Draft a Board Resolution of disclosure of interest by Mr. J, director of ABC Ltd. in a proposed contract to be entered into with M/s APL & Co. in which, such director is a partner.

12. Enumerate the given situations in the light of the term defined as Current Account Transaction under FEMA.

    (a) An Indian resident imports machinery from a vendor in UK for installing in his factory.

    (b) An Indian resident imports machinery from a vendor in UK for installing in his factory on a credit period of 3 months.

    (c) An Indian resident transfers US$ 1,000 to his NRI brother in New York as “gift”. The funds are sent from resident’s Indian bank account to the NRI brother’s bank account in New York.

13. Mr. X was found to be guilty of offence of money-laundering by being involved in an activity connected with proceeds of crime. Adjudicating Authority(AA) as per findings confirmed the attachment of the property and ordered for the investigation. The investigation was initiated by the AA on 1st February, 2019. The attachment of the property of Mr. X was still to be continued by 31st January 2020. Enumerate in the given situation the validity of the attachment period.

© The Institute of Chartered Accountants of India

14. ABZ Ltd. an unlisted company with total assets of ₹ one crore as per financial statement as on 31st March, 2018, defaulted in the payment of the financial debt against the financial creditor Mr. X. Mr. X filed an application for initiation of insolvency process against ABZ Ltd. under the fast track corporate insolvency resolution process on 31st May 2019. Discuss the relevancy for disposal through the mechanism of the fast track corporate insolvency resolution process and the legal position of holding of fast track corporate insolvency resolution process by Mr. X in the term of the IBC, 2016. Compute the time period for completion of fast track process in the said situation.

15. Bhrat Ltd. is a subsidiary of Global Ltd., which is a MNC registered in Hongkong. The Bhrat Ltd. had obtained the permission to receive foreign contribution in a designated account in the SBI. Later it was discovered that the obtained foreign contribution were deposited in other account for its functioning. Advise on the given situation as to depositing of the amount of foreign contribution from designated account to any other account. And state the duty of the bank on the said transactions made?

16. SEBI on an complaint of Mr. KG enquires that Mr. Mehta, a Chief Executive Officer of the X Company, on the basis of unpublished price sensitive information, has been indulged in the trading of the securities of that company. Examine, on the basis of the said finding, what action SEBI can take against Mr. Mehta under the Securities and Exchange Board of India Act, 1992.

17. Mr. R, the respondent had placed an order of purchase of various quantities of phosphoric acid from the Mr. P, the petitioner. The purchase order noted that the terms and conditions were to be as per the Fertilizer Association of India (FAI). Terms and Conditions for Sale and Purchase of Phosphoric Acid were as per Clause 15 of the FAI which also provided terms for settlement of disputes by arbitration. Enumerate in the light of the given circumstances as to existence of a valid arbitration agreement between the parties as per the Arbitration and Conciliation Act, 1996.

18. PQR Ltd. is holding 30% of the paid up equity capital of Cochin Stock Exchange. The company appoints MNL Ltd. as its proxy who is not a member of the Cochin Stock Exchange, to attend and vote at the meeting of the stock exchange. Examine whether the Cochin Stock Exchange can restrict the appointment of MNL Ltd. as proxy for PQR Ltd. and further restrict, the voting rights of PQR Ltd. in the Cochin Stock Exchange.

19. Mr. Mediator was proposed to be appointed as a resolution professional for the corporate insolvency resolution process initiated against BMR Ltd. Mr. R, a relative of director of BMR Ltd. is a partner in the insolvency professional entity in which Mr. Mediator is partner. In the light of the given facts, examine the nature of the proposal of the appointment of Mr. Mediator for the conduct of the CIRP as per the Insolvency and Bankruptcy Code, 2016.

20. In the annual general meeting of XYZ Ltd., while discussing on the matter of retirement and reappointment of director Mr. X, allegations of fraud and financial irregularities were marked against him by some members. This resulted into chaos in the meeting. The situation was normal only after the Chairman declared about initiating an inquiry against

© The Institute of Chartered Accountants of India

the director Mr. X, however, could not be re-appointed in the meeting. The matter was published in the newspapers next day. On the basis of such news, whether the court can take cognizance of the matter and take action against the director on its own? Justify your answer with reference to the provisions of the Companies Act, 2013.

SUGGESTED ANSWER

(1) Integrated case scenario 1

1. Answer – (a)
2. Answer - (c)
3. Answer - (c)
4. Answer- (d)
5. Answer - (b)

(2) Integrated case scenario 2

1. Answer: (a)
2. Answer: (b)
3. Answer: (b)
4. Answer: (c)
5. Answer: (b)

Multiple choice questions

3. Answer (b)

4. Answer (b)

5. Answer (b)

6. Answer (c)

7. Answer (c)

8. Answer (a)

Descriptive Questions

9. (i) As per section 196(3) of the Companies Act, 2013, no company shall appoint or continue the employment of any person as managing director, whole-time director or manager who is below the age of twenty-one years or has attained the age of seventy years, unless that appointment of a person who has attained the age of seventy years may be made by passing a special resolution(SR) with explanatory statement annexed to the notice for such an appointment of person.

© The Institute of Chartered Accountants of India

Where no such special resolution is passed but votes cast in favour of the motion exceed the votes, if any, cast against the motion and the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company, the appointment of the person who has attained the age of seventy years may be made.

Therefore, appointment of Mr. C as whole time director in the Aster Ltd. being of 70 years, is valid in compliance to above legal provisions.

(ii) As per section II of Part II of Schedule V to the Companies Act 2013, "effective capital" means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, overdrafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

According to the particulars given:

Particulars	Amounts (in Crore)
Paid up share capital (Excluding share application money) (215-15)	₹ 200
General Reserve (Excluding Revaluation Reserve) (170-20)	₹ 150
Long term loans	₹ 200
Less; Investments (40) and Accumulated losses (10)	₹ 50
Effective Capital	₹ 500

(iii) As per Section II of Part II of Schedule V to the Companies Act 2013,in case of no or inadequate profits, if effective capital of company is ₹ 250 crore or more then, yearly remuneration per person payable shall not exceed by ₹ 120 lakh plus 0.01% of the effective capital in excess of ₹ 250 crore.

The maximum remuneration that may be paid to each managerial person will be [120 lakh+ (0.01% x 250 cr)] = 122.5 lakh.

Provided that the remuneration in excess of above limits may be paid if the resolution passed by the shareholders is a special resolution.

10. According to the Section 248(2) of the Companies Act, 2013, a company may, after extinguishing all its liabilities, by a special resolution, or consent of seventy-five per cent. members in terms of paid-up share capital, file an application in the prescribed manner to the Registrar for removing the name of the company from the register of companies on all

© The Institute of Chartered Accountants of India

or any of the grounds specified in section 248(1) and the Registrar shall, on receipt of such application, cause a public notice to be issued in the prescribed manner.

Further Section 249 provides restrictions on making application under section 248 .

An application under section 248 on behalf of a company shall not be made if, at any time in the previous three months, the company—

(a) has changed its name or shifted its registered office from one State to another;

(b) has made a disposal for value of property or rights held by it, immediately before cesser of trade or otherwise carrying on of business, for the purpose of disposal for gain in the normal course of trading or otherwise carrying on of business;

(c) has engaged in any other activity except the one which is necessary or expedient for the purpose of making an application under that section, or deciding whether to do so or concluding the affairs of the company, or complying with any statutory requirement;

(d) has made an application to the Tribunal for the sanctioning of a compromise or arrangement and the matter has not been finally concluded; or

(e) is being wound up under Chapter XX of this Act or under the Insolvency and Bankruptcy Code, 2016.

Violation of above conditions on filing of application: If a company files an application in violation of restriction given above, it shall be punishable with fine which may extend to one lakh rupees.

Rights of registrar on non-compliance of conditions by the company: An application filed under above circumstances, shall be withdrawn by the company or rejected by the Registrar as soon as conditions are brought to his notice.

Aggrieved person to file an appeal against the order of registrar: As per section 252(1),any person aggrieved by an order of the Registrar, notifying a company as dissolved under section 248, may file an appeal to the Tribunal within a period of three years from the date of the order of the Registrar and if the Tribunal is of the opinion that the removal of the name of the company from the register of companies is not justified in view of the absence of any of the grounds on which the order was passed by the Registrar, it may order restoration of the name of the company in the register of companies. However a reasonable opportunity is given to the company and all the persons concerned.

According to the above provisions, following are the answers:

(i) As per the restrictions marked in the Section 249(d) stating that an application under section 248 on behalf of a company shall not be made if, at any time in the previous three months, the company has made an application to the Tribunal for the sanctioning of a compromise or arrangement and the matter has not been finally concluded.

© The Institute of Chartered Accountants of India

As per the facts application to the registrar for removal of the name of company from the register of companies, was filed by the Fame Ltd. within three months to the filing of an application to the Tribunal for approval of compromise or arrangement proposal. Therefore filing of such an application by Fame Ltd is not valid.

(ii) If a company files an application in above situation, it shall be punishable with fine which may extend to one lakh rupees. An application so filed, shall be withdrawn by the company or rejected by the Registrar as soon as conditions are brought to his notice.

(iii) According to the provision given in section 252(1),a person aggrieved by an order of the Registrar, notifying Fame Ltd. as dissolved under section 248, may:

- file an appeal to the Tribunal within a period of three years from the date of the order of the Registrar, and
- if the Tribunal is of the opinion that the removal of the name of the company from the register of companies is not justified in view of the absence of any of the grounds on which the order was passed by the Registrar, it may order restoration of the name of the Fame Ltd. in the register of companies.
- A reasonable opportunity is given to the Fame Ltd. and all the persons concerned.

11. Board Resolution of disclosure of Interest U/s 184

Resolved that pursuant to section 184(1) of the Companies Act, 2013 read with Rule 9(1) of the *Companies (Meetings of Board and its powers) Rules, 2014*, and other applicable provisions of the Companies Act, 2013, the general notice of disclosure of interest or concern in Form MBP-1 received from Mr. J, Director of the company, as placed before the meeting, be and hereby noted and taken on record by the Board.

Resolved further that Mr. J, Director of the company, and Mr. ------------Company Secretary of the company be and hereby severally authorised to make necessary entries in the register maintained for the purpose.

Further resolved that Mr. ----------- Company secretary and Mr. J director of the company, be and are severally authorised to affix his/ her DSC and file e-form MGT-14 with the Registrar of Companies.

12. (1) An Indian resident imports machinery from a vendor in UK for installing in his factory.

Answer: As per accounts and income-tax law, machinery is a “capital expenditure”. However, under FEMA, it does not alter (create) an asset in India for the UK vendor. It does not create any liability to a UK vendor for the Indian importer. Once the payment is made, the Indian resident or the UK vendor neither owns nor owes anything in the other country. Hence, the said transaction, is a Current Account Transaction.

© The Institute of Chartered Accountants of India

(2) An Indian resident imports machinery from a vendor in UK for installing in his factory on a credit period of 3 months.

Answer: As per accounts and income-tax law, for the credit period of 3 months, there is a liability of the Indian importer to the UK vendor. Technically under FEMA also, it is a liability outside India. However, under definition of Current Account Transaction [S. 2(j)(i)], "short-term banking and credit facilities in the ordinary course of business" are considered as a Current Account Transaction. Hence import of machinery on credit terms is Current Account Transaction.

(3) An Indian resident transfers US$ 1,000 to his NRI brother in New York as "gift". The funds are sent from resident's Indian bank account to the NRI brother's bank account in New York.

Answer: Under accounts and income-tax law, gift is a "capital receipt". However, under FEMA, once the gift is accepted by the NRI, no one owns or owes anything to anyone in India or USA. The transactions is over. Hence it is a Current Account Transaction.

13. Order for attachment/retention of property etc.: As per section 8 of the PMLA, 2002, where the Adjudicating Authority decides that any property is involved in money-laundering, he shall, by an order in writing, confirm the attachment of the property or retention of property or record seized or frozen under section 17 or section 18 and record a finding to that effect.

Period for attachment, retention, or freezing of the seized or frozen property or record: Whereupon such attachment, retention, or freezing of the seized or frozen property or record, AA shall—

(a) continue during investigation, for a period not exceeding three hundred and sixty-five days or the pendency of the proceedings relating to any offence under this Act before a court or under the corresponding law of any other country, before the competent court of criminal jurisdiction outside India, as the case may be; and

(b) become final after an order of confiscation is passed under section 8(7) or section 8(5) or section 58B or section 60(2A) by the Special Court .

For the purposes of computing the period of three hundred and sixty-five days under clause (a), the period during which the investigation is stayed by any court under any law for the time being in force shall be excluded.

Accordingly, the attachment of the property of Mr. X to be continued by 31st January 2020 is valid as it is within 365 days from the date of order of the investigation by the Adjudicating Authority.

14. Relevancy : Fast track corporate insolvency resolution process is a speedy process for corporate insolvency resolution for small corporates.

© The Institute of Chartered Accountants of India

As per section 55 of the IBC, 2016, it is applicable to following corporate debtors - (a) a corporate debtor with assets and income below a level as may be notified by the Central Government; or (b) a corporate debtor with such class of creditors or such amount of debt as may be notified by the Central Government; or (c) such other category of corporate persons as may be notified by the Central Government.

Applicability of the provisions - The provisions are applicable to - (a) small company under section 2(85) of Companies Act (b) a start-up (other than partnership firm)[as defined by Ministry of Commerce and Industry notification No. GSR 501(E) dated 23-5-2017] (c) an unlisted company with total assets not exceeding ₹ one crore as per financial statement immediately preceding the financial year [SO 1911(E) dated 14-6-2017].

Time period for completion of fast track process

The fast track corporate insolvency resolution process shall be completed within a period of 90 days from the insolvency commencement date. It can be extended by Adjudicating Authority by further 45 days, if resolution passed at a meeting of the committee of creditors and supported by a vote of seventy five per cent of the voting shares [section 56(3) of Insolvency Code, 2016].

According to the provisions, fast track corporate insolvency resolution process shall be completed by 29th of August 2019. On further extension uptil by 13th of October, 2019 in compliance with above provision.

15. Every person who has been granted a certificate or given prior permission shall receive foreign contribution in a single account only through such one of the branches of a bank as he may specify in his application for grant of certificate. However, person may open one or more accounts in one or more banks for utilising the foreign contribution received by him. No funds other than foreign contribution shall be received or deposited in such account or accounts.

Every bank or authorised person in foreign exchange shall report to such authority as may be specified —

(a) prescribed amount of foreign remittance;

(b) the source and manner in which the foreign remittance was received; and

(c) other particulars, in such form and manner as may be prescribed.

As per the above stated provisions, Foreign contributions should be received only in the branch of Bank as specified in the application for grant of registration certificate. If permission is obtained to receive foreign contribution in a designated account, and depositing the same in other account, is an offence. However, for utilisation of the funds, one or more banks are permissible [proviso to section 17(1) of FCRA, 2010].

© The Institute of Chartered Accountants of India

Obligations of Bank receiving foreign contribution of its customer

According to *Rule 16 of FCR, Rule 2011,* the bank shall report to the Central Government within forty-eight hours any transaction in respect of receipt or utilisation of any foreign contribution by any person whether or not such person is registered or granted prior permission under the Act.

16. Section 15G of the Securities and Exchange Board of India (SEBI) Act, 1992 deals with penalty for Insider Trading. According to this, if any insider

(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate on any stock exchange on the basis of any unpublished price sensitive information; or

(ii) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary cause of business or under any law, or

(iii) counsels or procures for, any other person to deal in any securities of any body corporate on the basis of unpublished price sensitive information,

shall be liable to a penalty of minimum ₹ 10 lacs which may extend upto twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher. As such SEBI can, after following the prescribed procedure, impose a penalty on Mr. Mehta. The maximum penalty that SEBI can impose is Rupees twenty-five crores or three times the amount of profits made out of insider trading, whichever is higher.

17. **Arbitration agreement through reference:** The Arbitration and Conciliation Act, 1996 envisages a possibility of an arbitration agreement coming into being through incorporation. In other words, parties to an agreement could agree to arbitrate by referring to another contract containing an arbitration agreement. The requirement is that the reference must leave no doubt in the mind of the reader that the parties indeed wanted to incorporate the arbitration agreement into the agreement between them.[Section 7(5)]

Accordingly, as per the said provision, yes this a valid reference for an arbitration agreement to come into existence. It was held by the Supreme Court of India in *Groupe Chimique Tunisien SA v. Southern Petrochemicals Industries Corpn Ltd 2006 (2) ArbLR 435 (SC)* that for a reference to constitute an arbitration agreement the contract should be in writing and reference should be such as to make that arbitration clause a part of the contract. Both the conditions were held to be fulfilled in the present instance.

18. Section 7(A) of the Securities (Contracts) Regulation Act, 1956 provides that a recognised stock exchange is empowered to amend rules to provide for all or any of the following matters:

(a) Restriction of voting right to members only.

(b) Regulation of voting rights by specifying that each member is entitled to one vote only irrespective of number of shares held.

© The Institute of Chartered Accountants of India

(c) Restriction on right of members to appoint proxy.

(d) such incidental, consequential and supplementary matters as may be necessary to give effect to any of the matters specified in clauses (*a*), (*b*) and (*c*).

As such Cochin Stock Exchange can restrict the appointment of MNL Ltd., as proxy, if rules of the exchange so provide. If it is not so provided, rules may be amended and after getting approval of the Central Government regarding amendment, it can restrict appointment of proxies.

Cochin Stock Exchange can also restrict the voting rights of PQR Ltd. if rules of the exchange so provide. If it is not so provided, rules maybe amended and after getting approval of Central Government regarding amendment, it can restrict the voting rights of PQR Ltd. on appointment of proxies.

19. As per Regulation 3 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, an insolvency professional shall be eligible to be appointed as a resolution professional for a corporate insolvency resolution process of a corporate debtor if he, and all partners and directors of the insolvency professional entity of which he is a partner or director, are independent of the corporate debtor.

Explanation– A person shall be considered independent of the corporate debtor, if he:

(a) is eligible to be appointed as an independent director on the board of the corporate debtor under section 149 of the Companies Act, 2013, where the corporate debtor is a company;

(b) is not a related party of the corporate debtor; or

(c) is not an employee or proprietor or a partner:

 (i) of a firm of auditors or secretarial auditors in practice or cost auditors of the corporate debtor in the last three financial years.

 (ii) of a legal or a consulting firm, that has or had any transaction with the corporate debtor amounting to five per cent or more of the gross turnover of such firm, in the last three financial years.

As per the given facts, Mr. Mediator was proposed to be appointed as a resolution professional for the insolvency resolution process initiated against BMR Ltd. Whereas, Mr. R, a relative of director of BMR Ltd. is a partner in the insolvency professional entity in which Mr. Mediator is partner.

Since, Mr. R is the partner in Insolvency Professional Entity in which Mr. Mediator is also a partner, so, Mr. Mediator is not eligible for appointment as Resolution Professional as he is not independent of the corporate debtor, because Mr. R is relative of Director of BMR Ltd. (Corporate Debtors).

© The Institute of Chartered Accountants of India

20. Section 439 of the Companies Act, 2013 provides that offences under the Act shall be non-cognizable. As per this section:

1. Every offence under this Act except the offences referred to in sub section (6) of section 212 shall be deemed to be non-cognizable within the meaning of the said Code.
2. No court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing of the Registrar, a shareholder, member of the company, or of a person authorized by the Central Government in that behalf.

Thus, in the given situation, the court shall not initiate any suo moto action against the director Mr. X without receiving any complaint in writing of the Registrar of Companies, a shareholder of the company or of a person authorized by the Central Government in this behalf.

© The Institute of Chartered Accountants of India