

MOCK TEST PAPER
FINAL (NEW) COURSE: GROUP – I
PAPER – 1: FINANCIAL REPORTING

Question No.1 is compulsory. Candidates are required to answer any four questions from the remaining five questions.

Wherever necessary, suitable assumptions may be made and disclosed by way of a note.

Working notes should form part of the answers.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) H Ltd. has the following assets and liabilities as at March 31, 20X1, prepared in accordance with previous GAAP:

Particulars	Notes	Amount (Rs.)
Property, Plant and Equipment	1	1,34,50,000
Investments in S. Ltd.	2	48,00,000
Debtors		2,00,000
Advances for purchase of inventory		50,00,000
Inventory		8,00,000
Cash		<u>49,000</u>
Total assets		<u>2,42,99,000</u>
Deferral loan	3	60,00,000
Creditors		30,00,000
Short term borrowing		8,00,000
Provisions		<u>12,00,000</u>
Total liabilities		<u>1,10,00,000</u>
Share capital		1,30,00,000
Reserves:		2,99,000
Cumulative translation difference	4	1,00,000
ESOP reserve	4	20,000
Retained earnings		<u>1,79,000</u>
Total equity		<u>1,32,99,000</u>
Total equity and liabilities		<u>2,42,99,000</u>

The following GAAP differences were identified by the Company on first-time adoption of Ind AS with effect from April 1, 20X1:

1. In relation to property, plant and equipment, the following adjustments were identified:
 - Property, plant and equipment comprise land held for capital appreciation purposes costing Rs. 4,50,000 and was classified as investment property as per Ind AS 40.
 - Exchange differences of Rs. 1,00,000 were capitalised to depreciable property, plant and equipment on which accumulated depreciation of Rs. 40,000 was recognised.
 - There were no asset retirement obligations.
 - The management intends to adopt deemed cost exemption for using the previous GAAP carrying values as deemed cost as at the date of transition for PPE and investment property.
2. The Company had made an investment in S Ltd. (subsidiary of H Ltd.) for Rs. 48,00,000 that carried a fair value of Rs. 68,00,000 as at the transition date. The Company intends to recognise the investment at its fair value as at the date of transition.
3. Financial instruments:

- **Deferral loan Rs. 60,00,000:**

The deferral loan of Rs. 60,00,000 was obtained on March 31, 20X1, for setting up a business in a backward region with a condition to create certain defined targets for employment of local population of that region. The loan does not carry any interest and is repayable in full at the end of 5 years. In accordance with Ind AS 109, the discount factor on the loan is to be taken as 10%, being the incremental borrowing rate. Accordingly, the fair value of the loan as at March 31, 20X1, is Rs. 37,25,528. The entity chooses to exercise the option given in paragraph B11 of Ind AS 101, i.e., the entity chooses to apply the requirements of Ind AS 109, Financial Instruments and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, retrospectively as required information had been obtained at the time of initially accounting for deferral loan.

4. The retained earnings of the Company contained the following:

- **ESOP reserve of Rs. 20,000:**

The Company had granted 1,000 options to employees out of which 800 have already vested. The Company followed an intrinsic value method for recognition of ESOP charge and recognised Rs. 12,000 towards the vested options and Rs. 8,000 over a period of time as ESOP charge and a corresponding reserve. If fair value method had been followed in accordance with Ind AS 102, the corresponding charge would have been Rs. 15,000 and Rs. 9,000 for the vested and unvested shares respectively. The Company intends to avail the Ind AS 101 exemption for share-based payments for not restating the ESOP charge as per previous GAAP for vested options.

- **Cumulative translation difference :**

Rs. 1,00,000 The Company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of Rs. 1,00,000 as part of reserves. On first-time adoption of Ind AS, the Company intends to avail Ind AS 101 exemption of resetting the cumulative translation difference to zero. **(15 Marks)**

- (b) Sumeru Limited holds 35% of total equity shares of Meru Limited, an associate company. The value of Investments in Meru Limited on March 31, 20X1 is Rs. 3 crores in the consolidated financial statements of Sumeru Limited.

Sumeru Limited sold goods worth Rs. 3,50,000 to Meru Limited. The cost of goods sold is Rs. 3,00,000. Out of these, goods costing Rs. 1,00,000 to Meru Limited were in the closing stock of Meru Limited.

During the year ended March 31, 20X2 the profit and loss statement of Meru Limited showed a loss of Rs. 1 crore.

- (A) What is the value of investment in Meru Limited as on March 31, 20X2 in the consolidated financial statements of Sumeru Limited, if equity method is adopted for valuing the investments in associates?
- (B) Will your answer be different if Meru Limited had earned a profit of Rs. 1.50 crores and declared a dividend of Rs. 75 lacs to the equity shareholders of the Company?

(5 Marks)

2. (a) RKA Private Ltd is an old company established in 1995. The company started with a very small capital base and today it is one of the leading companies in India in its industry. The company has an annual turnover of Rs. 11,000 crores and planning to get listed in the next year.

The company has a large employee base. The company provided a defined benefit plan to its employees. Following is the information relating to the balances of the fund's assets and liabilities as at 1st April, 20X1 and 31st March, 20X2. Rs. in lacs

Particulars	1 st April, 20X1	31 st March, 20X2
Present value of benefit obligation	1,400	1,580
Fair value of plan assets	1,140	1,275

For the financial year ended 31st March, 20X2, service cost was Rs. 55 lacs. The company made a contribution of an amount of Rs. 111 lacs to the plan. No benefits were paid during the year.

Consider a discount rate of 8%.

As per Ind AS, you are required to -

- (a) Compute the balance(s) of the company to be included its balance sheet as on 31st March, 20X2 and amounts to be recognized in the statement of profit and loss and other comprehensive income for the year ended 31st March, 20X2.
- (b) Give the journal entries in respect of amount(s) to be recognized. **(8 Marks)**
- (b) How should contingent consideration payable in relation to a business combination be accounted for on initial recognition and at the subsequent measurement as per Ind AS in the following cases:

- i) On 1 April 20X1, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:

- ❖ an immediate issuance of 10 lakhs shares of A Ltd. having face value of Rs. 10 per share;
- ❖ a further issuance of 2 lakhs shares after one year if the profit before interest and tax of B Ltd. for the first year following acquisition exceeds Rs. 1 crore.

The fair value of the shares of A Ltd. on the date of acquisition is Rs. 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is Rs. 25 lakhs.

During the year ended 31 March 20X2, the profit before interest and tax of B Ltd. exceeded Rs. 1 crore. As on 31 March 20X2, the fair value of shares of A Ltd. is Rs. 25 per share.

- ii) Continuing with the fact pattern in (a) above except for:

- ❖ The number of shares to be issued after one year is not fixed.
- ❖ Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to Rs. 40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds Rs. 1 crore. A Ltd. issued shares with Rs. 40 lakhs after an year. **(12 Marks)**

3. (a) X Ltd. has identified 4 operating segments for which revenue data is given below:

	External Sale (Rs.)	Internal Sale (Rs.)	Total (Rs.)
Segment A	30,00,000	Nil	30,00,000
Segment B	6,50,000	Nil	6,50,000
Segment C	8,50,000	1,00,000	9,50,000
Segment D	5,00,000	49,00,000	54,00,000
Total Sales	50,00,000	50,00,000	1,00,00,000

Additional information:

Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years.

Which of the segments would be reportable under the criteria identified in Ind AS 108?

(5 Marks)

- (b) X Ltd. sold JCB Machine having WDV of Rs. 50 Lakhs to Y Ltd. for Rs. 60 Lakhs and the same JCB was leased back by Y Ltd. to X Ltd. The lease is operating lease. Comment according to relevant Ind AS if:

- (a) Sale price of Rs. 60 Lakhs is equal to fair value.
(b) Fair value is Rs. 50 Lakhs and sale price is Rs. 45 Lakhs.
(c) Fair value is Rs. 55 Lakhs and sale price Rs. 62 Lakhs.
(d) Fair value is Rs. 45 Lakhs and sale price is Rs. 48 Lakhs.

(5 Marks)

- (c) Tee Limited is carrying on the business of developing light weight and medium weight guns for the Indian defence industry. Tee Limited acquired 48% of shares in Kay Limited, a company engaged in advanced research in weapons. Tee Limited acquired shares in Kay Limited to substantiate their position in the industry.

The remaining 52% of shares are held by the key management personnel of the Company Kay Limited. The Kay management consists of eleven people who are experts in the fields of advanced weapons and the core of the Company.

Tee Limited has the option to purchase remaining 52% at any time by paying 6 times the market price of the share. But on purchase of the shares it is highly possible that the key management personnel will leave the company.

- (A) State whether Tee Limited has control over Kay Limited.
(B) What will be your answer if Tee Limited had 51% of shares in Kay Limited and Kay Limited can start the research, development and production of weapon only with the stringent approval process of the defence ministry of the Central Government.

(5 Marks)

- (d) Mittal Motors Limited is preparing financials for the year ended March 31, 20X2. The Company had some queries in preparation of certain data that is required to be presented in the financials. As the retainer of the Company, please advise the company for the following issues:

- (i) Mittal Motors has issued 10,00,000 numbers of 9% cumulative preference shares. The Company has arrears of Rs. 15 crores of preference dividend as on March 31, 20X2, it includes current year arrears of Rs. 1.75 crores. The Company did not declare any dividend for equity shareholders as well as for preference shareholders.

What is the amount of dividend to be reduced from profit or loss for the year for calculating basic Earnings Per Share?

(ii) Further Mittal Motors has also issued certain convertible debentures, which are outstanding as at the year end. For the purpose of computation of weighted average number of shares (to arrive at diluted EPS) when should the dilutive potential shares should be deemed to have been converted into shares?

- (A) At the start of the period.
 - (B) The date of issue of the potential shares
 - (C) At the start of the period or, if later, the date of the issue of the potential shares
 - (D) At the end of the period.
- (5 Marks)**

4. (a) KK Ltd. runs a departmental store which awards 10 points for every purchase of Rs. 500 which can be discounted by the customers for further shopping with the same merchant. Unutilised points will lapse on expiry of two years from the date of credit. Value of each point is Rs. 0.50. During the accounting period 20X1-20X2, the entity awarded 1,00,00,000 points to various customers of which 18,00,000 points remained undiscounted. The management expects only 80% will be discounted in future of which normally 60-70% are redeemed during the next year.

The Company has approached your firm with the following queries and has asked you to suggest the accounting treatment (Journal Entries) under the applicable Ind AS for these award points:

(a)	How should the recognition be done for the sale of goods worth Rs. 10,00,000 on a particular day?
(b)	How should the redemption transaction be recorded in the year 20X1-20X2? The Company has requested you to present the sale of goods and redemption as independent transaction. Total sales of the entity is Rs. 5,000 lakhs.
(c)	How much of the deferred revenue should be recognised at the year-end (20X1-20X2) because of the estimation that only 80% of the outstanding points will be redeemed?
(d)	In the next year 20X2-20X3, 60% of the outstanding points were discounted Balance 40% of the outstanding points of 20X1-20X2 still remained outstanding. How much of the deferred revenue should the merchant recognize in the year 20X2-20X3 and what will be the amount of balance deferred revenue?
(e)	How much revenue will the merchant recognized in the year 20X2-20X3, if 3,00,000 points are redeemed in the year 20X2-20X3?

(14 Marks)

(b) A Ltd., whose functional currency is Indian Rupee, had a balance of cash and cash equivalents of Rs. 2,00,000, but there are no trade receivables or trade payables balances as on 1st April, 20X1. During the year 20X1-20X2, the entity entered into the following foreign currency transactions:

- ❖ A Ltd. purchased goods for resale from Europe for €2,00,000 when the exchange rate was €1 = Rs. 50. This balance is still unpaid at 31st March, 20X2 when the exchange rate is €1 = Rs. 45. An exchange gain on retranslation of the trade payable of Rs. 5,00,000 is recorded in profit or loss.
- ❖ A Ltd. sold the goods to an American client for \$ 1,50,000 when the exchange rate was \$1 = Rs. 40. This amount was settled when the exchange rate was \$1 = Rs. 42. A further exchange gain regarding the trade receivable is recorded in the statement of profit or loss.
- ❖ A Ltd. also borrowed €1,00,000 under a long-term loan agreement when the exchange rate was €1 = Rs. 50 and immediately converted it to Rs. 50,00,000. The loan was retranslated at 31st March, 20X2 @ Rs. 45, with a further exchange gain recorded in the statement of profit or loss.
- ❖ A Ltd. therefore records a cumulative exchange gain of Rs. 18,00,000 (10,00,000 + 3,00,000 + 5,00,000) in arriving at its profit for the year.
- ❖ In addition, A Ltd. records a gross profit of Rs. 10,00,000 (Rs. 60,00,000 – Rs. 50,00,000) on the sale of the goods.
- ❖ Ignore taxation.

How cash flows arising from the above transactions would be reported in the statement of cash flows of A Ltd. under indirect method? **(6 Marks)**

5. (a) ABC Company issued 10,000 compulsory cumulative convertible preference shares (CCCPS) as on 1 April 20X1 @ Rs 150 each. The rate of dividend is 10% payable every year. The preference shares are convertible into 5,000 equity shares of the company at the end of 5th year from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion options is 15% per annum. Transaction cost on the date of issuance is 2% of the value of the proceeds.

Key terms:

Date of Allotment	01-Apr-20X1
Date of Conversion	01-Apr-20X6
Number of Preference Shares	10,000
Face Value of Preference Shares	150
Total Proceeds	15,00,000

Rate of dividend	10%
Market Rate for Similar Instrument	15%
Transaction Cost	30,000
Face value of equity share after conversion	10
Number of equity shares to be issued	5,000
Effective interest rate	15.86%

You are required to compute the liability and equity component and pass journal entries for entire term of arrangement i.e. from the issue of preference shares till their conversion into equity shares keeping in view the provisions of relevant Ind AS. **(12 Marks)**

- (b) An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on 1st April, 20X1. The plant has a useful life of 40 years. Its initial cost was ₹ 1,20,000. This included an amount for decommissioning costs of ₹ 10,000, which represented ₹ 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on 31st March. Assume that a market-based discounted cash flow valuation of ₹ 1,15,000 is obtained at 31st March, 20X4. This valuation is after deduction of an allowance of ₹ 11,600 for decommissioning costs, which represents no change to the original estimate, after the unwinding of three years' discount. On 31st March, 20X5, the entity estimates that, as a result of technological advances, the present value of the decommissioning liability has decreased by ₹ 5,000. The entity decides that a full valuation of the asset is needed at 31st March, 20X5, in order to ensure that the carrying amount does not differ materially from fair value. The asset is now valued at ₹ 1,07,000, which is net of an allowance for the reduced decommissioning obligation.

How the entity will account for the above changes in decommissioning liability if it adopts revaluation model? **(8 Marks)**

6. (a) A Ltd. intends to open a new retail store in a new location in the next few weeks. It has spent a substantial sum on a series of television advertisements to promote this new store. It has paid for advertisements costing Rs. 8,00,000 before 31st March, 20X2. Rs. 7,00,000 of this sum relates to advertisements shown before 31st March, 20X2 and Rs. 1,00,000 to advertisements shown in April, 20X2. Since 31st March, 20X2, A Ltd. has paid for further advertisements costing Rs. 4,00,000. The accountant charged all these costs as expenses in the year to 31 March 20X2. However, CFO of A Ltd. does not want to charge Rs.12,00,000 against my 20X1-20X2 profits. He believes that these costs can be carried forward as intangible assets because the company's market research indicates that this new store is likely to be highly successful.

OR

As at 31st March, 20X1, a plantation consists of 100 Pinus Radiata trees that were planted 10 years earlier. The tree takes 30 years to mature, and will ultimately be processed into building material for houses or furniture. The enterprise's weighted average cost of capital is 6% p.a.

Only mature trees have established fair values by reference to a quoted price in an active market. The fair value (inclusive of current transport costs to get 100 logs to market) for a mature tree of the same grade as in the plantation is:

As at 31st March, 20X1: 171

As at 31st March, 20X2: 165

Assume that there would be immaterial cash flow between now and point of harvest.

The present value factor of Rs. 1 @ 6% for

19th year = 0.331

20th year = 0.312

State the value of such plantation as on 31st March, 20X1 and 20X2 and the gain or loss to be recognised as per Ind AS. **(6 Marks)**

- (b) ABC Ltd. is a company which has a net worth of Rs. 200 crores, it manufactures rubber parts for automobiles. The sales of the company are affected due to low demand of its products.

The previous year's financials state:

(Rs. in Crores)

	March 31, 20X4 (Current year)	March 31, 20X3	March 31, 20X2	March 31, 20X1
Net Profit	3.00	8.50	4.00	3.00
Sales (turnover)	850	950	900	800

Required

Does the Company have an obligation to form a CSR committee since the applicability criteria is not satisfied in the current financial year? **(6 Marks)**

- (c) Croton Limited is engaged in the business of trading commodities. The company's main asset are investments in equity shares, preference shares, bonds, non-convertible debenture (NCD) and mutual funds.

The Company collects the periodical income (i.e. interest, dividend, etc.) from the investments and regularly sells the investment in case of favourable market conditions. Such investments have been classified as non-current investments in the financial statements.

Also, the company buys and sells equity shares of companies for earning short term profits from the stock market.

The CFO of company classified all the non-current investments as Fair Value Through Other Comprehensive Income (FVTOCI) and all the current investment as Fair value Through Profit and Loss (FVTPL).

Croton Limited raised the following queries:

- (a) Can the Company classify the equity shares previously held under current investment as FVTOCI if the company decides to hold them for more than one-year (i.e. classify it as non-current)?
- (b) The Company had classified NCDs with a maturity period of less than twelve months from the reporting period as current. This has been classified as FVTPL by the CFO of the company. The Company wants to know whether these NCDs can be recognized as FVTOCI?

(8 Marks)

MOCK TEST PAPER 1

FINAL (NEW) COURSE

PAPER 1: FINANCIAL REPORTING

ANSWERS

1. (i)
 1. **Property, plant and equipment:** As the land held for capital appreciation purposes qualifies as investment property, such investment property should be reclassified from property, plant and equipment (PPE) to investment property and presented separately. As the Company has adopted the previous GAAP carrying values as deemed cost, all items of PPE and investment property should be carried at its previous GAAP carrying values. As such, the past capitalised exchange differences require no adjustment in this case.
 2. **Investment in subsidiary:** On first time adoption of Ind AS, a parent company has an option to carry its investment in subsidiary at fair value as at the date of transition in its separate financial statements. As such, the company can recognise such investment at a value of Rs. 68,00,000.
 3. **Financial instruments:** As the deferral loan is a financial liability under Ind AS 109, that liability should be recognised at its present value discounted at an appropriate discounting factor. Consequently, the deferral loan should be recognised at Rs. 37,25,528 and the remaining Rs. 22,74,472 would be recognised as deferred government grant.
 4. **ESOPs:** Ind AS 101 provides an exemption of not restating the accounting as per the previous GAAP in accordance with Ind AS 102 for all options that have vested by the transition date. Accordingly, out of 1000 ESOPs granted, the first-time adoption exemption is available on 800 options that have already vested. As such, its accounting need not be restated. However, the 200 options that are not vested as at the transition date, need to be restated in accordance with Ind AS 102. As such, the additional impact of Rs. 1,000 (i.e., 9,000 less 8,000) would be recognised in the opening Ind AS balance sheet.
 5. **Cumulative translation difference:** As per paragraph D12 of Ind AS 101, the first-time adopter can avail an exemption regarding requirements of Ind AS 21 in context of cumulative translation differences. If a first-time adopter uses this exemption the cumulative translation differences for all foreign operation are deemed to be zero as at the transition date. In that case, the balance is transferred to retained earnings. As such, the balance of Rs. 1,00,000 should be transferred to retained earnings.

6. Retained earnings should be increased by Rs. 20,99,000 on account of the following:

	Rs.
Increase in fair value of investment in subsidiary (note 2)	20,00,000
Additional ESOP charge on unvested options (note 4)	(1,000)
T transfer of cumulative translation difference balance to retained earnings (note 5)	1,00,000

After the above adjustments, the carrying values of assets and liabilities for the purpose of opening Ind AS balance sheet of Company H should be as under:

Particular	Notes	Previous	Adjustments	Ind AS GAAP
Non-Current Assets				
Property, plant and equipment	1	1,34,50,000	(4,50,000)	1,30,00,000
Investment property	1	0	4,50,000	4,50,000
Investment in S Ltd.	2	48,00,000	20,00,000	68,00,000
Advances for purchase of inventory		50,00,000		50,00,000
Current Assets				
Debtors		2,00,000		2,00,000
Inventory		8,00,000		8,00,000
Cash		49,000		49,000
Total assets		<u>2,42,99,000</u>	<u>20,00,000</u>	<u>2,62,99,000</u>
Non-current Liabilities				
Deferral loan	3	60,00,000	(22,74,472)	37,25,528
Deferred government grant	3	0	22,74,472	22,74,472
Current Liabilities				
Creditors		30,00,000		30,00,000
Short term borrowing		8,00,000		8,00,000
Provisions		<u>12,00,000</u>		<u>12,00,000</u>
Total liabilities		<u>1,10,00,000</u>		<u>1,10,00,000</u>
Share capital		1,30,00,000		1,30,00,000
Reserves:				

Cumulative translation difference	5	1,00,000	(1,00,000)	0
ESOP reserve	4	20,000	1,000	21,000
Other reserves	6	1,79,000	20,99,000	22,78,000
Total equity		<u>1,32,99,000</u>	<u>20,00,000</u>	<u>1,52,99,000</u>
Total equity and liabilities		<u>2,42,99,000</u>	<u>20,00,000</u>	<u>2,62,99,000</u>

- (b) (a) Value of investment in Meru Ltd. as on 31st March, 20X2 as per equity method in the consolidated financial statements of Sumeru Ltd.

	Rs.
Cost of Investment	3,00,00,000
Less: Share in Post-acquisition Loss (1,00,00,000 x 35%)	(35,00,000)
Less: Unrealised gain on inventory left unsold with Meru Ltd. $\{(50,000/3,00,000) \times 1,00,000\} \times 35\%$	<u>(5,833)</u>
Carrying value as per Equity method	<u>2,64,94,167</u>

- (b) Value of investment in Meru Ltd. as on 31st March, 20X2 as per equity method in the consolidated financial statements of Sumeru Ltd.

	Rs.
Cost of Investment	3,00,00,000
Add: Share in Post-Acquisition Profit (1,50,00,000 x 35%)	52,50,000
Less: Unrealised gain on inventory left unsold with Meru Ltd. $\{(50,000/3,00,000) \times 1,00,000\} \times 35\%$	(5,833)
Less: Dividend (75,00,000 x 35%)	<u>(26,25,000)</u>
Carrying value as per Equity method	<u>3,26,19,167</u>

2. (a) Extract of the Balance Sheet of RKA Private Ltd as at 31st March, 20X2

Rs. in lacs

Closing net defined liability (1,580 – 1,275) lacs

305

Extract of the Statement of Profit or Loss of RKA Private Ltd for the year ended 31st March, 20X2

Particulars	Rs. in lacs
Service cost	55
Net interest (Refer W.N.1)	<u>21</u>

Profit or loss	76
Other comprehensive income:	
Remeasurements (<i>Refer W.N.2</i>)	<u>80</u>
Total	<u>156</u>

(b) **Journal entries in the books of RKA Private Ltd**

Particulars	Rs in lacs	Rs in lacs
Profit & Loss Dr.	76	
Other comprehensive income Dr.	80	
To Cash (Contribution)		111
To Net defined benefit liability (<i>Refer WN 3</i>)		45

Working Notes:

1. Computation of Net interest taken to the Statement of Profit or Loss

= Discount rate x Opening net defined benefit liability

= 8% x (1,400 – 1,140) lacs

= 8% x 260 lacs

= 21 lacs (Rounded off to nearest lacs)

2. Computation of Remeasurements

Actuarial gain or loss on defined benefit liability:

Particulars	Rs. in lacs
Opening balance of liability	1,400
Current service cost	55
Interest on opening liability (1,400 x 8%)	112
Actuarial loss (Bal. fig)	<u>13</u>
Closing balance of liability	<u>1,580</u>

Actual return on plan assets:

Particulars	Amount Rs. In lacs
Opening balance of asset	1,140
Cash contribution	111
Actual return (Bal. fig)	<u>24</u>
Closing balance of asset	<u>1,275</u>

Net interest on opening balance of plan asset = Rs. 91 lacs (i.e. Rs. 1,140 lacs x 8%) (Rounded off to nearest lacs)

Hence there is a decrease in plan assets due to remeasurement for which computation is as follows:

Actual Return – Net interest on opening plan asset
= Rs. 24 lacs – Rs. 91 lacs
= Rs. 67 lacs.

Net remeasurement would be computed as follows:

Actuarial loss on liability + Loss on return
= Rs. 13 lacs + Rs. 67 lacs
= Rs. 80 lacs.

3. Computation of increase/ decrease in net defined benefit liability:

Particulars	₹ in lacs
Opening net liability (₹ 1,400 lacs – ₹ 1,140 lacs)	260
Closing net liability (₹ 1,580 lacs – ₹ 1,275 lacs)	<u>305</u>
Increase in liability	<u>45</u>

- (b) Paragraph 37 of Ind AS 103, inter alia, provides that the consideration transferred in a business combination should be measured at fair value, which should be calculated as the sum of (a) the acquisition-date fair values of the assets transferred by the acquirer, (b) the liabilities incurred by the acquirer to former owners of the acquiree and (c) the equity interests issued by the acquirer.

Further, paragraph 39 of Ind AS 103 provides that the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

With respect to contingent consideration, obligations of an acquirer under contingent consideration arrangements are classified as equity or a liability in accordance with Ind AS 32 or other applicable Ind AS, i.e., for the rare case of non-financial contingent consideration. Paragraph 40 provides that the acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, *Financial Instruments: Presentation*. The acquirer shall classify as an asset a right to the return of previously transferred consideration if

specified conditions are met. Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration.

- i) In the given case the amount of purchase consideration to be recognised on initial recognition shall be as follows:

Fair value of shares issued (10,00,000 x Rs. 20)	Rs. 2,00,00,000
Fair value of contingent consideration	Rs. 25,00,000
Total purchase consideration	Rs. 2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

- ❖ There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavourable conditions (for the issuer of the instrument).
- ❖ If the instrument will or may be settled in the issuer's own equity instruments, then it is:
 - a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or
 - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.

Here, the obligation to pay contingent consideration amounting to Rs. 25,00,000 is recognised as a part of equity and therefore not re-measured subsequently or on issuance of shares.

- ii) The amount of purchase consideration to be recognised on initial recognition is shall be as follows:

Fair value shares issued (10,00,000 x Rs. 20)	Rs. 2,00,00,000
Fair value of contingent consideration	<u>Rs. 25,00,000</u>
Total purchase consideration	<u>Rs. 2,25,00,000</u>

Subsequent measurement of contingent consideration payable for business combination

The contingent consideration will be classified as liability as per Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration not classified as equity should be measured at fair value at each reporting date and changes in fair value should be recognised in profit or loss.

As at 31 March 20X2, (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of Rs. 15,00,000 (Rs. 40,00,000 - Rs. 25,00,000) should be recognised in the profit or loss for the period. A Ltd. would recognise issuance of 160,000 (Rs. 40,00,000/ 25) shares at a premium of Rs. 15 per share.

3. (a) Threshold amount is Rs. 10,00,000 (Rs. 1,00,00,000 x 10%).

Segment A exceeds the quantitative threshold (Rs. 30,00,000 > Rs. 10,00,000) and hence reportable segment.

Segment D exceeds the quantitative threshold (Rs. 54,00,000 > Rs. 10,00,000) and hence reportable segment.

Segment B & C do not meet the quantitative threshold amount and may not be classified as reportable segment.

However, the total external revenue generated by these two segments A & D represent only 70% (Rs. 35,00,000 / 50,00,000 x 100) of the entity's total external revenue. If the total external revenue reported by operating segments constitutes less than 75% of the entity total external revenue, additional operating segments should be identified as reportable segments until at least 75% of the revenue is included in reportable segments.

In case of X Ltd., it is given that Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years. In accordance with the requirement of Ind AS 108, X Ltd. designates this start-up segment C as a reportable segment, making the total external revenue attributable to reportable segments 87% (Rs. 43,50,000 / 50,00,000 x 100) of total entity revenues.

- (b) **As per Ind AS 17, Leases:**

- (a) Since sale price is equal to fair value, profit of Rs. 10 lakhs (i.e., Rs. 60 lakhs –

Rs. 50 lakhs) is to be recognised as income immediately.

- (b) Assuming, the loss is not compensated by future lease payments at below market price, the loss of Rs. 5 lakhs (i.e., Rs. 50 lakhs – Rs. 45 lakhs) should be recognised immediately in the profit and loss account. In case, the loss is compensated by future lease payments at below market price, then the loss of Rs. 5 lakhs should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used.
 - (c) Profit of Rs. 7 lakhs (i.e., Rs. 62 lakhs – Rs. 55 lakhs) should be deferred and amortised over the period for which the asset is expected to be used. Profit of Rs. 5 lakhs (i.e., Rs. 55 lakhs – Rs. 50 lakhs) should be recognised immediately.
 - (d) Rs. 3 lakhs (i.e., Rs. 48 lakhs – Rs. 45 lakhs) should be deferred and amortised over the period for which the asset is expected to be used. Loss of Rs. 5 lakhs (i.e., Rs. 50 lakhs – Rs. 45 lakhs) should be recognised immediately in the profit and loss account.
- (c) As per para 7 of Ind AS 110 / IFRS 10, an investor controls an investee if and only if the investor has all the following:

1. Power over the investee

Further, as per para 10 of the standard, an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, ie the activities that significantly affect the investee's returns.

2. Exposure, or rights, to variable returns from its involvement with the investee

As per para 15 of the standard, an investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance.

3. The ability to use its power over the investee to affect the amount of the investor's returns

An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.

Based on the above guidance, following can be concluded:

- (a) Tee limited has acquired 48% in Kay Limited. The purpose of acquiring the shares by Tee limited in it is to substantiate their position in the industry. Kay Limited is a specialist entity that is engaged in advanced research in weapons. Acquiring Kay Limited will help Tee limited to gain access to their research

which would complement Tee limited's operations and business of developing light weight and medium weight guns.

The key management personnel who holds 52% shares of Kay Limited are key for running Kay Limited's business of advanced research and will help Tee limited to acquire the market through ground breaking advanced researches of Kay Limited. In case of acquisition of 52% stake of Kay Limited, the key management personnel may leave the organisation and in such a situation Tee limited will not enjoy any economic benefit or infact will lose the benefit of unique technical knowledge of those 11 experts.

Hence, Tee limited would not be able to use its power over Kay Limited to affect the amount of its returns which is one of the essential criteria to assess the control, so there is no control of Tee limited on Kay Limited.

- (b) Even though Tee limited has acquired 51% stake in Kay Limited yet it does not have power over Kay Limited as it would not be able to exercise its existing rights that give it the current ability to direct the relevant activities, ie the activities that significantly affect the investee's returns. In other words, the relevant activity of Kay Limited is advance research in weapons which will help Tee limited to substantiate their position. However, the research, development and production will start only after stringent approval process of the defence ministry of the Central Government. Thus regulations prevent Tee limited to direct the relevant activity of Kay Limited which ultimately lead to prevent Tee Limited to have control.

- (d) (i) As per para 14 (b) of Ind AS 33 "Earnings per share", "The after-tax amount of preference dividends that is deducted from profit or loss is the after-tax amount of the preference dividends for cumulative preference shares required for the period, whether or not the dividends have been declared. The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods".

In the given case, the amount of preference dividends Rs.1.75 crores declared for the year ended March 31, 20X2 (i.e., the current period) is to be deducted from profit or loss for calculating EPS.

- (ii) As per para 36 of Ind AS 33 "Earnings per share", "For the purpose of calculating diluted earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares. Dilutive potential ordinary shares shall be deemed to have been converted into ordinary shares at the beginning of the period or, if later, the date of the issue of the potential ordinary shares".

4. (a) (a) Points earned on Rs. 10,00,000 @ 10 points on every Rs. 500 = $[(10,00,000/500) \times 10] = 20,000$ points.

Value of points = 20,000 points x Rs. 0.5 each point = Rs. 10,000

Revenue recognized for sale of goods	Rs. 9,90,099	$[10,00,000 \times (10,00,000/10,10,000)]$
Revenue for points deferred	Rs. 9,901	$[10,00,000 \times (10,000/10,10,000)]$

Journal Entry

		Rs.	Rs.
Bank A/c	Dr.	10,00,000	
To Sales A/c			9,90,099
To Liability under Customer Loyalty programme			9,901

- (b) Points earned on Rs. 50,00,00,000 @ 10 points on every Rs. 500 = $[(50,00,00,000/500) \times 10] = 1,00,00,000$ points.

Value of points = 1,00,00,000 points x Rs. 0.5 each point = Rs. 50,00,000

Revenue recognized for sale of goods = Rs. 49,50,49,505 $[50,00,00,000 \times (50,00,00,000 / 50,50,00,000)]$

Revenue for points = Rs. 49,50,495 $[50,00,00,000 \times (50,00,000 / 50,50,00,000)]$

Journal Entry in the year 20X1

		Rs.	Rs.
Bank A/c	Dr.	50,00,00,000	
To Sales A/c			49,50,49,505
To Liability under Customer Loyalty programme			49,50,495
(On sale of Goods)			
Liability under Customer Loyalty programme	Dr.	42,11,002	
To Sales A/c			42,11,002
(On redemption of (100 lakhs -18 lakhs) points)			

Revenue for points to be recognized

Undiscounted points estimated to be recognized next year 18,00,000 x 80%

= 14,40,000 points

Total points to be redeemed within 2 years = $[(1,00,00,000-18,00,000) + 14,40,000]$

$$= 96,40,000$$

Revenue to be recognised with respect to discounted point

$$= 49,50,495 \times (82,00,000/96,40,000) = 42,11,002$$

(c) Revenue to be deferred with respect to undiscounted point in 20X1-20X2

$$= 49,50,495 - 42,11,002 = 7,39,493$$

(d) In 20X2-20X3, KK Ltd. would recognize revenue for discounting of 60% of outstanding points as follows:

Outstanding points = 18,00,000 x 60% = 10,80,000 points

Total points discounted till date = 82,00,000 + 10,80,000 = 92,80,000 points

Revenue to be recognized in the year 20X2-20X3

$$= \{[49,50,495 \times (92,80,000 / 96,40,000)] - 42,11,002\} = \text{Rs. } 5,54,620.$$

Liability under Customer Loyalty programme	Dr.	5,54,620	
To Sales A/c			5,54,620
(On redemption of further 10,80,000 points)			

The Liability under Customer Loyalty programme at the end of the year 20X2-20X3 will be Rs. 7,39,493 – 5,54,620 = 1,84,873.

(e) In the year 20X3-20X4, the merchant will recognized the balance revenue of Rs. 1,84,873 irrespective of the points redeemed as this is the last year for redeeming the points. Journal entry will be as follows:

Liability under Customer Loyalty programme	Dr.	1,84,873	
To Sales A/c			1,84,873
(On redemption of remaining points)			

(b) Statement of cash flows

Particulars		Amount (Rs.)
Cash flows from operating activities		
Profit before taxation (10,00,000 + 18,00,000)	28,00,000	
Adjustment for unrealised exchange gains/losses:		
Foreign exchange gain on long term loan [€ 2,00,000 x Rs. (50 – 45)]	(10,00,000)	
Decrease in trade payables [1,00,000 x Rs. (50 – 45)]	<u>(5,00,000)</u>	
Operating Cash flow before working capital changes	13,00,000	

Changes in working capital (Due to increase in trade payables)	<u>50,00,000</u>	
Net cash inflow from operating activities		63,00,000
Cash inflow from financing activity		<u>50,00,000</u>
Net increase in cash and cash equivalents		1,13,00,000
Cash and cash equivalents at the beginning of the period		<u>2,00,000</u>
Cash and cash equivalents at the end of the period		<u>1,15,00,000</u>

5. (a) This is a compound financial instrument with two components – liability representing present value of future cash outflows and balance represents equity component.

a. Computation of Liability & Equity Component

Date	Particulars	Cash Flow	Discount Factor	Net present Value
01-Apr-20X1		0	1	0.00
31-Mar-20X2	Dividend	150,000	0.869565	130,434.75
31-Mar-20X3	Dividend	150,000	0.756144	113,421.6
31-Mar-20X4	Dividend	150,000	0.657516	98,627.4
31-Mar-20X5	Dividend	150,000	0.571753	85,762.95
31-Mar-20X6	Dividend	150,000	0.497177	<u>74,576.55</u>
Total Liability Component				502,823.25
Total Proceeds				<u>1,500,000.00</u>
Total Equity Component (Bal fig)				<u>997,176.75</u>

b. Allocation of transaction costs

Particulars	Amount	Allocation	Net Amount
Liability Component	502,823	10,056	492,767
Equity Component	<u>997,177</u>	<u>19,944</u>	<u>977,233</u>
Total Proceeds	<u>1,500,000</u>	<u>30,000</u>	<u>1,470,000</u>

c. Accounting for liability at amortised cost:

- Initial accounting = Present value of cash outflows less transaction costs
- Subsequent accounting = At amortised cost, ie, initial fair value adjusted for interest and repayments of the liability.

Assume the effective interest rate is 15.86%

	Opening Financial Liability A	Interest B	Cash Flow C	Closing Financial Liability A+B-C
01-Apr-20X1	492,767	-	-	4,92,767
31-Mar-20X2	492,767	78,153	150,000	4,20,920
31-Mar-20X3	420,920	66,758	150,000	3,37,678
31-Mar-20X4	337,678	53,556	150,000	2,41,234
31-Mar-20X5	241,234	38,260	150,000	1,29,494
31-Mar-20X6	129,494	20,506	150,000	-

d. Journal Entries to be recorded for entire term of arrangement are as follows:

Date	Particulars	Debit	Credit
01-Apr-20X1	Bank A/c Dr. To Preference Shares A/c To Equity Component of Preference shares A/c (Being compulsorily convertible preference shares issued. The same are divided into equity component and liability component as per the calculation)	1,470,000	492,767 977,233
31-Mar-20X2	Preference shares A/c Dr. To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	150,000	150,000
31-Mar-20X2	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	78,153	78,153
31-Mar-20X3	Preference shares A/c Dr. To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	150,000	150,000
31-Mar-20X3	Finance cost A/c Dr. To Preference Shares A/c (Being interest as per EIR method recorded)	66,758	66,758

31-Mar-20X4	Preference shares A/c To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	Dr.	150,000	150,000
31-Mar-20X4	Finance cost A/c To Preference Shares A/c (Being interest as per EIR method recorded)	Dr.	53,556	53,556
31-Mar-20X5	Preference shares A/c To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	Dr.	150,000	150,000
31-Mar-20X5	Finance cost A/c To Preference Shares A/c (Being interest as per EIR method recorded)	Dr.	38,260	38,260
31-Mar-20X6	Preference shares A/c To Bank A/c (Being Dividend at the coupon rate of 10% paid to the shareholders)	Dr.	150,000	150,000
31-Mar-20X6	Finance cost A/c To Preference Shares A/c (Being interest as per EIR method recorded)	Dr.	20,506	20,506
31-Mar-20X6	Equity Component of Preference shares A/c To Equity Share Capital A/c To Securities Premium A/c (Being Preference shares converted in equity shares and remaining equity component is recognised as securities premium)	Dr.	977,233	50,000 927,233

(b) At 31st March, 20X4:

	₹
Asset at valuation (1)	1,26,600
Accumulated depreciation	Nil
Decommissioning liability	<u>(11,600)</u>

Net assets	<u>1,15,000</u>
Retained earnings (2)	(10,600)
Revaluation surplus (3)	5,600

Notes:

(1) When accounting for revalued assets to which decommissioning liabilities attach, it is important to understand the basis of the valuation obtained. For example:

- (a) if an asset is valued on a discounted cash flow basis, some valuers may value the asset without deducting any allowance for decommissioning costs (a 'gross' valuation), whereas others may value the asset after deducting an allowance for decommissioning costs (a 'net' valuation), because an entity acquiring the asset will generally also assume the decommissioning obligation. For financial reporting purposes, the decommissioning obligation is recognised as a separate liability, and is not deducted from the asset. Accordingly, if the asset is valued on a net basis, it is necessary to adjust the valuation obtained by adding back the allowance for the liability, so that the liability is not counted twice.
- (b) if an asset is valued on a depreciated replacement cost basis, the valuation obtained may not include an amount for the decommissioning component of the asset. If it does not, an appropriate amount will need to be added to the valuation to reflect the depreciated replacement cost of that component.

Since, the asset is valued on a net basis, it is necessary to adjust the valuation obtained by adding back the allowance for the liability. Valuation obtained of ₹ 1,15,000 plus decommissioning costs of ₹ 11,600, allowed for in the valuation but recognised as a separate liability = ₹ 1,26,600.

- (2) Three years' depreciation on original cost ₹ 1,20,000 \times 3/40 = ₹ 9,000 plus cumulative discount on ₹ 10,000 at 5 per cent compound = ₹ 1,600; total ₹ 10,600.
- (3) Revalued amount ₹ 1,26,600 less previous net book value of ₹ 1,11,000 (cost ₹ 120,000 less accumulated depreciation ₹ 9,000).

The depreciation expense for 20X4-20X5 is therefore ₹ 3,420 (₹ 1,26,600 \times 1 / 37) and the discount expense for 20X5 is ₹ 600. On 31st March, 20X5, the decommissioning liability (before any adjustment) is ₹ 12,200. However, as per estimate of the entity, the present value of the decommissioning liability has decreased by ₹ 5,000. Accordingly, the entity adjusts the decommissioning liability from ₹ 12,200 to ₹ 7,200.

The whole of this adjustment is taken to revaluation surplus, because it does not exceed the carrying amount that would have been recognised had the asset been carried under

the cost model. If it had done, the excess would have been taken to profit or loss. The entity makes the following journal entry to reflect the change:

	₹	₹	
Provision for decommissioning liability	Dr.	5,000	
To Revaluation surplus			5,000

As at 31st March, 20X5, the entity revalued its asset at ₹ 1,07,000, which is net of an allowance of ₹ 7,200 for the reduced decommissioning obligation that should be recognised as a separate liability. The valuation of the asset for financial reporting purposes, before deducting this allowance, is therefore ₹ 1,14,200. The following additional journal entry is needed:

Notes:

		₹	₹
Accumulated depreciation (1)	Dr.	3,420	
To Asset at valuation			3,420
Revaluation surplus (2)	Dr.	8,980	
To Asset at valuation (3)			8,980

- (1) Eliminating accumulated depreciation of ₹ 3,420 in accordance with the entity's accounting policy.
- (2) The debit is to revaluation surplus because the deficit arising on the revaluation does not exceed the credit balance existing in the revaluation surplus in respect of the asset.
- (3) Previous valuation (before allowance for decommissioning costs) ₹ 1,26,600, less cumulative depreciation ₹ 3,420, less new valuation (before allowance for decommissioning costs) ₹ 1,14,200.

Following this valuation, the amounts included in the balance sheet are:

Asset at valuation	1,14,200
Accumulated depreciation	Nil
Decommissioning liability	<u>(7,200)</u>
Net assets	<u>1,07,000</u>
Retained earnings (1)	(14,620)
Revaluation surplus (2)	11,620

Notes:

- (1) ₹ 10,600 at 31st March, 20X4, plus depreciation expense of ₹ 3,420 and discount expense of ₹ 600 = ₹ 14,620.
- (2) ₹ 15,600 at 31st March, 20X4, plus ₹ 5,000 arising on the decrease in the liability, less ₹ 8,980 deficit on revaluation = ₹ 11,620.

Following this valuation, the amounts included in the balance sheet are:

Asset at valuation	1,14,200
Accumulated depreciation	Nil
Decommissioning liability	<u>(7,200)</u>
Net assets	<u>1,07,000</u>
Retained earnings (1)	(14,620)
Revaluation surplus (2)	11,620

Notes:

- (1) ₹ 10,600 at 31st March, 20X4, plus depreciation expense of ₹ 3,420 and discount expense of ₹ 600 = ₹ 14,620.
- (2) ₹ 15,600 at 31st March, 20X4, plus ₹ 5,000 arising on the decrease in the liability, less ₹ 8,980 deficit on revaluation = ₹ 11,620.

6. (a) Ind AS 38 specifically prohibits recognising advertising expenditure as an intangible asset. Irrespective of success probability in future, such expenses have to be recognized in profit or loss. Therefore, the treatment given by the accountant is correct since such costs should be recognised as expenses.

However, the costs should be recognised on an accruals basis.

Therefore, of the advertisements paid for before 31st March, 20X2, Rs. 7,00,000 would be recognised as an expense and Rs. 1,00,000 as a pre-payment in the year ended 31st March 20X2.

Rs. 4,00,000 cost of advertisements paid for since 31st March, 20X2 would be charged as expenses in the year ended 31st March, 20X3.

OR

As at 31st March, 20X1, the mature plantation would have been valued at 17,100 (171 x 100).

As at 31st March, 20X2, the mature plantation would have been valued at 16,500 (165 x 100).

Assuming immaterial cash flow between now and the point of harvest, the fair value (and therefore the amount reported as an asset on the statement of financial position) of the plantation is estimated as follows:

As at 31st March, 20X1: $17,100 \times 0.312 = 5,335.20$.

As at 31st March, 20X2: $16,500 \times 0.331 = 5,461.50$.

Gain or loss

The difference in fair value of the plantation between the two year end dates is 126.30 ($5,461.50 - 5,335.20$), which will be reported as a gain in the statement of profit or loss (regardless of the fact that it has not yet been realised).

- (b) A company which meets the net worth, turnover or net profits criteria in immediate preceding financial year will need to constitute a CSR Committee and comply with provisions of sections 135 (2) to (5) read with the CSR Rules.

As per the criteria to constitute CSR committee -

- 1) Net worth greater than or equal to Rs. 500 Crores: This criterion is not satisfied.
- 2) Sales greater than or equal to Rs. 1000 Crores: This criterion is not satisfied.
- 3) Net Profit greater than or equal to Rs. 5 Crores: This criterion is satisfied in financial year ended March 31, 20X3 ie immediate preceding financial year.

Hence, the Company will be required to form a CSR committee.

- (c) (a) It seems that the equity shares are acquired for the purpose of selling it in the near term and therefore are held for trading. Such investments have been appropriately classified as subsequently measured at fair value through profit or loss. Such investments in equity shares cannot be classified as subsequently measured at fair value through other comprehensive income. The option to measure investment in equity shares at fair value through other comprehensive income has to be made at initial recognition. Therefore, equity shares that were held for trading previously cannot be reclassified to fair value through other comprehensive income due to change in business model to not held for trading.
- (b) In absence of contractual terms of NCDs, it is assumed that the contractual terms give rise on specified dates to cash flows that are solely payment of principal and interest on the principal outstanding. The business model also includes sales of these instruments on a regular basis. Hence, these instruments will be classified as FVTOCI. Therefore, such NCD investments shall be classified as subsequently measured at Fair Value through Other Comprehensive Income. The classification does not change based on whether the investment is current or non-current as the end of the reporting period. It seems the company has previously classified these investments at fair value through profit or loss. The company must rectify this by reclassifying as FVTOCI.

MOCK TEST PAPER 1
FINAL (NEW) COURSE: GROUP – I
PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

Question No. 1 is compulsory. Attempt any **four** questions from the remaining **five** questions.

Working notes should form part of the answer.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) The equity share of VCC Ltd. is quoted at Rs. 210. A 3-month call option is available at a premium of Rs. 6 per share and a 3-month put option is available at a premium of Rs. 5 per share. Calculate the net payoffs to the option holder of a call option and a put option.

- (i) the strike price in both cases is Rs. 220; and
(ii) the share price on the exercise day is Rs. 200,210,220,230,240.

Also recommend the price range at which the call and the put options may be gainfully exercised.

(7 Marks)

- (b) X Limited, just declared a dividend of Rs. 14.00 per share. Mr. B is planning to purchase the share of X Limited, anticipating increase in growth rate from 8% to 9%, which will continue for three years. He also expects the market price of this share to be Rs. 360.00 after three years.

You are required to calculate:

- (i) the maximum amount Mr. B should pay for shares, if he requires a rate of return of 13% per annum.
(ii) the maximum price Mr. B will be willing to pay for share, if he is of the opinion that the 9% growth can be maintained indefinitely and require 13% rate of return per annum.
(iii) the price of share at the end of three years, if 9% growth rate is achieved and assuming other conditions remaining same as in (ii) above.

Calculate rupee amount up to two decimal points.

	Year-1	Year-2	Year-3
FVIF @9%	1.090	1.188	1.295
FVIF @ 13%	1.130	1.277	1.443
PVIF @ 13%	0.885	0.783	0.693

(7 Marks)

- (c) Compare and contrast start-ups and entrepreneurship. Describe the priorities and challenges which start-ups in India are facing.

(6 Marks)

2. (a) NP and Co. has imported goods for US \$ 7,00,000. The amount is payable after three months. The company has also exported goods for US \$ 4,50,000 and this amount is receivable in two months. For receivable amount a forward contract is already taken at Rs. 48.90.

The market rates for Rupee and Dollar are as under:

Spot	Rs. 48.50/70
Two months	Rs. 48.25/30
Three months	Rs. 48.40/45

The company wants to cover the risk and it has two options as under:

- (A) To cover payables in the forward market and
 (B) To lag the receivables by one month and cover the risk only for the net amount. No interest for delaying the receivables is earned. Evaluate both the options if the cost of Rupee Funds is 12%. Which option is preferable? **(8 Marks)**

- (b) Expected returns on two stocks for particular market returns are given in the following table:

Market Return	Aggressive	Defensive
7%	4%	9%
25%	40%	18%

You are required to calculate:

- (i) The Betas of the two stocks.
 (ii) Expected return of each stock, if the market return is equally likely to be 7% or 25%.
 (iii) The Security Market Line (SML), if the risk free rate is 7.5% and market return is equally likely to be 7% or 25%.
 (iv) The Alphas of the two stocks. **(8 Marks)**
- (c) Describe the problems faced in the growth of Securitization of instruments especially in Indian context. **(4 Marks)**
3. (a) During the audit of the Weak Bank (W), RBI has suggested that the Bank should either merge with another bank or may close down. Strong Bank (S) has submitted a proposal of merger of Weak Bank with itself. The relevant information and Balance Sheets of both the companies are as under:

Particulars	Weak Bank (W)	Strong Bank (S)	Assigned Weights (%)
Gross NPA (%)	40	5	30
Capital Adequacy Ratio (CAR)	5	16	28
Total Capital/ Risk Weight Asset			
Market price per Share (MPS)	12	96	32
Book value			10
Trading on Stock Exchange	Irregular	Frequent	

Balance Sheet (Rs. in Lakhs)

Particulars	Weak Bank (W)	Strong Bank (S)
Paid up Share Capital (Rs. 10 per share)	150	500
Reserves & Surplus	80	5,500
Deposits	4,000	44,000
Other Liabilities	<u>890</u>	<u>2,500</u>
Total Liabilities	<u>5,120</u>	<u>52,500</u>

Cash in Hand & with RBI	400	2,500
Balance with Other Banks	-	2,000
Investments	1,100	19,000
Advances	3,500	27,000
Other Assets	70	2,000
Preliminary Expenses	<u>50</u>	<u>-</u>
Total Assets	<u>5,120</u>	<u>52,500</u>

You are required to

- (i) Calculate Swap ratio based on the above weights:
- (ii) Ascertain the number of Shares to be issued to Weak Bank;
- (iii) Prepare Balance Sheet after merger; and
- (iv) Calculate CAR and Gross NPA of Strong Bank after merger. **(8 Marks)**

- (b) Mercy is a Forex Dealer with XYZ Bank. She notices following information relating to Canadian Dollar (CAD) and German Deutschmark (DEM):

Exchange rate – CAD 0.775 per DEM (Spot)

CAD 0.780 per DEM (3 months)

Interest rates – DEM 7% p.a.

CAD 9% p.a.

- (i) Assuming that there is no transaction cost determine does the Interest Rate Parity holds in above quotations.
- (ii) If yes, then explain the steps that would be required to make an arbitrage profit if Mercy is authorized to work with CAD 1 Million for the same purpose. Also determine the profit that would be made in CAD.

Note: Ignore the decimal points in the amounts. **(8 Marks)**

- (c) Mention the various techniques used in economic analysis. **(4 Marks)**

4. (a) An investor purchased 300 units of a Mutual Fund at Rs. 12.25 per unit on 31st December, 2009. As on 31st December, 2010 he has received Rs. 1.25 as dividend and Rs. 1.00 as capital gains distribution per unit.

Required:

- (i) The return on the investment if the NAV as on 31st December, 2010 is Rs. 13.00.
 - (ii) The return on the investment as on 31st December, 2010 if all dividends and capital gains distributions are reinvested into additional units of the fund at Rs. 12.50 per unit. **(8 Marks)**
- (b) XYZ Limited borrows £ 15 Million of six months LIBOR + 10.00% for a period of 24 months. The company anticipates a rise in LIBOR, hence it proposes to buy a Cap Option from its Bankers at the strike rate of 8.00%. The lump sum premium is 1.00% for the entire reset periods and the fixed rate of interest is 7.00% per annum. The actual position of LIBOR during the forthcoming reset period is as under:

Reset Period	LIBOR
1	9.00%
2	9.50%
3	10.00%

You are required to show how far interest rate risk is hedged through Cap Option.

For calculation, work out figures at each stage up to four decimal points and amount nearest to £. It should be part of working notes. **(8 Marks)**

(c) Discuss briefly the key decisions falling within the scope of financial strategy. **(4 Marks)**

5. (a) The following information is given for 3 companies that are identical except for their capital structure:

	Orange	Grape	Apple
Total invested capital	1,00,000	1,00,000	1,00,000
Debt/assets ratio	0.8	0.5	0.2
Shares outstanding	6,100	8,300	10,000
Pre-tax cost of debt	16%	13%	15%
Cost of equity	26%	22%	20%
Net Income	8,970	12,350	14,950

The tax rate is uniform 35% in all cases.

- Compute the Weighted average cost of capital for each company.
- Compute the Economic Valued Added (EVA) for each company.
- Based on the EVA, which company would be considered for best investment? Give reasons.
- If the industry PE ratio is 11x, estimate the price for the share of each company.
- Calculate the estimated market capitalisation for each of the Companies. **(8 Marks)**

Note: Round off EPS and Share Prices upto 4 and 2 Decimal places respectively.

- (b) Details about portfolio of shares of an investor is as below:

Shares	No. of shares (lakh)	Price per share	Beta
A Ltd.	3.00	Rs. 500	1.40
B Ltd.	4.00	Rs. 750	1.20
C Ltd.	2.00	Rs. 250	1.60

The investor thinks that the risk of portfolio is very high and wants to reduce the portfolio beta to 0.91. He is considering two below mentioned alternative strategies:

- Dispose off a part of his existing portfolio to acquire risk free securities, or
- Take appropriate position on Nifty Futures which are currently traded at Rs. 8125 and each Nifty points is worth Rs.200.

You are required to determine:

- portfolio beta,
- the value of risk free securities to be acquired,
- the number of shares of each company to be disposed off,
- the number of Nifty contracts to be bought/sold; and
- the value of portfolio beta for 2% rise in Nifty. **(8 Marks)**

(c) Briefly explain how Angel Investors finance the Startups. **(4 Marks)**

6. (a) A Ltd. has issued convertible bonds, which carries a coupon rate of 14%. Each bond is convertible into 20 equity shares of the company A Ltd. The prevailing interest rate for similar credit rating bond is 8%. The convertible bond has 5 years maturity. It is redeemable at par at

Rs. 100. The relevant present value table is as follows.

Present values	t ₁	t ₂	t ₃	t ₄	t ₅
PVIF _{0.14, t}	0.877	0.769	0.675	0.592	0.519
PVIF _{0.08, t}	0.926	0.857	0.794	0.735	0.681

You are required to estimate:

(Calculations be made upto 3 decimal places)

- (i) current market price of the bond, assuming it being equal to its fundamental value,
 - (ii) minimum market price of equity share at which bond holder should exercise conversion option; and
 - (iii) duration of the bond. **(8 Marks)**
- (b) Your forex dealer had entered into a cross currency deal and had sold US \$ 10,00,000 against EURO at US \$ 1 = EURO 1.4400 for spot delivery.

However, later during the day, the market became volatile and the dealer in compliance with his management's guidelines had to square – up the position when the quotations were:

Spot US \$ 1	INR 31.4300/4500
1 month margin	25/20
2 months margin	45/35
Spot US \$ 1	EURO 1.4400/4450
1 month forward	1.4425/4490
2 months forward	1.4460/4530

What will be the gain or loss in the transaction? **(8 Marks)**

- (c) Briefly explain Counter Party Risk and the various techniques to manage this risk.

OR

Explain some of the parameters to identify the currency risk. **(4 Marks)**

MOCK TEST PAPER 1
FINAL (NEW) COURSE: GROUP – I
PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT (NEW COURSE)
SUGGESTED ANSWERS/HINTS

1. (a) **Net payoff for the holder of the call option**

	(Rs.)				
Share price on exercise day	200	210	220	230	240
Option exercise	No	No	No	Yes	Yes
Outflow (Strike price)	Nil	Nil	Nil	220	220
Out flow (premium)	6	6	6	6	6
Total Outflow	6	6	6	226	226
Less inflow (Sales proceeds)	-	-	-	230	240
Net payoff	-6	-6	-6	4	14

Net payoff for the holder of the put option

	(Rs.)				
Share price on exercise day	200	210	220	230	240
Option exercise	Yes	Yes	No	No	No
Inflow (strike price)	220	220	Nil	Nil	Nil
Less outflow (purchase price)	200	210	-	-	-
Less outflow (premium)	5	5	5	5	5
Net Payoff	15	5	-5	-5	-5

The call option can be exercised gainfully for any price above Rs. 226 (Rs. 220 + Rs. 6) and put option for any price below Rs. 215 (Rs. 220 - Rs. 5).

(b) (i) Expected dividend for next 3 years.

$$\text{Year 1 (D}_1\text{)} \quad \text{Rs. } 14.00 (1.09) = \text{Rs. } 15.26$$

$$\text{Year 2 (D}_2\text{)} \quad \text{Rs. } 14.00 (1.09)^2 = \text{Rs. } 16.63$$

$$\text{Year 3 (D}_3\text{)} \quad \text{Rs. } 14.00 (1.09)^3 = \text{Rs. } 18.13$$

$$\text{Required rate of return} = 13\% (\text{Ke})$$

$$\text{Market price of share after 3 years} = (\text{P}_3) = \text{Rs. } 360$$

The present value of share

$$P_0 = \frac{D_1}{(1+ke)} + \frac{D_2}{(1+ke)^2} + \frac{D_3}{(1+ke)^3} + \frac{P_3}{(1+ke)^3}$$

$$P_0 = \frac{15.26}{(1+0.13)} + \frac{16.63}{(1+0.13)^2} + \frac{18.13}{(1+0.13)^3} + \frac{360}{(1+0.13)^3}$$

$$P_0 = 15.26(0.885) + 16.63(0.783) + 18.13(0.693) + 360(0.693)$$

$$P_0 = 13.50 + 13.02 + 12.56 + 249.48$$

$$P_0 = \text{Rs. } 288.56$$

- (ii) If growth rate 9% is achieved for indefinite period, then maximum price of share should Mr. A willing be to pay is

$$P_0 = \frac{D_1}{(k_e - g)} = \frac{\text{₹ } 15.26}{0.13 - 0.09} = \frac{\text{₹ } 15.26}{0.04} = \text{Rs. } 381.50$$

- (iii) Assuming that conditions mentioned above remain same, the price expected after 3 years will be:

$$P_3 = \frac{D_4}{k_e - g} = \frac{D_3(1.09)}{0.13 - 0.09} = \frac{18.13 \times 1.09}{0.04} = \frac{19.76}{0.04} = \text{Rs. } 494$$

(c) Differences between a start-up and entrepreneurship

Startups are different from entrepreneurship. The major differences between them have been discussed in the following paragraphs:

- (i) Start up is a part of entrepreneurship. Entrepreneurship is a broader concept and it includes a startup firm.
- (ii) The main aim of startup is to build a concern, conceptualize the idea which it has developed into a reality and build a product or service. On the other hand, the major objective of an already established entrepreneurship concern is to attain opportunities with regard to the resources they currently control.
- (iii) A startup generally does not have a major financial motive whereas an established entrepreneurship concern mainly operates on financial motive.

Priorities and challenges which start-ups in India are facing

The priority is on bringing more and more smaller firms into existence. So, the focus is on need based, instead of opportunity based entrepreneurship. Moreover, the trend is to encourage self-employment rather than large, scalable concerns. The main challenge with the startup firms is getting the right talent. And, paucity of skilled workforce can hinder the chances of a startup organization's growth and development. Further, startups had to comply with numerous regulations which escalates its cost. It leads to further delaying the chances of a breakeven or even earning some amount of profit.

2. (a) (A) To cover payable and receivable in forward Market

Amount payable after 3 months	\$7,00,000
Forward Rate	Rs. 48.45
Thus Payable Amount (Rs.) (A)	Rs. 3,39,15,000
Amount receivable after 2 months	\$ 4,50,000
Forward Rate	Rs. 48.90
Thus Receivable Amount (Rs.) (B)	Rs. 2,20,05,000
Interest @ 12% p.a. for 1 month (C)	Rs. 2,20,050
Net Amount Payable in (Rs.) (A) – (B) – (C)	Rs. 1,16,89,950

- (B) Assuming that since the forward contract for receivable was already booked it shall be cancelled if we lag the receivables. Accordingly any profit/ loss on cancellation of contract shall also be calculated and shall be adjusted as follows:

Amount Payable (\$)	\$ 7,00,000
Amount receivable after 3 months	<u>\$ 4,50,000</u>
Net Amount payable	<u>\$ 2,50,000</u>

Applicable Rate	Rs. 48.45
Amount payable in (Rs.) (A)	Rs. 1,21,12,500
Profit on cancellation of Forward cost (48.90 – 48.30) × 4,50,000 (B)	Rs. 2,70,000
Thus net amount payable in (Rs.) (A) + (B)	Rs. 1,18,42,500

Since net payable amount is least in case of first option, hence the company should cover payable and receivables in forward market.

(b) (i) The Betas of two stocks:

Aggressive stock	-	$40\% - 4\% / 25\% - 7\% = 2$
Defensive stock	-	$18\% - 9\% / 25\% - 7\% = 0.50$

Alternatively, it can also be solved by using the Characteristic Line Relationship as follows:

$$R_s = \alpha + \beta R_m$$

Where,

α = Alpha

β = Beta

R_m = Market Return

For Aggressive Stock

$$4\% = \alpha + \beta(7\%)$$

$$40\% = \alpha + \beta(25\%)$$

$$36\% = \beta(18\%)$$

$$\beta = 2$$

For Defensive Stock

$$9\% = \alpha + \beta(7\%)$$

$$18\% = \alpha + \beta(25\%)$$

$$9\% = \beta(18\%)$$

$$\beta = 0.50$$

(ii) Expected returns of the two stocks:-

Aggressive stock	-	$0.5 \times 4\% + 0.5 \times 40\% = 22\%$
------------------	---	---

Defensive stock	-	$0.5 \times 9\% + 0.5 \times 18\% = 13.5\%$
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(iii) Expected return of market portfolio = $0.5 \times 7\% + 0.5 \times 25\% = 16\%$

\therefore Market risk prem. = $16\% - 7.5\% = 8.5\%$

\therefore SML is, required return = $7.5\% + \beta_i 8.5\%$

(iv) $R_s = \alpha + \beta R_m$

For Aggressive Stock

$$22\% = \alpha_A + 2(16\%)$$

$$\alpha_A = -10\%$$

For Defensive Stock

$$13.5\% = \alpha_D + 0.50(16\%)$$

$$\alpha_b = 5.5\%$$

- (c) Following are main problems faced in growth of Securitization of instruments especially in Indian context:

Stamp Duty

Stamp Duty is one of the obstacles in India. Under Transfer of Property Act, 1882, a mortgage debt stamp duty which even goes upto 12% in some states of India and this impeded the growth of securitization in India. It should be noted that since pass through certificate does not evidence any debt only able to receivable, they are exempted from stamp duty.

Moreover, in India, recognizing the special nature of securitized instruments in some states has reduced the stamp duty on them.

Taxation

Taxation is another area of concern in India. In the absence of any specific provision relating to securitized instruments in Income Tax Act experts' opinion differ a lot. Some are of opinion that in SPV as a trustee is liable to be taxed in a representative capacity then other are of view that instead of SPV, investors will be taxed on their share of income. Clarity is also required on the issues of capital gain implications on passing payments to the investors.

Accounting

Accounting and reporting of securitized assets in the books of originator is another area of concern. Although securitization is slated to an off-balance sheet instrument but in true sense receivables are removed from originator's balance sheet. Problem arises especially when assets are transferred without recourse.

Lack of standardization

Every originator follows own format for documentation and administration have lack of standardization is another obstacle in growth of securitization.

Inadequate Debt Market

Lack of existence of a well-developed debt market in India is another obstacle that hinders the growth of secondary market of securitized or asset backed securities.

Ineffective Foreclosure laws

For last many years there are efforts are going on for effective foreclosure but still foreclosure laws are not supportive to lending institutions and this makes securitized instruments especially mortgaged backed securities less attractive as lenders face difficulty in transfer of property in event of default by the borrower.

3. (a) (i) Swap Ratio

Gross NPA	5:40	5/40 x 30%	0.0375
CAR	5:16	5/16 x 28%	0.0875
Market Price	12:96	12/96 x 32%	0.0400
Book Value Per Share	12:120	12/120x 10%	0.0100
			0.1750

Thus for every share of Weak Bank, 0.1750 share of Strong Bank shall be issued.

Calculation of Book Value Per Share

Particulars	Weak Bank (W)	Strong Bank (S)
Share Capital (Rs. Lakhs)	150	500

Reserves & Surplus (Rs. Lakhs)	80	5,500
	230	6,000
Less: Preliminary Expenses (Rs. Lakhs)	50	--
Net Worth or Book Value (Rs. Lakhs)	180	6,000
No. of Outstanding Shares (Lakhs)	15	50
Book Value Per Share (Rs.)	12	120

(ii) No. of equity shares to be issued:

$$\frac{150}{10} \times 0.1750 = 2.625 \text{ lakh shares}$$

(iii) **Balance Sheet after Merger**

Calculation of Capital Reserve

Book Value of Shares	Rs. 180.00 lac
Less: Value of Shares issued	Rs. 26.25 lac
Capital Reserve	Rs. 153.75 lac

Balance Sheet

	Rs. lac		Rs. lac
Paid up Share Capital	526.25	Cash in Hand & RBI	2900.00
Reserves & Surplus	5500.00	Balance with other banks	2000.00
Capital Reserve	153.75	Investment	20100.00
Deposits	48000.00	Advances	30500.00
Other Liabilities	3390.00	Other Assets	2070.00
	57570.00		57570.00

(iv) **Calculation of CAR & Gross NPA % of Bank 'S' after merger**

$$\text{CAR / CRWAR} = \frac{\text{Total Capital}}{\text{Risky Weighted Assets}}$$

	Weak Bank	Strong Bank	Merged
	5%	16%	
Total Capital	Rs. 180 lac	Rs. 6000 lac	Rs. 6180 lac
Risky Weighted Assets	Rs. 3600 lac	Rs. 37500 lac	Rs. 41100 lac

$$\text{CAR} = \frac{6180}{41100} \times 100 = 15.04\%$$

$$\text{GNPA Ratio} = \frac{\text{Gross NPA}}{\text{Gross Advances}} \times 100$$

	Weak Bank	Strong Bank	Merged
GNPA (Given)	0.40	0.05	
	$0.40 = \frac{\text{GNPA}_R}{\text{₹ 3500 lac}}$	$0.05 = \frac{\text{GNPA}_S}{\text{₹ 27000 lac}}$	
Gross NPA	Rs. 1400 lac	Rs. 1350 lac	Rs. 2750 lac

- (b) (i) For 3 months, $r_{CAD} = 2.25\%$ and $r_{DEM} = 1.75\%$. Since the exchange rate is in CAD/ DEM term the appropriate equation for Interest Rate Parity is as follows:

$$\frac{F}{S} = \frac{(1 + r_{CAD})}{(1 + r_{DEM})}$$

$$\frac{0.780}{0.775} = \frac{(1 + 0.0225)}{(1 + 0.0175)}$$

$$1.00645 \neq 1.00491$$

Since both sides are not equal, Interest Rate Parity does not hold.

- (ii) Since IRP does not hold there is an arbitrage opportunity.

$$\text{Interest Differential} = 2.25\% - 1.75\% = 0.50\%$$

$$\text{Premium} = \frac{0.780 - 0.775}{0.775} \times 100 = 0.645\%$$

Since the interest rate differential is smaller than the premium, it will be profitable to place money in Deutschmarks the currency whose 3-months interest is lower.

The following operations are carried out:

- (i) Borrow CAD 1 Million at 9 per cent for 3- months;
(ii) Change this sum into DEM at the spot rate
 $= (1,000,000/0.775) = 1,290,323$
(iii) Place DM 1,290,323 in the money market for 3 months to obtain a sum of DM
- | | |
|-----------------------------------|------------------|
| Principal: | 1,290,323 |
| Add: Interest @ 7% for 3 months = | <u>22,581</u> |
| Total | <u>1,312,904</u> |
- (iv) Sell DEM at 3-months forward to obtain CAD $= (1,312,904 \times 0.780) = \text{CAD } 1,024,065$
(v) Refund the debt taken in CAD with the interest due on it, i.e.,

	CAD
Principal	1,000,000
Add: Interest @9% for 3 months	<u>22,500</u>
Total	<u>1,022,500</u>

$$\text{Net arbitrage gain} = \text{CAD } 1,024,065 - \text{CAD } 1,022,500 = \text{CAD } 1,565$$

- (c) Some of the techniques used for economic analysis are:

- (i) **Anticipatory Surveys:** They help investors to form an opinion about the future state of the economy. It incorporates expert opinion on construction activities, expenditure on plant and machinery, levels of inventory – all having a definite bearing on economic activities. Also future spending habits of consumers are taken into account.
- (ii) **Barometer/Indicator Approach:** Various indicators are used to find out how the economy shall perform in the future. The indicators have been classified as under:
- (1) *Leading Indicators:* They lead the economic activity in terms of their outcome. They relate to the time series data of the variables that reach high/low points in advance of economic activity.

- (2) *Roughly Coincidental Indicators*: They reach their peaks and troughs at approximately the same in the economy.
- (3) *Lagging Indicators*: They are time series data of variables that lag behind in their consequences vis-a-vis the economy. They reach their turning points after the economy has reached its own already.

All these approaches suggest direction of change in the aggregate economic activity but nothing about its magnitude.

(iii) **Economic Model Building Approach**: In this approach, a precise and clear relationship between dependent and independent variables is determined. GNP model building or sectoral analysis is used in practice through the use of national accounting framework.

4. (a) Return for the year (all changes on a per year basis)

Particulars	Rs./Unit
Change in price (Rs. 13.00 – Rs. 12.25)	0.75
Dividend received	1.25
Capital gain distribution	<u>1.00</u>
Total Return	<u>3.00</u>

$$\text{Return on investment} = \frac{3.00}{12.25} \times 100 = 24.49\%$$

Alternatively, it can also be computed as follows:

$$\frac{(\text{NAV}_1 - \text{NAV}_0) + D_1 + \text{CG}_1}{\text{NAV}_0} \times 100$$

$$= \frac{(13 - 12.25) + 1.25 + 1.00}{12.25} \times 100$$

$$= 24.49\%$$

If all dividends and capital gain are reinvested into additional units at Rs. 12.50 per unit the position would be.

$$\text{Total amount reinvested} = \text{Rs. } 2.25 \times 300 = \text{Rs. } 675$$

$$\text{Additional units added} = \frac{\text{₹ } 675}{12.50} = 54 \text{ units}$$

$$\text{Value of 354 units as on 31-12-2010} = \text{Rs. } 4,602$$

$$\text{Price paid for 300 units on 31-12-2009} (300 \times \text{Rs. } 12.25) = \text{Rs. } 3,675$$

$$\text{Return} = \frac{\text{₹ } 4,602 - \text{₹ } 3,675}{\text{₹ } 3,675} = \frac{\text{₹ } 927}{\text{₹ } 3,675} = 25.22\%$$

(b) First of all we shall calculate premium payable to bank as follows:

$$P = \frac{rp}{\left[(1+i) - \frac{1}{i \times (1+i)^t} \right]} \times A \text{ or } \frac{rp}{\text{PVAF}(3.5\%, 4)} \times A$$

Where

P = Premium

A = Principal Amount

rp = Rate of Premium

i = Fixed Rate of Interest

t = Time

$$= \frac{0.01}{\left[(1/0.035) - \frac{1}{0.035 \times 1.035^4} \right]} \times \text{£}15,000,000 \text{ or } \frac{0.01}{(0.966 + 0.933 + 0.901 + 0.871)} \times \text{£}15,000,000$$

$$= \frac{0.01}{\left[(28.5714) - \frac{1}{0.04016} \right]} \times \text{£}15,000,000 \text{ or } \frac{\text{£}150,000}{3.671} = \text{£} 40,861$$

Please note above solution has been worked out on the basis of four decimal points at each stage.

Now we see the net payment received from bank

Reset Period	Additional interest due to rise in interest rate	Amount received from bank	Premium paid to bank	Net Amt. received from bank
1	£ 75,000	£ 75,000	£ 40,861	£34,139
2	£ 112,500	£ 112,500	£ 40,861	£71,639
3	£ 150,000	£ 150,000	£ 40,861	£109,139
TOTAL	£ 337,500	£ 337,500	£122,583	£ 214,917

Thus, from above it can be seen that interest rate risk amount of £ 337,500 reduced by £ 214,917 by using of Cap option.

(c) The key decisions falling within the scope of financial strategy include the following:

- Financing decisions:** These decisions deal with the mode of financing or mix of equity capital and debt capital.
- Investment decisions:** These decisions involve the profitable utilization of firm's funds especially in long-term projects (capital projects). Since the future benefits associated with such projects are not known with certainty, investment decisions necessarily involve risk. The projects are therefore evaluated in relation to their expected return and risk.
- Dividend decisions:** These decisions determine the division of earnings between payments to shareholders and reinvestment in the company.
- Portfolio decisions:** These decisions involve evaluation of investments based on their contribution to the aggregate performance of the entire corporation rather than on the isolated characteristics of the investments themselves.

5. (a) (i) Working for calculation of WACC

	Orange	Grape	Apple
Total debt	80,000	50,000	20,000
Post tax Cost of debt	10.4%	8.45%	9.75%
Equity Fund	20,000	50,000	80,000

WACC

Orange: $(10.4 \times 0.8) + (26 \times 0.2) = 13.52\%$

Grape: $(8.45 \times 0.5) + (22 \times 0.5) = 15.225\%$

Apple: $(9.75 \times 0.2) + (20 \times 0.8) = 17.95\%$

(ii) EVA of companies can be computed as follows:

	Orange	Grape	Apple
Net Income (Rs.)	8,970	12,350	14,950
Pre Tax Income (Rs.) (A)	13,800	19,000	23,000
Debt Amount (Rs.)	80,000	50,000	20,000
Interest (Rs.) (B)	12,800	6,500	3,000
EBIT (Rs.) (A) + (B)	26,600	25,500	26,000
Tax 35% (Rs.)	9,310	8,925	9,100
EAT	17,290	16,575	16,900
Less: WACC X Invested Capital	13,520	15,220	17,950
EVA (Rs.)	3,770	1,355	-1,050

(iii) Orange would be considered as the best investment since the EVA of the company is highest and its weighted average cost of capital is the lowest.

(iv) Estimated Price of each company shares

	Orange	Grape	Apple
Net Income (Given) (Rs.)	8,970	12,350	14,950
Shares	6,100	8,300	10,000
EPS (Rs.)	1.4705	1.4880	1.4950
Stock Price (EPS x PE Ratio) (Rs.)	16.18	16.37	16.45

(v) **Market Capitalisation**

Estimated Stock Price (Rs.)	16.18	16.37	16.45
No. of shares	6,100	8,300	10,000
Estimated Market Cap (Rs.)	98,698	1,35,871	1,64,500

(b)

Shares	No. of shares (lakhs) (1)	Market Price of Per Share (2)	× (2) (Rs. lakhs)	% to total (w)	β (x)	wx
A Ltd.	3.00	500.00	1500.00	0.30	1.40	0.42
B Ltd.	4.00	750.00	3000.00	0.60	1.20	0.72
C Ltd.	2.00	250.00	500.00	0.10	1.60	0.16
			<u>5000.00</u>	1.00		<u>1.30</u>

(1) Portfolio beta 1.30

(2) Required Beta 0.91

Let the proportion of risk free securities for target beta $0.91 = p$

$$0.91 = 0 \times p + 1.30 (1 - p)$$

$$p = 0.30 \text{ i.e. } 30\%$$

Shares to be disposed off to reduce beta (5000 × 30%) Rs. 1,500 lakh and Risk Free securities to be acquired.

(3) Number of shares of each company to be disposed off

Shares	% to total (w)	Proportionate Amount (Rs. lakhs)	Market Price Per Share	No. of Shares (Lakh)
A Ltd.	0.30	450.00	500.00	0.90
B Ltd.	0.60	900.00	750.00	1.20
C Ltd.	0.10	150.00	250.00	0.60

(4) Number of Nifty Contract to be sold

$$\frac{(1.30-0.91) \times 5000 \text{ lakh}}{8,125 \times 200} = 120 \text{ contracts}$$

(5) 2% rises in Nifty is accompanied by 2% x 1.30 i.e. 2.6% rise for portfolio of shares

	Rs. Lakh
Current Value of Portfolio of Shares	5000
Value of Portfolio after rise	5130
Mark-to-Market Margin paid (8125 × 0.020 × Rs. 200 × 120)	39
Value of the portfolio after rise of Nifty	5091
% change in value of portfolio (5091 – 5000)/ 5000	1.82%
% rise in the value of Nifty	2%
Beta	0.91

(c) Despite being a country of many cultures and communities traditionally inclined to business and entrepreneurship, India still ranks low on comparative ratings across entrepreneurship, innovation and ease of doing business. The reasons are obvious. These include our old and outdated draconian rules and regulations which provides a hindrance to our business environment for a long time. Other reasons are red tapism, our time consuming procedures, and lack of general support for entrepreneurship. Off course, things are changing in recent times.

As per Investopedia, Angel investors invest in small startups or entrepreneurs. Often, angel investors are among an entrepreneur's family and friends. The capital angel investors provide may be a one-time investment to help the business propel or an ongoing injection of money to support and carry the company through its difficult early stages.

Angel investors provide more favorable terms compared to other lenders, since they usually invest in the entrepreneur starting the business rather than the viability of the business. Angel investors are focused on helping startups take their first steps, rather than the possible profit they may get from the business. Essentially, angel investors are the opposite of venture capitalists.

Angel investors are also called informal investors, angel funders, private investors, seed investors or business angels. These are affluent individuals who inject capital for startups in exchange for ownership equity or convertible debt. Some angel investors invest through crowdfunding platforms online or build angel investor networks to pool in capital.

Angel investors typically use their own money, unlike venture capitalists who take care of pooled money from many other investors and place them in a strategically managed fund.

Though angel investors usually represent individuals, the entity that actually provides the fund may be a limited liability company, a business, a trust or an investment fund, among many other kinds of vehicles.

Angel investors who seed startups that fail during their early stages lose their investments completely. This is why professional angel investors look for opportunities for a defined exit strategy, acquisitions or initial public offerings (IPOs).

6. (a) (i) Current Market Price of Bond

Time	CF	PVIF 8% PV (CF)	PV (CF)
1	14	0.926	12.964
2	14	0.857	11.998
3	14	0.794	11.116
4	14	0.735	10.290
5	114	0.681	<u>77.634</u>
		Σ PV (CF) i.e. $P_0 =$	<u>124.002</u>

Say

Rs. 124.00

(ii) Minimum Market Price of Equity Shares at which Bondholder should exercise conversion option:

$$\frac{124.00}{20.00} = \text{Rs. } 6.20$$

(iii) Duration of the Bond

Year	Cash flow	P.V. @ 8%		Proportion of bond value	Proportion of bond value x time (years)
1	14	0.926	12.964	0.105	0.105
2	14	0.857	11.998	0.097	0.194
3	14	0.794	11.116	0.089	0.267
4	14	0.735	10.290	0.083	0.332
5	114	0.681	<u>77.634</u>	<u>0.626</u>	<u>3.130</u>
			<u>124.002</u>	<u>1.000</u>	<u>4.028</u>

(b) The amount of EURO bought by selling US\$

$$\text{US\$ } 10,00,000 * \text{EURO } 1.4400 = \text{EURO } 14,40,000$$

$$\text{The amount of EURO sold for buying USD } 10,00,000 * 1.4450 = \underline{\text{EURO } 14,45,000}$$

$$\text{Net Loss in the Transaction} = \underline{\text{EURO } 5,000}$$

To acquire EURO 5,000 from the market @

(a) USD 1 = EURO 1.4400 &

(b) USD 1 = INR 31.4500

Cross Currency buying rate of EUR/INR is Rs. 31.4500 / 1.440 i.e. Rs. 21.8403

$$\text{Loss in the Transaction Rs. } 21.8403 * 5000 = \text{Rs. } 1,09,201.50$$

Alternatively, if delivery to be affected then computation of loss shall be as follows:

$$\text{EURO to be surrendered to acquire \$ } 10,00,000 = \text{EURO } 14,45,000$$

$$\text{EURO to be received after selling \$ } 10,00,000 = \underline{\text{EURO } 14,40,000}$$

$$\text{Loss} = \underline{\text{EURO } 5,000}$$

To acquire EURO 5,000 from market @

US \$ 1 = EURO 1.4400

US \$ 1 = INR 31.45

$$\text{Cross Currency} = \frac{31.45}{1.440} = \text{Rs. } 21.8403$$

Loss in Transaction (21.8403 x EURO 5,000) = Rs. 1,09,201.50

- (c) The various hints that may provide counter party risk are as follows:
- (a) Failure to obtain necessary resources to complete the project or transaction undertaken.
 - (b) Any regulatory restrictions from the Government.
 - (c) Hostile action of foreign government.
 - (d) Let down by third party.
 - (e) Have become insolvent.

The various techniques to manage this type of risk are as follows:

- (1) Carrying out Due Diligence before dealing with any third party.
- (2) Do not over commit to a single entity or group or connected entities.
- (3) Know your exposure limits.
- (4) Review the limits and procedure for credit approval regularly.
- (5) Rapid action in the event of any likelihood of defaults.
- (6) Use of performance guarantee, insurance or other instruments.

OR

Some of the parameters to identify the currency risk are as follows:

- (1) Government Action: The Government action of any country has a visible impact in its currency. For example, the UK Govt. decision to divorce from European Union i.e. Brexit brought the pound to its lowest since 1980's.
- (2) Nominal Interest Rate: As per interest rate parity (IRP) the currency exchange rate depends on the nominal interest of that country.
- (3) Inflation Rate: Purchasing power parity theory impacts the value of currency.
- (4) Natural Calamities: Any natural calamity can have a negative impact.
- (5) War, Coup, Rebellion etc.: All these actions can have a far-reaching impact on currency's exchange rates.
- (6) Change of Government: The change of government and its attitude towards foreign investment also helps to identify the currency risk.

MOCK TEST PAPER -1
FINAL (NEW) COURSE: GROUP – I
PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

All MCQs are compulsory

Question No. 1 is compulsory.

*Attempt any **four** questions from the Rest.*

Time Allowed – 3 Hours

Maximum Marks – 100

DIVISION A – MCQs (30 Marks)

Questions no. (1-10) carry 1 Mark each and Questions no. 11-20 carry 2 Marks each.

1. CA Ram is practicing in the field of financial management planning for over 12 years. He has gained expertise in this domain over others. Mr. Ratan, a student of Chartered Accountancy course, is very much impressed with the knowledge of CA. Ram. He approached CA. Ram to take guidance on some topics of financial management subject related to his course. CA. Ram, on request, decided to spare some time and started providing private tutorship to Mr. Ratan along with some other aspirants for 4 days in a week and for 3 hours in a day. However, he forgot to take specific permission for such private tutorship from the Council. Later on, he came to know that the Council has passed a Resolution under Regulation 190A granting general permission (for private tutorship, and part-time tutorship under Coaching organization of the Institute) and specific permission (for part-time or full time tutorship under any educational institution other than Coaching organization of the Institute). Such general and specific permission granted is subject to the condition that the direct teaching hours devoted to such activities taken together should _____ in order to be able to undertake attest functions.
 - (a) not exceed 25 hours a week
 - (b) not exceed 21 hours a week
 - (c) not exceed 25 hours a month
 - (d) not exceed 21 hours a month
2. Rana & Co LLP is a large firm of Chartered Accountants based out of Delhi-NCR. During the financial year ended 31 March 2019, the firm Rana & Co LLP got an intimation for the peer review on 1 July. The entire peer review process including on-site review got completed. The peer reviewer did not share any of his observations with Rana & Co LLP as draft and final report was submitted to the firm.
 - (a) Peer reviewer need not share any draft report with the firm if there are no observations.
 - (b) Even the final report is not required to be submitted to the firm.
 - (c) Peer reviewer needs to share draft report with the firm before finalisation.
 - (d) There are no reports in case of peer review. On completion, a certificate to that effect is issued.
3. OPE Ltd issued a prospectus in respect of an IPO which had the auditor's report on the financial statements for the year ended 31 March 2019. The issue was fully subscribed.

During this year, there was an abnormal rise in the profits of the company for which it was found later on that it was because of manipulated sales in which there was participation of Whole-time director and other top officials of the company. On discovery of this fact, the company offered to refund all moneys to the subscribers of the shares and sued the auditors for the damages alleging that the auditors failed to examine and ascertain any satisfactory explanation for steep increase in the rate of profits and related accounts.

The company emphasized that the auditor should have proceeded with suspicion and should not have followed selected verification. The auditors were able to prove that they found internal controls to be satisfactory and did not find any circumstance to arouse suspicion.

The company was not able to prove that auditors were negligent in performance of their duties. Which of the following is correct:

- (a) The stand of the company was correct in this case. Considering the nature of the work, the Auditors should have proceeded with suspicion and should not have followed selected verification.
 - (b) The approach of the auditors look reasonable in this case. The auditors found internal controls to be satisfactory and also did not find any circumstance to arouse suspicion and hence they performed their procedures on the basis of selected verification.
 - (c) In the given case, the auditors should have involved various experts along with them to help them on their audit procedures. Prospectus is one area wherein management involves various experts and hence the auditors should also have done that. In the given case, by not involving the experts the auditors did not perform their job in a professional manner. If they had involved experts like forensic experts etc, the manipulation could have been detected. Hence the auditors should be held liable.
 - (d) In case of such type of engagements, the focus is always on the management controls. If the controls are found to be effective then an auditor can never be held liable in respect of any deficiency or misstatement or fraud.
4. Rajeev Ltd is a listed company having business of production of motion pictures. For the year ended 31 March 2018, the company wanted to appoint GST auditor. For the purpose, somebody who is familiar with the business of the company/industry was to be preferred for appointment i.e. who would have worked with the company in the past to avoid efforts/ duplication in terms of providing the information to get the GST audit completed. The company had following options for the same. Please advise.
- (a) Internal auditors can be appointed for this work.
 - (b) Both statutory and internal auditors can be jointly appointed for this work.
 - (c) Internal auditors along with the tax consultants of the company can be appointed for this work.
 - (d) Statutory auditors can be appointed for this work.
5. CER Ltd is a non-banking financial company and has been operating for the last 10 years. The company is duly registered as per the requirements of the Reserve Bank of India. The company's assets base has been very strong over the years due to its efficient management function. The company is also planning to get listed for which required work is going on.
- For the financial year ended 31 March 2019, the company has closed its books of accounts and prepared the financial statements for the purpose of statutory audit in a timely manner. The auditors of the company have started their fieldwork. It has been observed by the auditors that the company's various term loans which have been given to various parties have become overdue in terms of instalment including interest for a period of 5 months. As per the auditors these terms loans should be considered by the company for making provision at the rate of 20% of total outstanding amount, however, the management has considered a provision at the rate of 0.30%. Please advise the auditors and the management regarding this matter considering that "Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016" are applicable to this NBFC.
- (a) Provision should be made at 10%.
 - (b) Provision should be made 0.30%
 - (c) Provision should be made at 20%.
 - (d) Provision should be made at 0.40%

6. PFS Bank was engaged in the business of providing Portfolio Management Services to its customers, for which it took prior approval from RBI. Your firm has been appointed as the statutory auditors of the Bank's financial statements for the year 2018-19. Your senior has instructed you to verify the transactions of Portfolio Management Services (PMS). While verifying the transactions you noticed that the bank has not prepared separate record for PMS transactions from the Bank's own investments. As a statutory auditor what will be your decision for verification of PMS transactions?
- (a) It is not necessary to maintain separate records for PMS clients from Bank's own investments, so the auditor can verify the PMS transactions as part of investment verification for Bank's financial statements and submit the audit report accordingly.
 - (b) As per RBI guidelines PMS investments need to be audited separately by the external auditors and the auditors are required to give a certificate separately for the same. So, in the above case the auditor should not verify the PMS transactions till the Bank segregates the transactions from its own investments.
 - (c) The auditor can give a qualified opinion in his audit report on the financial statements of the Bank and report the matter in special purpose certificate.
 - (d) Auditor should verify that PMS funds are not utilised for lending, inter-bank deposits or deposits to corporate bodies and bills re-discounting only. So, whether the PMS transactions are recorded separately or not will not matter for the auditor.
7. The auditor should ensure that the board of directors of the top 100 listed entities shall comprise of –
- (a) not less than 7 directors.
 - (b) not less than 4 directors.
 - (c) not less than 6 directors.
 - (d) not less than 2 directors
8. 50:50 test determination is popularly used in
- (a) Banking Company
 - (b) Insurance Company
 - (c) NBFC Company
 - (d) Stock Trading Company
9. CA Sameer, after developing the audit strategy for Menka Ltd., develops an audit plan but finds a need to revise the materiality levels set earlier and therefore a deviation from the already set audit strategy is felt necessary. In this case, he should
- (a) Continue with the Audit Plan without considering the Audit Strategy
 - (b) Drop the audit and withdraw from the engagement
 - (c) First Modify the audit strategy and thereafter prepare the audit plan according to the modified strategy.
 - (d) Devise a new audit plan and then, change the strategy as per the Revised Plan.
10. An auditor's expert may be either an auditor's internal or an external expert. Which of the following can not be an auditor's internal expert?
- (a) Partner of the Auditor's Firm
 - (b) Temporary Staff of the Auditor's Firm
 - (c) Permanent Staff of Auditor's Network Firm
 - (d) A Prospective CA, soon to join the Auditor's Firm as a Partner.
- (10 x 1 = 10 Marks)**

Questions (11-20) carry 2 Marks each

11. The Chanakya Bank Ltd. was having 150 branches all over India by the year ending 31st March, 2019. Ten branches of the bank were already covered for concurrent audit and the Bank's Audit Committee decided to include the below mentioned branches for concurrent audit from the year 2019-20.

1. Allahabad branch which started foreign exchange business from February 2019.
2. Rae Bareilly branch whose aggregate deposits were more than 35% of the aggregate deposits of the bank.

Whether the decision of audit committee to include both the branches mentioned in above paragraph for concurrent audit is as per RBI Guidelines?

- (a) The decision of audit committee is valid as according to RBI Guidelines, both the branches fulfil the criteria for compulsory concurrent audit.
 - (b) Allahabad branch falls under the compulsory audit criteria as per RBI Guidelines, however Rae Bareilly branch whose aggregate deposits are less than 50% of the aggregate deposits of the Bank is not required to be compulsorily covered for concurrent audit.
 - (c) Allahabad and Rae Bareilly branch are compulsorily not required to be covered under concurrent audit as per RBI Guidelines.
 - (d) Allahabad branch has started foreign exchange business in February 2019 and as per RBI Guidelines only the branches dealing in Foreign exchange business from more than three years are covered under concurrent audit. Therefore, Allahabad branch is not covered under compulsory concurrent audit criteria as per RBI Guidelines but the Rae Bareilly branch is covered under compulsory concurrent audit criteria.
12. KIC Ltd is a company engaged in the business of general insurance and has been in existence for over 15 years. The company has a subsidiary company, PIC Ltd, which is also engaged in the business of insurance other than general insurance.

The previous statutory auditors of PIC Ltd have completed their tenure as an auditor and accordingly have resigned and the management of PIC Ltd is looking for new statutory auditors.

KB & Associates, a firm of Chartered Accountants, have vast experience of audit of insurance companies and would like to get appointed as auditor of PIC Ltd. KB & Associates is a large firm and have also employed experts – engineers, valuers, lawyers for various client services. The firm is evaluating as to what should be the criteria for get appointed as auditors of PIC Ltd because in the past they have audited only the holding companies and considering a subsidiary company for the first time.

In this context, please help the firm by answering which of the following options would be correct?

- (a) KB & Associates, a firm of Chartered Accountants, should be appointed by the Board of Directors of PIC Ltd and should ensure that they don't take up audit of more than 2 insurance companies.
 - (b) KB & Associates can take up the audit if the firm is appointed by the Comptroller and Auditor General of India and should ensure that they don't take up audit of more than 3 insurance companies.
 - (c) KB & Associates cannot take audit of PIC Ltd because they have employed experts which is not permitted by the IRDAI Guidelines.
 - (d) KB & Associates can take up audit of PIC Ltd by ensuring that they are eligible to be appointed as per the criteria laid down in the Companies Act 2013 for audit of subsidiary companies and they would need to submit a certificate in this respect to the ICAI.
13. KJ Private Ltd has a business of pharmaceuticals and has an annual turnover of INR 1,500 crores. During the last few years, considering the environment in which the company operates, its profit has reduced and is still falling. Hence the management has been looking at various ways to cut the costs.

AD & Associates are the statutory auditors of the company and RM & Associates are the internal auditors of the company.

Initially the company did not want to appoint any internal auditors to save costs, however, at insistence of the statutory auditors, the company appointed the internal auditors.

During the course of the statutory audit for the financial year ended 31 March, 2019, the statutory auditors requested for the detailed working papers of the internal auditors which the internal auditors refused. However, the statutory auditors told the management if the same are not provided then they would qualify their report.

In this situation, please advise which of the following would be correct.

- (a) The statutory auditors should review the detailed working papers but they cannot qualify their report on this ground.
 - (b) The statutory auditors may review the detailed working papers and even after that they may qualify their report.
 - (c) The statutory auditors are not required to go to the extent of review of detailed working papers of internal auditors.
 - (d) The statutory auditors may review the detailed working papers of internal auditors but for that purpose they would require prior approval of the ICAI.
14. Employees of LIG Ltd. have to travel frequently for business purposes, so the company entered into a contract with a Simon Travels Ltd. for managing booking, cancellation and other services required by their employees. As per contract terms, Simon travels has to raise its monthly bills for the tickets booked or cancelled during the period and the same are paid by LIG Ltd. within 15 days of the bill date. The bills raised by Simon travels were of huge amount, so the management of LIG Ltd. decided to get an audit conducted of the process followed for booking/ cancellation of tickets and verify the accuracy of bills raised by the travel agency. Which audit do you feel the management should opt for?
- (a) Internal audit, as it relates to examine the operational efficiency of the organisation.
 - (b) Management audit, as it is an audit desired by the management.
 - (c) Performance audit so as to assess the performance of the Simon travels appointed by the organisation.
 - (d) Operational audit, as it is the audit for the management and involves verifying the effectiveness, efficiency and economy of operations done by the Simon travels for the organisation.
15. ZARI & Associates is a partnership firm and has been in existence for the last 15 years. The firm is engaged in consultancy business related to various areas and has built a good name for itself over the period.

Some of the clients of the firm are very old who have been continuing since its existence. The business of the firm has gone through various phases some of them were very bad. But currently the business is going very well and the firm is looking to expand its operations into different geographies. For this, the firm's management decided that some of its senior partners will move to new offices and new partners would be inducted.

A team of new partners is in discussion with the senior old partners regarding their joining the firm.

The new partners would be interested to know whether the terms offered to them are reasonable having regard to the nature of the business, profit records, capital distribution, personal capacity of the existing partners, socio-economic setting etc. and whether they would be able to derive continuing benefits in the shape of return of capital to be contributed and remuneration of services to be offered. In addition, they also want to ascertain whether the capital to be contributed by them would be safe and applied usefully or not.

For this purpose, an investigation of the business of the firm was set up on behalf of these new partners.

At the time of scrutiny of the record of profitability of the firm's business, the investigating accountant picked up records of last 4-5 years wherein he observed 2 years which were unusual because the profits during those 2 years were highly erratic and fluctuating. The investigating accountant, therefore, went into the profits of last 7-8 years to iron out the fluctuation. He also examined the provisions of the partnership deed particularly the composition of partners, their capital contribution, drawing rights, retirement benefits and goodwill. He also asked for details of jobs/ contracts in hand and the range of current clientele of the firm for his examination. Some of these procedures of the investigating accountant were not found appropriate by the senior partners of the firm and they advised the investigating accountant not to go beyond his scope. In the given situation, which of the following is correct:

- (a) The investigating accountant should not have asked for the records of the profits of last 7-8 years as that would be too much of the information for his review. Also the details of jobs/ contracts in hand and the range of current clientele of the firm are confidential and hence does not get covered in his scope.
 - (b) After finding 2 years which were unusual because the profits during those 2 years were highly erratic and fluctuating, the investigating accountant should have reported the matter to the new partners instead of asking for more details related to the profits of last 7-8 years. Also he is not required to examine the provisions of the partnership deed as these details would have already been discussed with the new partners and they would have checked that.
 - (c) The procedures of the investigating accountant looks completely reasonable considering his scope of work. Further, no changes are required in his work approach.
 - (d) At the outset, it can be said that investigation in the given case was not required. However, even if the new partners decided to carry out the investigation it should have been limited to mainly inquiry procedures by the investigating accountant. The investigating accountant could have also reviewed the manner of computation of goodwill which doesn't seem to have been performed on the basis of the above mentioned facts.
16. While conducting the current year audit of Finco Ltd, the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements. This misstatement was related to recognition of research and development expenditure. The provisions of Ind AS 38 Intangible Assets relating to capitalisation of development expenditure was not applied properly. On this, unmodified opinion had been previously issued. The current auditor verified that the misstatement had not been dealt with as required under Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Accordingly, the current auditor will:
- (a) Express a qualified or an adverse opinion in the auditor's report on the current period financial statements modified with respect to the corresponding figures included therein.
 - (b) Express an unmodified opinion in the auditor's report on the current period financial statements since it was related to the prior year.
 - (c) Express a qualified opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.
 - (d) Express an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.
17. Honeywell Ltd, a listed company pays its key managerial persons the remuneration in excess of the limits which have been prescribed under 197 of the Companies Act, 2013 without obtaining the necessary approvals from the regulatory authority. In this circumstance, the auditor while reporting under CARO 2016, is required to state:
- (a) Name of the managerial persons to whom the remuneration has been paid in excess of limits and the amount involved.

- (b) Name of the managerial persons to whom the remuneration in excess of limits are paid and the steps taken by the company for securing refund of the same.
 - (c) The maximum remuneration payable and amount paid in excess of the maximum remuneration to the managerial persons.
 - (d) The amount involved and steps taken by the company for securing the refund of the same.
18. You are the audit senior in charge of the audit of Swandive Co, and have been informed by your audit manager that during the current year a fraud occurred at the client. A payroll clerk sets up fictitious employees and the wages were paid into the clerk's own bank account. This clerk has subsequently left the company, but the audit manager is concerned that additional frauds have taken place in the wages department. Which of the following audit procedures would be undertaken during the audit of wages as a result of the manager's assessment of the increased risk of fraud?
- (1) Discuss with the payroll manager the nature of the payroll fraud, how it occurred and the financial impact of amounts incorrectly paid into the payroll clerk's bank account.
 - (2) Review the supporting documentation to confirm the total of the fraudulent payments made and assess the materiality of this misstatement.
 - (3) Review and test the internal controls surrounding setting up of and payments to new joiners to assess whether further frauds may have occurred.
 - (4) Review the legal action taken by the management against the payroll clerk who was involved in the fraud and see whether he is punished for his actions.
- (a) Audit procedures 1,2,3
 - (b) Audit procedures 2,3,4
 - (c) Audit procedures 1,3,4
 - (d) Audit procedures 1,2,4
19. One of your audit client Vernon Co with a year ending 31 March 2019 is planning to prepare the financial statements from the next year as per Indian Accounting Standards (Ind AS). The finance director of Vernon Co has contacted the audit engagement partner, asking if your firm can provide training on Ind AS to the accounts department of the entity. This will help them to understand all the provisions of Ind AS and the transition process will be easier.
- Which of the following options needs to be considered by the audit engagement partner?
- (a) The issue is whether there is a self-interest threat, as the auditor will receive separate training fees for the service provided. The audit partner should decline the training assignment.
 - (b) The issue is whether the audit firm would be likely to possess the requisite competence to provide such training to the staff of the entity. The audit partner should decline not all the qualified people are good trainers.
 - (c) The audit partner could go ahead with the training service and disclose the fact in its audit report about the service provided during the period. This will safeguard and reduce the threat to an acceptable level.
 - (d) The audit partner needs to assess the materiality of the figure, and the degree of subjectivity involved. If it considers that safeguards like using separate personnel, could reduce the threat to an acceptable level, then it can go ahead with both the audit and the training assignment.
20. AJ Private Ltd. was incorporated on 21 March, 2018 and has limited operations. However, the capital induction in the company was huge because it would be capital intensive. The company is in the process to set up a plant in Karnataka which should be completed by 31 May, 2019. The company's management prepared its financial statements for the year ended 31 March, 2019. The auditors were also called to start the work in April 2019. The auditors would be able to complete their work by 31 May, 2019 and

accordingly would issue their audit report by 1st week of June, 2019 as per the plan agreed with the management. The auditors have some observations related to preparations of financial statements which are not in compliance with Schedule III and most importantly the point related to capitalization of the plant as Property, Plant and Equipment in the financial statements for the year ended 31 March, 2019. Please suggest which of the following statements would be correct.

- (a) The compliance of Schedule III shall start from 1 April 2019 for this company as per Companies Accounts (Amendment) Rules 2016.
- (b) The compliance of Schedule III shall start from first financial period, however, some exemptions would be applicable as per Companies Accounts Rules 2014.
- (c) There should be full compliance of Schedule III and plant should be kept as CWIP as per Schedule III.
- (d) There should be full compliance of Schedule III and plant should be shown as PPE as per Schedule III. **(10 x 2 = 20 Marks)**

Division B- Descriptive Questions-70 Marks

Question No. 1 is compulsory.

Attempt any **four** questions from the Rest.

1. Comment on the following:

- (a) MIO Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of MIO Ltd. as to how he can obtain an understanding of how MIO Ltd. uses the services of the outsourced agency in its operations. **(4 Marks)**
- (b) In an initial audit engagement, the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements, which may materially affect the current financial statements. Advise, the auditor about the audit procedures to be followed, when financial statements are audited for the first time.

If, after performing the procedure, as an auditor you are not satisfied about the correctness of 'Opening Balances', what approach you will adopt in drafting your audit report? **(6 Marks)**

- (c) AKY Ltd. is a listed company engaged in the business of software and is one of the largest company operating in this sector in India. The company's annual turnover is Rs. 40,000 crores with profits of Rs. 5,000 crores. Due to the nature of the business and the size of the company, the operations of the company are spread out in India as well as outside India. The company's contracts with its various customers are quite complicated and different. During the course of the audit, the audit team spends significant time on audit of revenue – be it planning, execution or conclusion. This matter was also discussed with management at various stages of audit. The efforts towards audit of revenue also involve significant involvement of senior members of the audit team including the audit partner. After completion of audit for the year ended 31 March 2019, the audit partner was discussing significant matters with the management wherein they also communicated to the management that he plans to include revenue recognition as key audit matter in his audit report. The management did not agree with revenue recognition to be shown as key audit matter in the audit report. Comment. **(4 Marks)**

- 2. (a) In the course of audit of Z Ltd, its auditor wants to rely on audit evidence obtained in previous audit in respect of effectiveness of internal controls instead of retesting the same during the current audit. As an auditor discuss the factors that may warrant a re-test of controls. **(4 Marks)**
- (b) Whilst the Audit team has identified various matters, they need your advice to include the same in your audit report in view of CARO 2016:-
 - (i) Physical verification of only 40% of items of inventory has been conducted by the company. The balance 60% will be conducted in next year due to lack of time and resources. **(2 Marks)**

- (ii) An amount of Rs. 3.25 Lakhs per month is paid to M/s. WE CARE Associates, a partnership firm, which is a 'related party' in accordance with the provisions of the Companies Act, 2013 for the marketing services rendered by them. Based on an independent assessment, the consideration paid is higher than the arm's length pricing by Rs. 0.25 Lakhs per month. Whilst the transaction was accounted in the financial statements based on the amounts paid, no separate disclosure has been made in the notes forming part of the accounts highlighting the same as a 'related party' transaction. **(3 Marks)**
- (c) Mr. Rival, a Chartered Accountant in practice, delivered a speech in the national conference organized by the Ministry of Textiles. While addressing the audience, he informed that he is a management expert and his firm provides services of taxation and audit at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services and at the request of audience he also distributed his business cards and telephone number of his firm to those in the audience. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. **(5 Marks)**
3. (a) The Comptroller and Auditor General assists the legislature in reviewing the performance of public undertakings. He conducts an efficiency-cum-performance audit other than the field which has already been covered either by the internal audit of the individual concerns or by the professional auditors. He locates the area of weakness for managements' information. Explain stating clearly the issues examined in comprehensive audit. **(4 Marks)**
- (b) You are doing Tax Audit of Private Limited Company for the financial year ending 31st March, 2019. During audit, you notice that the company is not regular in deposit of VAT/GST and there remains pendency every year. The details of VAT/GST payable are:
- (i) GST payable as on 31/03/2018 of FY 2017-18 was Rs. 200 Lakh and out of which Rs. 100 Lakh was paid on 15/09/2018 and Rs. 50 Lakh on 30/03/2019 and balance of ` 50 Lakh paid on 16/09/2019.
- (ii) GST payable of current financial year 2018-19 was ` 100 lakh and out of this, 40 Lakh was paid on 25/05/2018 and balance of Rs. 60 Lakh remained unpaid till the due date of return.
- The date of Tax Audit report and due date of return was 30th September.
- Now as a Tax Auditor, how/where the said transaction will be reflected in Tax Audit Report under Section 43B(a)? **(6 Marks)**
- (c) A Chartered Accountant in practice certified in requisite Form that an articled assistant was undergoing training with him, whereas, he was also employed in a company between 9:30 a.m. and 5:30 p.m. on a monthly salary of Rs. 18,000 and attended the office of the Chartered Accountant thereafter until 7 p.m. The Chartered Accountant pleaded that the articled assistant was on audit of the company. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. **(4 Marks)**
4. (a) Aviral & Co LLP are the auditors of NBFC (Investment and Credit Company). In this context, please explain what verification procedures should be performed in relation to audit of NBFC - Investment and Credit Company (NBFC-ICC). **(6 Marks)**
- (b) OPQ Ltd is in the software consultancy business. The company had large balance of accounts receivables in the past years which have been assessed as area of high risk. For the year ended 31 March 2019, in respect of the valuation of accounts receivable, the statutory auditor was assigned with the checking of accuracy of the aging of the accounts receivables and provision based on ageing, to the internal auditor providing direct assistance to him. Comment. **(4 Marks)**
- (c) Mr. Avin, a practicing Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. Lucky, under the nomenclature of office allowance and such an arrangement continued for a number of years. Comment with reference to the Chartered Accountants Act, 1949, and Schedules thereto. **(4 Marks)**

5. (a) INDO Bank appointed your firm of Chartered Accountants as a branch auditor for the financial year 2018-19. Being head-in-charge of the assignment, while planning, you distributed the work among your team members and assigned Mr. Pary for verification of bills payable. However, Mr. Pary, being fresh to the bank audits, needs your guidance. **(5 Marks)**
- (b) Vivan Ltd is a company engaged in the business of software development. It is one of the largest companies in this sector with a turnover of INR 25,000 crores. The operations of the company are increasing constantly, however, the focus of the management is more on cost cutting in the coming years to improve its profitability. In respect of the financial statements of the company which are used by various stakeholders, some fraud was observed in respect of assets reported therein due to which those stakeholders suffered damages. As a result, those stakeholders applied to Tribunal for change of auditor on the basis that auditor is colluded in the fraud.
- Elucidate the power of Tribunal to change the auditor of a company if found acting in a fraudulent manner as provided under sub-section (5) of section 140 of the Companies Act, 2013. **(4 Marks)**
- (c) BSF Limited is engaged in the business of trading leather goods. You are the internal auditor of the company for the year 2018-19. In order to review internal controls of the Sales Department of the company, you visited the Department and noticed the work division as follows:
- (1) An officer was handling the sales ledger and cash receipts.
 - (2) Another official was handling dispatch of goods and issuance of Delivery challans.
 - (3) One more officer was there to handle customer/ debtor accounts and issue of receipts.
- As an internal auditor, you are required to briefly discuss the general condition pertaining to the internal check system prevalent in internal control system. Do you think that there was proper division of work in BSF Limited? If not, why? **(5 Marks)**
6. (a) Mr. Shah is reviewing the anti-fraud controls for a construction company. The company has witnessed a few frauds in the past mainly in the nature of material stolen from the sites and fake expense vouchers.
- Mr. Shah is evaluating options for verifying the process in detecting fraud and the corrective action to be taken in such cases. As an expert, you are required to advise Mr. Shah as how inventory fraud occurs and the verification procedure to be followed for detecting the same. **(5 Marks)**
- (b) As an auditor, how would you deal with the following situations:
- (i) Nick Ltd. is a subsidiary of Ajanta Ltd., whose 20% shares have been held by Central Government, 25% by Uttar Pradesh Government and 10% by Madhya Pradesh Government. Nick Ltd. appointed Mr. Prem as its statutory auditor.
 - (ii) Contravene Ltd. appointed CA Innocent as an auditor for the company for the current financial year. Further the company offered him the services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors. **(5 Marks)**
- (c) During the audit of FMP Ltd, a listed company, Engagement Partner (EP) completed his reviews and also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner and not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this and refused to sign off the documentation. Please advise as per SA 220. **(4 Marks)**

OR

Aarav, a practicing Chartered Accountant is appointed to conduct the peer review of another practicing unit. What areas A should review in the assessment of independence of the practicing unit? **(4 Marks)**

MOCKTEST PAPER 1
FINAL (NEW) COURSE: GROUP – I
PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS
SUGGESTED ANSWERS/HINTS

DIVISION A - MCQs(30 Marks)

Questions no. (1-10) carry 1 Mark each and Questions no. 11-20 carry 2 Marks each.

1. (a) not exceed 25 hours a week
2. (c) Peer reviewer needs to share draft report with the firm before finalisation.
3. (b) The approach of the auditors look reasonable in this case. The auditors found internal controls to be satisfactory and also did not find any circumstance to arouse suspicion and hence they performed their procedures on the basis of selected verification.
4. (d) Statutory auditors can be appointed for this work.
5. (a) Provision should be made at 10%.
6. (b) As per RBI guidelines PMS investments need to be audited separately by the external auditors and the auditors are required to give a certificate separately for the same. So, in the above case the auditor should not verify the PMS transactions till the Bank segregates the transactions from its own investments.
7. (c) not less than 6 directors.
8. (c) NBFC Company
9. (c) First Modify the audit strategy and thereafter prepare the audit plan according to the modified strategy.
10. (d) A Prospective CA, soon to join the Auditor's Firm as a Partner.

Questions (11-20) carry 2 Marks each

11. (b) Allahabad branch falls under the compulsory audit criteria as per RBI Guidelines, however Rae Bareilly branch whose aggregate deposits are less than 50% of the aggregate deposits of the Bank is not required to be compulsorily covered for concurrent audit.
12. (b) KB & Associates can take up the audit if the firm is appointed by the Comptroller and Auditor General of India and should ensure that they don't take up audit of more than 3 insurance companies.
13. (c) The statutory auditors are not required to go to the extent of review of detailed working papers of internal auditors.
14. (d) Operational audit, as it is the audit for the management and involves verifying the effectiveness, efficiency and economy of operations done by the Simon travels for the organisation.
15. (c) The procedures of the investigating accountant looks completely reasonable considering his scope of work. Further, no changes are required in his work approach.
16. (a) Express a qualified or an adverse opinion in the auditor's report on the current period financial statements modified with respect to the corresponding figures included therein.
17. (d) The amount involved and steps taken by the company for securing the refund of the same.
18. (a) Audit procedures 1,2,3.
19. (d) The audit partner needs to assess the materiality of the figure, and the degree of subjectivity

involved. If it considers that safeguards like using separate personnel, could reduce the threat to an acceptable level, then it can go ahead with both the audit and the training assignment.

20. (c) There should be full compliance of Schedule III and plant should be kept as CWIP as per Schedule III.

DIVISION B - DESCRIPTIVE QUESTIONS (70 Marks)

1. (a) As per **SA 402 on “Audit Considerations Relating to an Entity Using a Service Organisation”**, when obtaining an understanding of the user entity in accordance with SA 315 “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment”, the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity’s operations, including:
- (i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity’s internal control;
 - (ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
 - (iii) The degree of interaction between the activities of the service organisation and those of the user entity; and
 - (iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.
- (b) **Audit Procedure for ensuring correctness of Opening Balances:** As per SA 510 “Initial Audit Engagements-Opening Balances”, the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period’s financial statements by -
- (i) Determining whether the prior period’s closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year’s Statement of Profit and Loss;
 - (ii) Determining whether the opening balances reflect the application of appropriate accounting policies; and
 - (iii) By evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or performing specific audit procedures to obtain evidence regarding the opening balances.

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

Approach for drafting Audit Report: SA 705 establishes requirements and provides guidance on circumstances that may result in a modification to the auditor’s opinion on the financial statements, the type of opinion appropriate in the circumstances, and the content of the auditor’s report when the auditor’s opinion is modified. The inability of the auditor to obtain sufficient appropriate audit evidence regarding opening balances may result in one of the following modifications to the opinion in the auditor’s report:

- (i) A qualified opinion or a disclaimer of opinion, as is appropriate in the circumstances; or
- (ii) Unless prohibited by law or regulation, an opinion which is qualified or disclaimed, as appropriate, regarding the results of operations, and cash flows, where relevant, and unmodified regarding State of Affairs.

If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705.

- (c) **Determining Key Audit Matters: SA 701, "Communicating Key Audit Matters in the Independent Auditor's Report"**, deals with the auditor's responsibility to communicate key audit matters in the auditor's report. It is intended to address both the auditor's judgment as to what to communicate in the auditor's report and the form and content of such communication.

The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- (i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.
- (ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- (iii) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters determined in accordance with above were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

In the instant case, AKY Ltd., a listed company engaged in the business of software and its contracts with its various customers are also quite complicated and different. Further, the audit team spends significant time on audit of revenue and efforts towards audit of revenue also involve significant involvement of senior members of the audit team including audit partner during audit. This matter was also discussed with management at various stages. After completion of audit, the audit partner communicated the management regarding inclusion of paragraph on revenue recognition as key audit matter in his audit report.

In view of SA 701, the assessment of the auditor is valid as above matter qualifies to be a key audit matter in the opinion of auditor. Hence, it should be reported accordingly by the auditor in his audit report.

2. (a) As per **SA 330 on "The Auditor's Responses to Assessed Risks"**, changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance.

The auditor's decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment.

Factors that may warrant a re-test of controls are-

- (i) A deficient control environment.
- (ii) Deficient monitoring of controls.
- (iii) A significant manual element to the relevant controls.
- (iv) Personnel changes that significantly affect the application of the control.
- (v) Changing circumstances that indicate the need for changes in the control.
- (vi) Deficient general IT-controls.

(b) (i) **Physical Verification of Inventory:** Clause (ii) of Para 3 of CARO, 2016 requires the auditor to report on whether physical verification of inventory has been conducted at reasonable intervals by the management. Physical verification of inventory is the responsibility of the management which should normally verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification. In the given case, the above requirement of CARO, 2016 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact on financial statement and report accordingly.

(ii) As per clause (xiii) of para 3 of CARO 2016, the auditor is required to report, "whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;"

Therefore, the duty of the auditor, under this clause is to report (i) Whether all transactions with the related parties are in compliance with section 177 and 188 of the Companies Act, 2013 ("Act"); (ii) Whether related party disclosures as required by relevant Accounting Standards (AS 18, as may be applicable) are disclosed in the financial statements.

In the present case, the auditor is required to report as per clause xiii of para 3 of CARO 2016, as one of related party transaction amounting 3.25 lakhs per month i.e. in lieu of marketing services has been noticed of which amount Rs. 0.25 lakh per month is exceeding the arm's length price has not been disclosed highlighting the same as related party transactions as per AS 18. Thus, the auditor is required to report accordingly.

(c) **Using Designation Other Than a CA and Providing Details of Services Offered:** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment and may be able to command respect from their prospective clients.

Section 7 of the Chartered Accountants Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

Member may appear on television and films and agree to broadcast in the Radio or give lectures at forums and may give their names and describe themselves as Chartered Accountants. Special qualifications or specialized knowledge directly relevant to the subject matter of the programme may also be given but no reference should be made, in the case of practicing member to the name and address or services of his firm. What he may say or write must not be promotional of his or his firm but must be an objective professional view of the topic under consideration.

Thus, it is improper to use designation "Management Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) and Clause (7) as he has used the designation "Management Expert" in his speech and also he has made reference to the

services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also a misconduct in terms of Clause (6).

3. (a) The Comptroller and Auditor General assist the legislature in reviewing the performance of public undertakings. He conducts an efficiency-cum-performance audit other than the field which has already been covered either by the internal audit of the individual concerns or by the professional auditors. He locates the area of weakness and extravagance for managements' information.

The areas covered in comprehensive audit naturally vary from enterprise to enterprise depending on the nature of the enterprise, its objectives and operations. However, in general, the covered areas are those of 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.

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?

The efficiency and effectiveness audit of public enterprises is conducted on the basis of certain standards and criteria. Profit is not the key criterion on performance; management's performance in the economical and efficient use of public funds and in the achievement of objectives is more relevant. Public enterprises have been set up with certain socio-economic purposes and for fulfillment of certain objectives. The objectives vary from enterprise to enterprise. Audit appraisal analyses the performance of an enterprise to bring out the extent to which the objectives for which the enterprise was set up have been served.

- (b) **Reporting in Tax Audit Report:** Any amount of GST/Tax payable on the last day of previous year (opening balance) as well as on the last day of current year has to be reported in Tax Audit Report under clause 26(A) and 26(B) in reference of section 43 B.

Clause 26 (A) dealt GST/VAT payable on the pre-existed of the first day of the previous year but was not allowed in the assessment of any preceding previous year and was either paid {clause 26(A) (a)} or/ and/ not paid during the previous year {clause 26(A)(b)}

The details will be as under in regard to opening balances:

Liability Pre-existed on the previous year.

Sr. No.	Section	Nature of Liability	Outstanding Opening balance not allowed in previous year	Amount paid/set-off during the year	Amount written back to P&L Account	Amount unpaid at the end of the year
01	43B(a)	VAT/GST	100 lakh	50 lakh	0	50 lakh

It has been assumed that 50 lakh was allowed in last year as it was paid before the due date of return.

Liability incurred during the previous year

Sr. No.	Section	Nature of Liability	Amount incurred in previous year but remaining outstanding on last day of previous year.	Amount paid/set-off before the due date of filing return/date upto which reported in the tax audit report, whichever is earlier	Amount unpaid on the due of filing of return/date upto which reported in the tax audit report, whichever is earlier
01	43B(a)	VAT/GST	100 lakh	40 lakh	60 lakh

- (c) **Failure to Observe Regulations:** As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member shall be held guilty of professional misconduct if he contravenes any of the provisions of the Act or the regulations made thereunder or any guidelines issued by the Council. The chartered accountant, as per Regulations also, is expected to impart proper practical training.

In the instant case, the articled assistant is not attending office on timely basis and the explanation of the Chartered Accountant that the articled assistant was on audit of the company cannot be accepted particularly in view of the fact that articled assistant is getting monthly salary from that company. Under the circumstances, the Chartered Accountant would be held guilty of professional misconduct in regard to the discharge of his professional duties as per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949.

4. (a) **Some points that may be covered in the audit of NBFC - Investment and Credit Company (NBFC-ICC):**
- Physically verify all the shares and securities held by a NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.
 - Verify whether the NBFC has not advanced any loans against the security of its own shares.
 - Verify that dividend income wherever declared by a company, has been duly received by an NBFC and interest wherever due [except in case of NPAs] has been duly accounted for. NBFC

Prudential Norms directions require dividend income on shares of companies and units of mutual funds to be recognised on cash basis. However, the NBFC has an option to account for dividend income on accrual basis, if the same has been declared by the body corporate in its Annual General Meeting and its right to receive the payment has been established. Income from bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears.

- iv. Test check bills/contract notes received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.
- v. Verify the Board Minutes for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long Term Investments.
- vi. Check whether the investments have been valued in accordance with the NBFC Prudential Norms Directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.
- vii. Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares.
- viii. Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.
- ix. An auditor will have to ascertain whether the requirements of AS 13 "Accounting for Investments" or other accounting standard, as applicable, (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.
- x. In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.
- xi. Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon).
- xii. Verify charges received or paid in respect of securities lend/borrowed.
- xiii. Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.
- xiv. An auditor should examine whether each loan or advance has been properly sanctioned. He should verify the conditions attached to the sanction of each loan or advance i.e. limit on borrowings, nature of security, interest, terms of repayment, etc.
- xv. An auditor should verify the security obtained and the agreements entered into, if any, with the concerned parties in respect of the advances given. He must ascertain the nature and value of security and the net worth of the borrower/guarantor to determine the extent to which an advance could be considered realisable.
- xvi. Obtain balance confirmations from the concerned parties.
- xvii. As regards bill discounting, verify that proper records/documents have been maintained for every bill discounted/rediscounted by the NBFC. Test check some transactions with reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.
- xviii. Check whether the NBFC has not lent/invested in excess of the specified limits to any single borrower or group of borrowers as per NBFC Prudential Norms Directions.

- xix. An auditor should verify whether the NBFC has an adequate system of proper appraisal and follow up of loans and advances. In addition, he may analyse the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPAs.
- xx. Check the classification of loans and advances (including bills purchased and discounted) made by a NBFC into Standard Assets, Sub-Standard Assets, Doubtful Assets and Loss Assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms Directions.

(Note: The above checklist is not exhaustive. It is only illustrative. There could be various other audit procedures which may be performed for audit of an NBFC.)

- (b) As per SA 610 Using the Work of Internal Auditor, the external auditor (Statutory Auditor) shall not use internal auditors to provide direct assistance to perform procedures that:
 - (i) Involve making significant judgments in the audit;
 - (ii) Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;
 - (iii) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
 - (iv) Relate to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

In the given case where the valuation of accounts receivable is assessed as an area of higher risk, the statutory auditor could assign the checking of the accuracy of the aging to an internal auditor providing direct assistance. However, because the evaluation of the adequacy of the provision based on the aging would involve more than limited judgment, it would not be appropriate to assign that latter procedure to an internal auditor providing direct assistance.

- (c) **Sharing of Audit Fees with Non-Member:** As per Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949 a member shall be held guilty if a Chartered Accountant in practice 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 qualification as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

In the instant case, Mr. Avin, a practising Chartered Accountant gave 50% of the audit fees received by him to a non-Chartered Accountant, Mr. Lucky, under the nomenclature of office allowance and such an arrangement continued for a number of years. In this case, it is not the nomenclature to a transaction that is material but it is the substance of the transaction, which has to be looked into.

The Chartered Accountant had shared his profits and, therefore, Mr. Avin will be held guilty of professional misconduct under the Clause (2) of Part I of First Schedule to the Chartered Accountants Act, 1949.

- 5. (a) **Bills Payable:** Evaluate the existence, effectiveness and continuity of internal controls over bills payable. Such controls should usually include the following-
 - Drafts, mail transfers, traveller's cheques, etc. should be made out in standard printed forms.
 - Unused forms relating to drafts, traveller's cheques, etc. should be kept under the custody of a responsible officer.
 - The bank should have a reliable private code known only to the responsible officers of its

branches, coding and decoding of the telegrams should be done only by such officers.

- The signatures on a demand draft should be checked by an officer with the specimen signature book.
- All the telegraphic transfers and demand drafts issued by a branch should be immediately confirmed by advices to the branches concerned. On payment of these instruments, the paying branch should send a debit advice to the originating branch.

Examine an appropriate sample of outstanding items comprised in bills payable accounts with the relevant registers. Reasons for old outstanding debits in respect of drafts or other similar instruments paid without advice should be ascertained.

Correspondence with other branches after the year-end (e.g., responding advices received from other branches, advices received from other branches in respect of drafts issued by the branch and paid by the other branches without advice) should be examined specially in so far as large value items outstanding on the balance sheet date are concerned.

- (b) Direction by Tribunal in case auditor acted in a fraudulent manner:** As per sub-section (5) of the section 140, the Tribunal either *suo motu* or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

It is hereby clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

- (c)** 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.
 - (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.

In the given scenario, Company has not done proper division of work as: (i) the receipts of cash should not be handled by the official handling sales ledger and (ii) delivery challans should be verified by an authorised official other than the officer handling despatch of goods.

6. (a) Inventory frauds - Inventory frauds are many and varied but here we are concerned with misappropriation of goods and their concealment.

- (i) Employees may simply remove goods from the premises.
- (ii) Theft of goods may be concealed by writing them off as damaged goods, etc.
- (iii) Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.

Verification Procedure for Defalcation of inventory - It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for their detection, the entire system of receipts, storage and despatch of all goods, etc. should be reviewed to localise the weakness in the system.

The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of:

- (a) a system of inventory control, and existence of detailed record of the movement of inventory, or
- (b) availability of sufficient data from which such a record can be constructed.

The first step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book.

Afterwards, all the receipts and issues of inventory recorded in the Inventory Book should be verified by reference to entries in the Goods Inward and Outward Registers and the documentary evidence as regards purchases and sales. This would reveal the particulars of inventory not received but paid for as well as that issued but not charged to customers. Further, entries in respect of returns, both inward and outward, recorded in the financial books should be checked with corresponding entries in the Inventory Book. Also, the totals of the Inventory Book should be checked. Finally, the shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. In the case of an industrial concern, issue of raw materials, stores and tools to the factory and receipts of manufactured goods in the godown also should be verified with relative source documents.

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer. For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated. In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent.

The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.

- (b) (i) **According to Section 139(7) of the Companies Act, 2013**, the auditors of a government company shall be appointed or re-appointed by the Comptroller and Auditor General of India(C&AG). As per section 2(45), a Government company is defined as any company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a Government Company as thus defined.

In the given case, Ajanta Ltd is a government company as its 20% shares have been held by Central Government, 25% by U.P. State Government and 10% by M.P. State Government. Total 55% shares have been held by Central and State governments, therefore, it is a Government company.

Nick Ltd. is a subsidiary company of Ajanta Ltd. Hence, Nick Ltd. is covered in the definition of a government company. Therefore, auditor of Nick Ltd. can be appointed only by C&AG.

Consequently, appointment of Mr. Prem is invalid and he should not give acceptance to the Directors of Nick Ltd.

- (ii) **Services not to be Rendered by the Auditor:** Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under the Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

- (i) accounting and book keeping services;
- (ii) internal audit;
- (iii) design and implementation of any financial information system;
- (iv) actuarial services;
- (v) investment advisory services;
- (vi) investment banking services;
- (vii) rendering of outsourced financial services;
- (viii) management services; and
- (ix) any other kind of services as may be prescribed.

Further section 141(3)(i) of the Companies Act, 2013 also disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

In the given case, CA Innocent was appointed as an auditor of Contravene Ltd. He was offered additional services of actuarial, investment advisory and investment banking which was also approved by the Board of Directors. The auditor is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

- (c) As per SA 220, Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, Engagement Partner shall:
- Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;

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

Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

In the given case, Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

OR

Review in the Assessment of Independence of the Practicing Unit – The reviewer should carry out the compliance review of the five general controls, i.e., independence, maintenance of professional skills and standards, outside consultation, staff supervision and development and office administration and evaluate the degree of reliance to be placed upon them. The degree of reliance will, ultimately, affect the attestation service engagements to be reviewed.

Aarav, a practicing Chartered Accountant should review following controls in respect of assessment of independence of the practicing unit:

- Does the practice unit have a policy to ensure independence, objectivity and integrity, on the part of partners and staff? Who is responsible for this policy?
- Does the practice unit communicate these policies and the expected standards of professional behaviour to all staff?
- Does the practice unit monitor compliance with policies and procedures relating to independence?
- Does the practice unit periodically review the practice unit's association with clients to ensure objectivity and independence?

MOCKTEST PAPER 1
FINAL (NEW) COURSE GROUP I
PAPER 4: CORPORATE AND ECONOMIC LAWS

Question no. 1 is compulsory.

*Attempt any **four** questions out of the remaining **Five** questions*

Time Allowed: 3 Hours

Maximum Marks-100 Marks

DIVISION A: MULTIPLE CHOICE QUESTIONS (TOTAL OF 30 MARKS)

Instructions: All questions are compulsory.

Questions nos. 1-11 are of 2 marks each and from 12- 19 are of 1 marks each)

1. Three directors, namely Samiksha, Santosh and Samta intimated Pluto Plastic & Mechanical Toys Limited about their participation in the Board Meetings through video conferencing at the appropriate time of the year. However, after attending the first Board Meeting held in the Financial Year 2019-20 by means of video conferencing, Santosh wants to participate in the next Meeting to be held at a future date in person. Is it possible for him to do so when consent given for participation in meetings through video conferencing remains valid for full one year.
 - (a) No, Santosh cannot attend future Board Meetings in person even if the company is intimated of such intention sufficiently in advance.
 - (b) Yes, Santosh can attend future Board Meetings in person if he intimates the company of his intention sufficiently in advance.
 - (c) Yes, Santosh can attend future Board Meetings in person only if all the remaining directors consent to such request.
 - (d) Yes, Santosh can attend future Board Meetings in person but at least seventy five percent of the remaining directors (rounded off to next higher figure in case of a fraction) consent to such request.

2. A highly reputed construction company of Mumbai, decided to launch an ultra modern residential project in Goa especially for non-resident HNI Indians. For the purpose it appointed 4 agents worldwide to look for prospective buyers for 12 exclusive flats. The terms of their appointment clearly mentioned that they themselves will be responsible for inward remittance on the flats booked by them. As the project was one of its kind, so it got overwhelming response and all the flats got booked. However only 2/3 of the price of each flat could be remitted into India through proper channel during the financial year ended on 31st March 2019. Price of per flat was USD 1500000 inclusive of all. From the following how much maximum commission can be given to each agent, without any intervention of any authority. Each agent booked 3 flats.
 - (a) 75000 USD
 - (b) 150000 USD
 - (c) 225000 USD
 - (d) 300000USD

3. Mr. X took multiple loans for the same home from three different banks. The total amount is greatly in excess of the actual value of the property, which is 2 crores. Out of this amount, he invested 50 lakh in shell companies abroad. He bought one property in his son name at Jaipur worth 30 lakh out of which he took loan of 10 lakh. Mr. X gifted a diamond set to his wife worth 10 lakh. Mr. X bought one house in London for 1 Crore via Mr. Z a hawala broker. Mr. X gave his driver M, 10 lakh to keep it in safe place. Mr. A, a financial manager of Mr. X knew about all the transactions. Who all are liable in these chain of transactions?
- (a) Mr. X and Mr. Z
 - (b) Mr. X, his wife and son, Mr. Z and Mr. A
 - (c) Mr. X, Mr. Z, Mr. A and Mr. M
 - (d) Mr. X, Mr. Z and Mr. M
4. All the three directors of Cygnus Wires Limited generally remain out of India for developing connections and securing business opportunities on behalf of the company. However, the company must strictly follow the legal requirement that at least one of its directors must stay for the specified statutory period in India. To reckon as 'resident director' for the financial year 2018-19, advise the company as to which period spent in India by Jennifer shall count towards statutory period.
- (a) Period spent in India during the previous financial year 2017-18.
 - (b) Total of fifty percent each of the period spent in India during the financial year 2016-17 and 2017-18.
 - (c) Period spent in India during the financial year 2018-19.
 - (d) Total of fifty percent each of the period spent in India during the financial year 2017-18 and 2018-19.
5. Kumar Ltd. filed a complaint to conduct an inquiry against the past directors who were in whole time employment of the company for the entering into an arrangement of business of vested interest. Registrar was of the opinion that further information were necessitated to disclose the state of affairs that existed in the company. A notice was served to the company to furnish such information. Examine in the light of the given situation, the correct statement of the following as to the conduct of enquiry in the said matter-
- (a) No enquiry can be conducted on said business arrangement because past directors are no more part of the Kumar Ltd.
 - (b) Enquiry can be conducted by seeking an information by serving notice to the Kumar Ltd and all the officers.
 - (c) Enquiry can be conducted by seeking required information from the past directors (officers who were earlier in employment of the company) and they are bound to furnish information and explanation to the best of their knowledge.
 - (d) No enquiry can be conducted as central government is authorised to look into the matter.
6. Rachna, Ridhdhi, Ruby and Rakhi are directors in Zippona Tours and Travellers Private Limited whose equity shares are partly paid-up. The company required the shareholders to make payment of Rs. 3 per share (FV Rs. 10 per share) being the final call in respect of shares held by them latest by 30th June, 2018. As director, Ruby held individually 2,00,000 shares and also at the same time held jointly 1,00,000 shares along with her brother Rajesh whose name appeared first in the Register of Members. In respect

of 2,00,000 shares held individually by her, Ruby duly made the payment before the last date; however, in respect of joint shareholding of 1,00,000 shares, Rajesh was unable to make payment even though six months also expired from the last day i.e. 30th June, 2018. Advise whether Ruby incurs any disqualification regarding her directorship in the company.

- (a) Since Rajesh's name appears first in the Register of Members, he is primarily responsible for making payment and therefore Ruby incurs no disqualification regarding her directorship in the company for non-payment of required amount in respect of joint shareholding; moreover, she has already discharged her liability in respect of shares individually held by her.
 - (b) In case of joint shareholding, if Ruby earlier made payment of Rs. 7 per share from her personal bank account then she is also liable to pay Rs. 3 per share before the expiry of six months from the last date of payment i.e. 30th June, 2018; otherwise she is disqualified to be a director in the company irrespective of discharging her liability in respect shares individually is held by her.
 - (c) In case of joint shareholding, Ruby as director is equally liable to get the payment made similar to her individual shareholding before the expiry of six months from the last date of payment i.e. 30th June, 2018; otherwise she is disqualified to be a director in the company.
 - (d) In case of joint shareholding, Ruby as director is liable to get the payment made in respect of 50% of the joint holding and if that is done before the expiry of six months from the last date of payment i.e. 30th June, 2018, she incurs no disqualification regarding her directorship in the company irrespective of whether the remaining 50% is received by the company or not.
7. Infra Ltd. was wound up by an order of Tribunal dated 10th March, 2019 by the Tribunal. The appointed official liquidator of the company noticed that the MD of the Infra Ltd. had sold certain properties belonging to the company to a Supra Pvt. Ltd. in which his brother was interested on 15th October, 2018. This caused loss to the Infra Ltd. to the extent of INR 60 lakhs. Examine the course of action, the official liquidator can take in this matter.
- (1) The official liquidator can recover the sale of assets of the company as per the Section 328 of the Companies Act, 2013
 - (2) The transaction made will be regarded as invalid and restore the position of the company.
 - (3) This transaction made will be regarded as valid as being made under ordinary course of its business.
- (a) Only statement (1) is correct
 - (b) Only statement (2) is correct
 - (c) Only statement (3) is correct
 - (d) Statements (1) & (2) are correct
8. Mr. K, a Manager of XYZ Ltd. retired on 12th May 2019. On examination of the final accounts of the company for the year ended on 31st March 2019, the Registrar of Companies found some serious irregularities in writing off of the huge amounts of bad debts and no satisfactory explanation was provided for the same from the company. In such a situation the Registrar of Companies wants some explanation from the company and Mr. K. Can the ROC seek explanation from Mr. K? Advice –
- (a) No, Mr. K can't be called upon, as he does not hold the position or any office in the company any more.
 - (b) Mr. K can be called upon within a period of one year from the date of completion of his service.

- (c) Mr. K can be called upon for necessary explanation within a period of 180 days from the date of leaving his office through a written notice served upon him.
- (d) Mr. K can be called upon by the Registrar through a written notice served on him without any time period limit.
9. Vision Ltd., a foreign Company incorporated in Singapore, appointed Mr. X as a representative in India for the management of place of business in India. Due to un-satisfactory services of Mr. X, Vision Ltd. replaced him and appointed Mr. Y. Vision Ltd. is required to comply with which of the following requirement-
- (a) Vision Ltd. shall file return to the Registrar of Company in India, within 30 days of the appointment of Mr. Y
- (b) Vision Ltd. being a foreign co. in singapore does not require to give any such intimation of replacement/ change made for management of place of business in India
- (c) Vision Ltd. shall intimate of such alteration at the place where its registered within 15 days from such alteration.
- (d) Vision Ltd. shall file return to the Registrar, within 1 month of such alteration as to appointment of Mr. Y
10. Alpha Industries Limited, a Listed Entity with good market image adhered the required corporate governance practices. The Company maintained its Website, in compliance to the provisions of the SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015. The Company having one material subsidiary company named as Beta Industries Limited. One of the Board Members of the Beta Industries Limited is also Board Member of Alpha industries Limited. Being a consultant of the company, advise time period within which Alpha industries Limited shall submit quarterly and year-to-date standalone financial results to the stock exchange –
- (a) Within 45 days of end of each quarter
- (b) Within 45 days of end of each month
- (c) Within 45 days of end of each quarter, other than the last quarter.
- (d) Within 45 days of end of half year.
11. SEBI ordered DSE, to produce their books of accounts and audited financial statements for the period 1st April 2016 to 31st March 2018 within 30 days of the receipt of the communication by the stock exchange. The communication was received by the company on 30th April 2018 and no documents were furnished to SEBI in reply to the notice till 15th May 2018. State the consequences of not supplying the said documents to SEBI:
- (a) Period of submission of said documents may be condoned on reasonable grounds.
- (b) Show cause notice may be served why DSE not be penalized for not submitting of the documents within the time limit.
- (c) DSE shall be punishable with a fine.
- (d) DSE shall be punishable with fine and imprisonment.
12. NCLT shall appoint an interim resolution professional within how many days from the insolvency commencement date:
- (a) 7 days

- (b) 10 days
 - (c) 14 days
 - (d) 30 days
13. Save as otherwise provided in Insolvency and Bankruptcy Code, 2016, all the decisions of the committee of the creditors shall be taken by a vote of not less than----- of voting share of the financial creditors.
- (a) 51%
 - (b) 66%
 - (c) 75%
 - (d) 90%
14. State the required majority in the case where a company wants to file an application to the registrar for removal of names of the company from the register of companies for its failure to commence its business within one year of its incorporation-
- (a) Required consent of fifty one per cent members holding shares in the company
 - (b) Required consent of ninety per cent members holding shares in the company
 - (c) Required consent of seventy-five per cent members present in the meeting approving for filing of an application for removal of names
 - (d) Required consent of seventy-five per cent members in terms of paid-up share capital
15. Adjudicating authority received a complaint against Mr. R for being involved in activities connected to the proceeds of crime due to his unlawful association. On the basis of available evidence, Adjudicating authority called Mr. R to give details of his sources of income, earning or assets etc. The notice period of summoning to Mr. R will be –
- (a) not less than fifteen days
 - (b) less than thirty days
 - (c) not less than thirty days
 - (d) sixty
16. What is the main purpose of the Arbitration and Conciliation Act, 1996?
- (a) to consolidate and amend the law relating to domestic arbitration, international commercial arbitration and enforcement of foreign arbitral awards as also to define the law relating to conciliation and for matters connected therewith or incidental thereto.
 - (b) to cover enforcement of domestic arbitration
 - (c) to cover international commercial arbitration
 - (d) to cover enforcement of foreign arbitral awards
17. Every asset reconstruction company shall make an application for registration to
- (a) The Reserve Bank in prescribed format.
 - (b) The Central Government

- (c) SEBI
 - (d) A & B both.
18. In case of a contravention of the resolution plan, an application for liquidation can be made by
- (a) Only the original applicant
 - (b) Only by the corporate debtor
 - (c) By any person other than the corporate debtor whose rights have been prejudicially affected
 - (d) By the financial creditors only
19. Where a valuer has been convicted, he shall be liable to_____
- (a) Refund of the remuneration received
 - (b) Pay damages to the company and to any person bearing loss by incorrect or misleading statements of particulars made in his report
 - (c) Both (a) & (b)
 - (d) Only refund of remuneration to the company and no payment of damages to the company and to any person

Descriptive Questions (70 Marks)

Question No. 1 is compulsory

Out of remaining five questions attempt any four

1. (a) Eternal Ltd., a wholly owned government company consisting of 10 directors in its Board with the subsidiary company, Evergreen Ltd., having 9 directors in its board. Referring to the provisions of the Companies Act, 2013, examine the following situations:
- (i) Number of directors liable to retire by rotation in Eternal Ltd. at an AGM.
 - (ii) Number of directors liable to retire in Evergreen Ltd.
 - (iii) What will be the legal situation in case Eternal Ltd. is a listed Government Company?

(6 Marks)

- (b) Shining star limited, a listed company, deals in sole business of trading of Aluminum foils and sheets. Due to economic slowdown and less domestic consumption company was running into the losses. Mr Chander, an eminent professional with vast experience in cost management, was appointed on the Board of company as whole time director. He enjoyed his 75th birthday on the same date of his appointment i.e 18.07.2019.

Following relevant extracts from latest audited financial statements (as on 31 March 2019), were;

1. Authorised Share capital is INRs 390 crores, out of which paid up share capital was INRs 215 crores; company was in process of FPO, hence had balance of INRs 15 crores in share application money account.
2. Balance of reserve and surplus was INRs 170 crores, out of which INRs 150 crores was general reserve and INRs 20 crores was on accounts of revaluation reserve.
3. Outstanding amount for long term loans was INRs 200 crores

4. Company had investment of INRs 40 crores at book value; due to economic slowdown same is not liquid investment
5. Accumulated losses were of INRs 10 crores.

In the light of the stated facts, evaluate the given situations in terms of the relevant provisions of the Companies Act, 2013-

- (i) As to the validity of appointment of Mr. Chander, as managerial person in office of whole time director in Shining Star Limited.
- (ii) Compute the Effective capital of Shining Star Limited for payment of managerial remuneration.
- (iii) Since Shining Star was running in loss, state the maximum amount of remuneration to be paid on yearly basis to each managerial person. **(8 Marks)**

2. (a) The members of company with no paid up share capital, filed a complaint against change in the management of the company due to which it was likely that the affairs of the company will be conducted in a manner that it will be prejudicial to the interest of its 25 members. Total number of members of company were 100. On inquiry and investigation of the complaint, having a reasonable ground to believe that the transfer or disposal of assets of the company may be against the interests of its shareholders. The Tribunal passed an order that such transfer or disposal of assets shall not be made during the period of one year of such order.

Evaluate on the basis of the given facts, the following situations according to the Companies Act, 2013:

- (i) Eligibility of the members to file a complaint.
- (ii) Where if the management dispose of the certain assets in contravention to the order of the Tribunal. **(8 Marks)**

- (b) Examine the given situations in the light of the respective laws:

- (i) Toy Ltd. is a Japanese company having several business units all over the world. It has a robotic unit with its head quarter in Mumbai and has a branch in Singapore. Headquarter at Mumbai controls the branch of robotic unit. Determine the residential status of robotic unit in Mumbai and that of the Singapore branch in reference to FEMA, 1999?
- (ii) Apex Limited failed to repay the amount borrowed from the bankers, ACE Bank Limited, which is holding a charge on all the assets of the company. The Bank took over management of the company in accordance with the provisions of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 by appointing four persons as directors. The company is managed by a Managing Director, Mr. X. Referring to the provisions of the said Act, examine whether Mr. X is entitled to compensation for loss of office.

(3 + 3 = 6 Marks)

3. (a) Eminence Ltd. after passing special resolution filed an application to the registrar for removal of the name of company from the register of companies. 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 Eminence 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 Eminence Ltd. before the registrar.
 - (ii) Consequences if Eminence Ltd. files an application in the above given situation.
 - (iii) In case registrar notifies eminence Ltd as dissolved under section 248 in compliances to the required provisions, what remedy will be available to the aggrieved party? **(8 Marks)**
- (b) (i) The Adjudicating Authority appointed under the Prevention of Money Laundering Act, 2002 issued an order attaching certain properties of XYZ Limited alleged to be involved in money laundering for a specified period. The company aggrieved by the order of the Adjudicating Authority seeks your advice about the remedy that is available under the Act. Analyse and apply the relevant provisions of the Prevention of Money Laundering Act, 2002 in relation to the above given situation. **(3 Marks)**
- (ii) Sohan Lal, a farmer, was found involved in embezzlement of opium cultivated by him. State the nature of the act committed by Sohan Lal in the light of the Prevention of Money Laundering Act, 2002. **(3 Marks)**
4. (a) (i) PQR Ltd., is a listed entity with its subsidiary, Twig Ltd. State the Corporate Governance requirements with respect to the subsidiary of Listed Entity as per the SEBI (LODR) Regulations, 2015. **(4 Marks)**
- (ii) Mr. Vijay is having 400 shares of Travel Everywhere Limited and the current price of these shares in the market is Rs. 100. Vijay's goal is to sell these shares in 6 months' time. However, he is worried that the price of these shares could fall considerably, by then. At the same time, Vijay doesn't want to sell off these shares today, as he conjectured that the share price might appreciate in the near future. Determine how should Mr. Vijay protect his security and reduce the risk of loss on the share price under the Securities Contract (Regulation) Act, 1956? **(4 Marks)**
- (b) Answer the following given situations:-
- (i) Mr. Indian received foreign contribution of amount 1.10 lakh from his relative residing abroad. Examine whether foreign remittances received by Mr. Indian to be treated as foreign contribution as per the FCRA, 2010. **(3 Marks)**
- (ii) Ms. Rajkumari launch her boutique. She contacted with M/s Shyamlal merchants for supply of dress materials. The communication between the parties were over email. There was a term of service between the parties containing that "any disputes regarding quality or delivery shall be submitted to arbitration conducted under the guidance of Indian Clothes Manufacturers Association. Please place your order if the above terms and conditions are agreeable to you." Ms. Rajkumari placed an order. Comment on the validity of the such arbitration agreement according to the Arbitration and Conciliation Act, 1996. **(3 Marks)**
5. (a) Determine the legal positions in the given situations:
- (i) Excel Ltd. committed an offence under the Companies Act, 2013. The offences falls within the jurisdiction of a special court of Bundi district in which the registered office of Excel Ltd was situated. However in that Bundi district, there were two special courts one in X place and other in Y place. Identify the jurisdiction of the special court for trial of an offences committed by Excel Ltd. **(3 Marks)**

(ii) As per provisions of the Companies Act, 2013, what is the status of XYZ Ltd., a Company incorporated in London, U.K., which has a share transfer office at Mumbai? **(2 Marks)**

(iii) ABC Ltd., a foreign company having its Indian principal place of business at Kolkata, West Bengal is required to deliver various documents to Registrar of Companies under the provisions of the Companies Act, 2013. Advise, ABC Ltd. as to submission of desired documents to ROC. **(3 Marks)**

(b) X Ltd. was intending to initiate voluntarily liquidation proceedings. A declaration was made on affidavit of the some of the directors of the X Ltd. verifying full inquiry of the affairs of the company. They declared that the company will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation.

Analyse the given situation and comment whether X Ltd can initiate voluntary liquidation proceeding in compliance with the conditions given in the Insolvency and Bankruptcy Code, 2016. What are the required documents to be accompanied with the declaration?

Also, state the consequences, where if the articles fixed the period of duration for which company may be continued and that period expires. **(6 Marks)**

6. (a) One of the Objects Clauses of the Memorandum of Association of Info Company Limited conferred upon the company power to sell its undertaking to another company with identical objects. Company's Articles also conferred upon the directors whereby power was conferred upon them to sell or otherwise deal with the property of the company. At an Extraordinary General Meeting of the company, members passed an ordinary resolution for the sale of its assets on certain terms and authorized the directors to carry out the sale. Directors refused to comply with the wishes of the members where upon it was contended on behalf of the members that they were the principals and directors being their agents, were bound to give effect to their (members') decisions.

Examining the provisions of the Companies Act, 2013, answer the following:

Whether the contention of members against the non-compliance of members' decision by the directors is tenable?

Whether it is possible for the members usurp the powers which by the Articles are vested in the directors by passing a resolution in the general meeting? **(8 Marks)**

(b) (i) Wisdom Ltd. commits a default against the debt taken from the financial creditor, Mr. F. He initiated the corporate insolvency resolution process against the Wisdom Ltd. as the company defaulted in the payment of financial debt of Rs. 2 lakh. In the mean time, Mr. X, another financial creditor, thereof files an application for initiating corporate insolvency resolution process with the Adjudicating Authority. Examine with reference to the validity as to the filing of an application by Mr. X for initiation of corporate insolvency resolution process? **(3 Marks)**

(ii) What are the possible actions which can be taken against persons / properties involved in Money Laundering? **(3 Marks)**

MODEL TEST PAPER 1
FINAL (NEW) COURSE
PAPER 4: CORPORATE AND ECONOMIC LAWS
SUGGESTED ANSWER/HINTS

DIVISION A: MULTIPLE CHOICE QUESTIONS

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

Descriptive Questions

1. (a) Section 152(6) of the Companies Act, 2013 specifies the legal provision as to the retirement of directors by rotation of public company. According to the said provision, out of retiring directors, 1/3rd of directors must retire every year. However, as per amendment to the Companies Act, 2013, by MCA vide Notification No. 463(E) on 13/6/17, the government companies are exempted from the applicability of Section 152(6) and 152 (7) of the Act. Accordingly, a Government company, which is not a listed company, in which not less than fifty-one per cent of paid up of share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments; and a subsidiary of a Government company, referred above, the provision as to retirement by rotation is not applicable.

Following are the answers in the light of the stated provisions:

- (i) Since Eternal Ltd. is a wholly owned Government Company (other than listed company), so section 152(6) in given circumstances is not applicable. None of the directors of Eternal Ltd. will be retired by rotation under section 152(6).

- (ii) Since Evergreen Ltd. is a subsidiary company of Eternal Ltd. so retirement by rotation is also not applicable here. None of the directors of Evergreen Ltd. will be retired by rotation under section 152(6).
- (iii) In case Eternal Ltd. is a listed Government Company, then section 152(6) will be applicable presuming that a company has not committed a default in filing its financial statements under Section 137 or Annual Return under Section 92 with the Registrar. According to it, the Eternal Ltd will be treated as a public company, with 10 directors in its Board, 3 can be non-retiring and out of 7 retiring directors, 2 must retire every year.
- (b) (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 in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person.

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. Chander in the shining Ltd. being of 75 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 Crores)
Paid up share capital (Excluding share application money) (215-15)	INRs 200
General Reserve (Excluding Revaluation Reserve) (170-20)	INRs 150
Long term loans	INRs 200
Less: Investments (40) and Accumulated losses (10)	(INRs 50)
Effective Capital	INRs 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 INR 250 crore or more then, yearly remuneration per person payable shall not exceed by INR 120 lakh plus 0.01% of the effective capital in excess of INR 250 crore.

The maximum remuneration that may be paid to each managerial person will be $[120 \text{ lakh} + (0.01\% \times 250 \text{ cr})] = 122.5 \text{ lakh}$.

Provided that the remuneration in excess of above limits may be paid if the resolution passed by the shareholders is a special resolution.

2. (a) (i) Section 244 of the Companies Act, 2013 provides the eligibility of members who hold the right to file the application under section 241 for oppression and mismanagement with the Tribunal. These qualifications as provided in section 244 ensure that only the persons with sufficient interest in the affairs of the company can file the petition under section 241 of the Act. According to the section in the case of a company not having a share capital, not less than one-fifth of the total number of its members are eligible to make an application before the Tribunal. Where any members of a company are entitled to make an application under Section 244 (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.

In the given scenario, requirement of minimum numbers of members is fulfilled i.e. it is more than $1/5^{\text{th}}$ of the total number of its members of the company ($1/5 \times 100 = 20$). So the members of the company are eligible to file the petition to tribunal under section 241.

- (ii) According to section 221 of the Companies Act, 2013, if it appears to the Tribunal, on a complaint made by members as specified under section 244(1) that the removal, transfer or disposal of funds, assets, properties of the company is likely to take place in a manner that is prejudicial to the interests of its members, Tribunal may order that such transfer, removal or disposal shall not take place during such period not exceeding three years as may be specified in the order or may take place subject to such conditions and restrictions as the Tribunal may deem fit.

Here in the given case, management disposed of the certain assets within 1 year of such order of Tribunal. So accordingly, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

- (b) (i) Toy Ltd. being a Japanese company would be a person resident outside India. [Section 2(w)]. Section 2(u) defines 'person'. Under clause (vi) of section 2(u), thereof person would include any agency, office or branch owned or controlled by such 'person'. The term such 'person' appears to refer to a person who is included in clauses (i) to (v). Accordingly, robotic unit in Mumbai, being a branch of a company, would be a 'person'.

Section 2(v) defines 'person resident in India'. Under clause (iii) 'person resident in India' would include an office, branch or agency in India owned or controlled by a person resident outside India. Robotic unit in Mumbai is owned or controlled by a person 'resident outside India'. Hence, it would be 'person resident in India'.

However, robotic unit in Mumbai, though not 'owned' controls Singapore branch, which is a person resident in India. Hence *prima facie*, it may be possible to hold a view that the Singapore branch is 'person resident in India'.

- (ii) Apex Limited failed to repay the amount borrowed from the bankers, ACE Bank Limited, which is holding a charge on all the assets of the company. The bank took over management of the company in accordance with the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 by appointing four persons as directors. The company is managed by a Managing Director, Mr. X.

Here, Apex Limited is a borrower and ACE Bank Limited is a secured creditor.

Compensation to Managing director (Mr. X) for loss of office: According to section 16 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, irrespective of anything contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act. However any such

managing director or any other director or manager or any such person in charge of management has the right to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

3. (a) 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 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.

As per the facts application to the registrar for removal of the name of company from the register of companies, was filed by the Eminence 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 Eminence 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 Eminence 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 Eminence Ltd. in the register of companies.
 - A reasonable opportunity is given to the Eminence Ltd. and all the persons concerned.

- (b) (i) Section 25 of the Prevention of Money Laundering Act, 2002 empowers the Central Government to establish an Appellate Tribunal to hear appeal against order of the Adjudicating Authority and other authorities under the Act.

Section 26 deals with the right and time frame to make an appeal to the Appellate Tribunal. Any person aggrieved by an order made by the Adjudicating Authority may prefer an appeal to the Appellate Tribunal within a period of 45 days from the date on which a copy of the order is received by him. The appeal shall be in such form and be accompanied by such fee as may be prescribed. The Appellate Tribunal may extend the period if it is satisfied that there was sufficient cause for not filing it within the period of 45 days.

The Appellate Tribunal may after giving the parties to the appeal an opportunity of being heard, pass such order as it thinks fit, confirming, modifying or setting aside the order appealed against.

The Act also provides further appeal. According to Section 42 any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within 60 days from the date of communication of the order of the Appellate Tribunal.

In the light of the provisions of the Act explained above the company is advised to prefer an appeal to Appellate Tribunal in the first instance.

- (ii) In the present case, Sohan Lal, a farmer, who was involved in embezzlement of opium cultivated by him shall be said to have committed a scheduled offence under the Paragraph 2 of Part A of Schedule to the Prevention of Money Laundering Act, 2002. It covers offences under the Narcotic Drugs and Psychotropic Substances Act, 1985 whereby, embezzlement of opium by cultivator (section 19) is an offence which is illegal by law and hence the person involved in the proceeds of crimes arising out of the commission of scheduled offences shall be liable for commission of trial under PMLA.

Accordingly, as per section 4 of the PMLA, 2002, Sohan Lal shall be liable for the rigorous imprisonment for a term which may extend to 10 years and shall also be liable to fine.

4. (a) (i) Regulation 24: Corporate Governance Requirements with respect to Subsidiary of Listed Entity.

The Board: At least one Independent Director on Board shall be a Director on Board of Unlisted Material Subsidiary. The management of the unlisted subsidiary shall periodically bring to the notice of the board of directors of the listed entity, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary.

A listed entity shall not dispose of shares in its material subsidiary resulting in reduction of its shareholding (either on its own or together with other subsidiaries) to less than 50 % or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting except in cases where such divestment is made under a scheme of arrangement duly approved by a Court/Tribunal or under a resolution plan duly approved under section 31 of the IBC and such an event is disclosed to the recognised stock exchange within one day of the resolution plan being approved.

Selling, disposing and leasing of assets amounting to more than 20% of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of special resolution, unless the sale/disposal/lease is made under a scheme of arrangement duly approved by a Court/Tribunal/ duly approved resolution plan.

- (ii) In this case, Mr. Vijay may opt for 'Option' derivative contract, which is an agreement to buy or sell a set of assets at a specified time in the future for a specified amount. However, it is not obligatory for him to hold the terms of the agreement, since he has an 'option' to exercise the contract. For example, if the current market price of the share is Rs. 100 and he buy an option to sell the shares to Mr. X at Rs. 200 after three-month, so Vijay bought a put option.

Now, if after three months, the current price of the shares is Rs. 210, Mr. Vijay may opt not to sell the shares to Mr. X and instead sell them in the market, thus making a profit of Rs. 110. Had the market price of the shares after three months would have been Rs. 90, Mr. Vijay would have obliged the option contract and sold those shares to Mr. X, thus making a profit, even though the current market price was below the contracted price. Thus, here, the shares of Travel Everywhere Limited is the underlying asset and the option contract is a form of derivative.

- (b) (i) No. As per Section 4(e) of FCRA, 2010 read with Rule 6 of FCRR, 2011, even the persons prohibited under section 3, i.e., persons not permitted to accept foreign contribution, are allowed to accept foreign contribution from their relatives. However, in terms of Rule 6 of FCRR, 2011, any person receiving foreign contribution in excess of one lakh rupees or equivalent thereto in a financial year from any of his relatives shall inform the Central Government in prescribed Form within thirty days from the date of receipt of such contribution.

So Mr. Indian shall inform the Central Government of his receiving of the foreign contribution of 1.10 lakh from his relative due to receiving of foreign contribution in excess of 1 lakh rupees.

- (ii) As per the Arbitration and Conciliation Act, 1996 an agreement must be in writing There is however no requirement for the same to be in writing in one document. There is also no particular form or template for an arbitration agreement. The communication over email of the term of services is proper valid agreement and the same have been stood affirmed by reason of their conduct. This would be an arbitration agreement in writing contained in correspondence between the parties.

5. (a) (i) All offences which are punishable in this Act with imprisonment of 2 years or more, shall be triable only by the special court established for the area in which the registered office of the company in relation to which the offence is committed. According to section 436 where there are more special courts than one for such area, by such one of them as may be specified in this behalf by the high court concerned.

Accordingly, in the given case, there are more than one special court in Bundi district where registered office of Excel Ltd. is situated. The jurisdiction for trial in special court will be specified by H.C of the State (i.e. Rajasthan).

- (ii) In terms of the definition of a foreign company under section 2 (42) of the Companies Act, 2013 a "foreign company" means any company or body corporate incorporated outside India which:

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

According to section 386 of the Companies Act, 2013, for the purposes of Chapter XXII of the Companies Act, 2013 (Companies incorporated outside India), "Place of business" includes a share transfer or registration office.

From the above definition, the status of XYZ Ltd. will be that of a foreign company as it is incorporated outside India, has a place of business in India and it may be presumed that it carries on a business activity in India.

- (iii) The Companies Act, 2013 vide section 380 provides that every foreign company is required to deliver to the Registrar for registration, within 30 days of the establishment of office in India, documents which have been specified therein. According to *the Companies (Registration of Foreign Companies) Rules, 2014*, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.
- (b) Section 59 of the Insolvency & Bankruptcy Code, 2016 empowers a corporate person intending to liquidate itself voluntarily if it has not committed any default, to initiate voluntary liquidation proceedings under the provisions of this Code.

Any corporate person registered as a company shall meet the following conditions to initiate a voluntary liquidation process:-

- (a) A declaration from majority of the directors of the company verified by an affidavit stating
 - i. That they have made a full inquiry into the affairs of the company and have formed an opinion that either the company has no debts or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation; and
 - ii. That the company is not being liquidated to defraud any person.
- (b) The declaration shall be accompanied with the following documents, namely:
 - i. Audited financial statements and a record of business operations of the company for the previous two years or for the period since its incorporation, whichever is later;
 - ii. A report of the valuation of the assets of the company, if any, prepared by a registered valuer.
- (c) After making the declaration the corporate debtor shall within four weeks -
 - i. Pass a special resolution at a general meeting stating that the company should be liquidated voluntarily and insolvency professional to act as the liquidator may be appointed.
 - ii. Pass a resolution at a general meeting stating that the company be liquidated voluntarily as a result of expiry of the period of its duration (fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, if any) and appointing an insolvency professional to act as the liquidator.

Here, in the given situations, according to the above provisions, a declaration made with an affidavit of the some of the directors of the X Ltd. verifying that company have made full inquiry of the affairs of the company, is not in compliance, as the majority was the requirement for initiation of the voluntary liquidation proceedings. And the further declaration that the company is not being liquidated to defraud any person is not given in the affidavit. The documents to be accompanied with declaration shall be as per the point (b) given above in the stated provision.

Where if the articles fixed the period of duration of continuation of the Company and that period expires, X Ltd. after making declaration, shall within 4 weeks pass a resolution at a general meeting stating that the company be liquidated voluntarily as a result of expiry of the period of its duration as fixed by its articles and appointing an insolvency professional to act as the liquidator.

6. (a) **Powers of Board:** In accordance with the provisions of the Companies Act, 2013, as contained under Section 179(1), the Board of Directors of a company shall be entitled to exercise all such powers and to do all such acts and things, as the company is authorized to exercise and do:

Provided that in exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in this Act, or in the memorandum or articles, or in any regulations not inconsistent therewith and duly made there under including regulations made by the company in general meeting.

Provided further that the Board shall not exercise any power or do any act or thing which is directed or required, whether under this Act or by the members or articles of the company or otherwise to be exercised or done by the company in general meeting.

Section 180(1) of the Companies Act, 2013, provides that the powers of the Board of Directors of a company which can be exercised only with the consent of the company by passing of a special resolution. Clause (a) of Section 180(1) defines one such power as the power to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking of the whole or substantially the whole or any of such undertakings.

Therefore, the sale of the undertaking of a company can be made by the Board of Directors only with the consent of members of the company accorded vide a special resolution.

Even if the power is given to the Board by the memorandum and articles of the company, the sale of the undertaking must be approved by the shareholders in general meeting by passing a special resolution.

Therefore, the correct procedure to be followed is for the Board to approve the sale of the undertaking clearly specifying the terms of such sale and then convene a general meeting of members to have the proposal approved by a special resolution.

In the given case, the procedure followed is completely incorrect and violative of the provisions of the Act. The shareholders cannot on their own make out a proposal of sale and pass an ordinary resolution to implement it through the directors.

The contention of the shareholders is incorrect in the first place as it is not within their authority to approve a proposal independently of the Board of Directors. It is for the Board to approve a proposal of sale of the undertaking and then get the members to approve it by a special resolution. Accordingly the contention of the members that they were the principals and directors being their agents were bound to give effect to the decisions of the members, is not correct.

Further, in exercising their powers the directors do not act as agent for the majority of members or even all the members. The members therefore, cannot by resolution passed by a majority or even unanimously supersede the powers of directors or instruct them how they shall exercise their powers. The shareholders have, however, the power to alter the Articles of Association of the company in the manner they like subject to the provisions of the Companies Act, 2013.

- (b) (i) In the given problem, on commission of default by the Wisdom Ltd. against Mr. F, entitled him to file an application for initiating corporate insolvency resolution process before adjudicating authority. Further, Mr. X another financial creditor also moved an application for initiation of insolvency resolution process against the Wisdom Ltd.

According to the section 6 of the Code, where any corporate debtor commits a default, a financial creditor, Operational creditor or the Corporate debtor itself may initiate insolvency resolution process against such corporate debtor.

As per the facts given in the question default has been committed only against Mr. F and not against Mr. X. So Mr. F is prima facie entitled to file an application for initiation of the CIRP.

Further, section 7 of the Code specifies financial creditor either by itself jointly with other financial creditor may file an application only when default has occurred. Since in the given case, default has occurred only against Mr. F and so further no application for initiation of CIRP can be initiated by Mr. X, however he being a creditor, is entitled under the Code to raise his claim in this case against the Wisdom Ltd. in compliance with the Insolvency and Bankruptcy Code, 2016.

- (ii) Following actions can be taken against the persons involved in Money Laundering:-
- (a) Attachment of property under Section 5, seizure/ freezing of property and records under Section 17 or Section 18. Property also includes property of any kind used in the commission of an offence under PMLA, 2002 or any of the scheduled offences.
 - (b) Persons found guilty of an offence of Money Laundering are punishable with imprisonment for a term which shall not be less than three years but may extend up to seven years and shall also be liable to fine [Section 4].
 - (c) When the scheduled offence committed is under the Narcotics and Psychotropic substances Act, 1985 the punishment shall be imprisonment for a term which shall not be less than three years but which may extend up to ten years and shall also be liable to fine.
 - (d) The prosecution or conviction of any legal juridical person is not contingent on the prosecution or conviction of any individual.