MOCK TEST PAPER

FINAL (OLD) COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

*Question No. **1** is compulsory.*

*Attempt any **five** questions from the remaining **six** questions.*

Working notes should form part of the answer.

Wherever necessary, suitable assumption(s) may be made by the candidates.

1. (a) How will you disclose following items while preparing Cash Flow Statement of Gagan Ltd. as per AS 3 for the year ended 31st March, 20X2?

(i)	10% Debentures:	As on 01-04-20X1	Rs. 1,10,000
		As on 31-03-20X2	Rs. 77,000

(ii) Debentures were redeemed at 5% premium at the end of the year. Premium was charged to the Profit & Loss Account for the year.

(iii)	Unpaid Interest on Debentures:	As on 01-04-20X1	Rs. 275
		As on 31-03-20X2	Rs. 1,175

(iv) Debtors of Rs. 36,000 were written off against the Provision for Doubtful Debts A/c during the year.

(v)	10% Bonds (Investments):	As on 01-04-20X1	Rs. 3,50,000
		As on 31-03-20X2	Rs. 3,50,000
(vi)	Accrued Interest on Investments:	As on 31-03-20X2	Rs. 10,500

(b) Samvedan Limited is a non-banking finance company. It accepts public deposit and also deals in hire purchase business. It provides you with the following information regarding major hire purchase deals as on 31-03-20X1. Few machines were sold on hire purchase basis. The hire purchase price was set as Rs. 100 lakhs as against the cash price of Rs. 80 lakhs. The amount was payable as Rs. 20 lakhs down payment and balance in 5 equal instalments. The hire vendor collected first instalment as on 31-03-20X2, but could not collect the second instalment which was due on 31-03-20X3. The company was finalising accounts for the year ending 31-03-20X3. Till 15-05-20X3, the date on which the Board of Directors signed the accounts, the second instalment was not collected. Presume IRR to be 10.42%.

Required:

(i) What should be the principal outstanding on 1-4-20X2? Should the company recognize finance charge for the year 20X2-20X3 as income?

(ii) What should be the net book value of assets as on 31-03-20X3 so far Samvedan Ltd. is concerned as per NBFC prudential norms requirement for provisioning?

(iii) What should be the amount of provision to be made as per prudential norms for NBFC laid down by RBI?

(c) From the given information, you are required to compute the deferred tax assets and deferred tax liability for Ramanujam Limited as on 31st March 20X2. The tax rate applicable is 35%.

(i) The company has charged depreciation of Rs. 7,42,900 in its books of accounts while as per income-tax computation, the depreciation available to the company is Rs. 8,65,400.

(ii) The company has made provision for doubtful debts for Rs. 54,300 during the year.

(iii) The company has debited share issue expenses of Rs. 6,23,500 which will be available for deduction under the Income-tax Act from the next year.

(iv) The expense of Rs. 7,84,500 has been charged to profit and loss account which are disallowed under the Income-tax Act.

(v) The company has made donation of Rs. 2,00,000 which has been debited to profit and loss account and only 50% thereof will be allowed as deduction as per Income-tax law.

(d) A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment.

What is the cash-generating unit? ***(4 x 5 Marks each = 20 Marks)***

2. The summarized Balance Sheet of three companies R. Ltd. S Ltd. and T Ltd. as on 31st March are given as below:

	As on 31st March, 20X2 (Rs. in lakhs)		
	R Ltd.	S Ltd.	T Ltd.
Equity and Liabilities			
Shareholder's Funds			
Equity Shares (Rs. 10 each fully paid up)	300	250	200
10% Non-convertible Cumulative Preference Shares (Rs. 100 each fully paid up)	75	60	50
Capital Reserve	600		
General Reserve	125	75	50
Profit & Loss Account	480	170	110
Non-current Liabilities			
Secured Loan:			
12,500, 11% Mortgage Debenture Bonds of Rs. 1,000 each	125	-	-
Bank Loans	765	355	260
Unsecured Loan:			
From S Ltd.	-	-	60
From T Ltd.	75	-	-
Deposit from Public	90	60	15
Current Liabilities:			
Inter-company balances	45	-	-
Other Liabilities & Provision	1,570	625	355
	4,250	1,595	1,100

Assets			
Non-Current Assets			
Property, Plant and Equipment: Tangible Assets	1,695	625	320
Investment (At Cost):			
15,00,000 shares of S Ltd.	150		
4,00,000 Equity Shares of T Ltd.	40		
8,00,000 Equity Shares of T Ltd.		120	
50,000 Cumulative Preference Shares of R Ltd.			50
7,500 Mortgage Debentures of R Ltd.			70
Current Assets	2,365	850	660
	4,250	1,595	1,100

Additional Information:

(i) R Ltd. subscribed for the shares of S Ltd. and T Ltd. at par at the time of first issue of shares by both the companies.

(ii) S Ltd. subscribed for 4,00,000 shares of T Ltd. at par at the time of first issue and later on it acquired by purchase in the market 4,00,000 shares of T Ltd. at Rs. 20 each when balance in General Reserve and Profit & Loss Account of T Ltd. stood at Rs. 25 lakhs and Rs. 40 lakhs respectively.

(iii) Current assets of S Ltd. and T Ltd. included Rs. 20 lakhs and Rs. 30 lakhs respectively being the current account balance against R Ltd. These accounts remained unreconciled.

Prepare the consolidated balance sheet of the group as on 31st March, 20X2. ***(16 Marks)***

3. AB Ltd. and CD Ltd. two private companies, decide to amalgamate their business into a new holding company EF Ltd., which was incorporated on 1st August, 20X1 with an authorised capital of Rs. 40,00,000 in equity shares of Rs. 10 each. The new company plans to commence operations on 1st October, 20X1.

From the information given below, and assuming that all transactions are completed by 31st March, 20X2, you are required to:

(a) Prepare Projected Statement of Profit & Loss of EF Ltd. for the six months ending 31st March, 20X2.

(b) Prepare Projected Balance Sheet of EF Ltd. as on 31st March, 20X2.

(c) Show the computation of number of shares to be issued to the former shareholders of AB Ltd. and CD Ltd.

Information

(1) EF Ltd. will acquire the whole of the Equity share capital of AB Ltd. and CD Ltd. by issuing its fully paid own shares.

(2) The number of shares to be issued is to be calculated by multiplying the future annual maintainable profits available to the Equity shareholders in each of the two companies by agreed price earnings ratios.

The following information is relevant:

	AB Ltd. (Rs.)	*CD Ltd. (Rs.)*
Equity Shares of Rs. 10 each fully paid	10,00,000	4,00,000
8% Cumulative Preference shares		1,00,000
10% Debentures	2,00,000	
Future annual maintainable pre-tax profits (before interest/ dividend)	2,30,000	1,12,000
Price Earnings Ratio	10 times	8 times

(3) Shares in the holding company are to be issued to the shareholders in subsidiary companies at a premium of 20% and thereafter these shares will be marketed on the stock exchange.

(4) It is expected that the Group profits of the new company in 20X1-X2 will be at least Rs. 4,50,000 but that will be required as additional working capital to facilitate expansion. Accordingly, it is planned to make a further issue of 37,500 Equity shares to the public for cash at a premium of 30% on 1st February, 20X2. The new shares will not rank for interest/dividend to be paid on 31st March, 20X2.

(5) Out of the proceeds of the right issue EF Ltd. will advance Rs. 2,50,000 to AB Ltd. and Rs. 2,00,000 to CD Ltd. on 1st February, 20X2 for working capital. These advances will carry interest @ 15% p.a. to be paid monthly.

(6) Preliminary Expenses are estimated at Rs. 8,000 and Administrative Expenses for the half-year ended 31st March, 20X2 at Rs. 16,000 but this expenditure will be covered by temporary overdraft facility. It is estimated that Interest on Bank Overdraft cost will be Rs. 1,600 in the first six months.

(7) A provision for Rs. 7,500 should be made for Directors Fee for the half-year.

(8) On 31st March, 20X2, Interim Dividends on Equity Shares, will be paid by AB Ltd. @ 5%, by CD Ltd. @ 4.4% and by EF Ltd. @ 4%.

(9) Income tax is to be taken @ 50% for calculation of number of shares. However, ignore tax effect while preparing Projected Statement of Profit and Loss. ***(16 Marks)***

4. (a) As point of staff welfare measures, Y Co. Ltd. has contracted to lend to its employees sums of money at 5 percent per annum rate of interest. The amounts lent are to be repaid in five equal annual instalments alongwith the interest on the principal amount due. The market rate of interest is 10 per cent per annum.

Y lent Rs. 16,00,000 to its employees on 1st January, 20X1.

Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for the year ended 31st December, 20X1 for the transaction and also calculate the value of the loan initially to be recognized and the amortized cost for all the subsequent years.

For purposes of calculation, the following discount factors at interest rate of 10 percent may be adopted.

At the end of year

1	0.909
2	0.827
3	0.751
4	0.683
5	0.620

(b) Kush Ltd. announced a Share Based Payment Plan for its employees who have completed 3 years of continuous service, on 1st of April, 20X1. The plan is subject to a 3 year vesting period. The following information is supplied to you in this regard:

(i) The eligible employees can either have the option to claim the difference between the exercise price of Rs. 144 per share and the market price in respect of the share on vesting date in respect of 5,000 shares or such employees are entitled to subscribe to 6,000 shares at the exercise price.

(ii) Any shares subscribed to by the employees shall carry a 3 year lock in restriction. All shares carry face value of Rs. 10.

(iii) The Current Fair Value of the shares at (ii) above is Rs. 60 and that in respect of freely tradable shares is higher by 20%.

(iv) The Fair Value of the shares not subjected to lock in restriction at the end of each year increases by a given % from its preceding value as under:

Year	% of Increase
20X1-X2	6
Year 20X2-X3	10
Year 20X3-X4	15

You are required to draw up the following accounts under both options:

(I) Employee Compensation Account,

(II) Provision for Liability Component Account,

(III) ESOP Outstanding Account **_(8+8=16 Marks)_**

5. (a) Value Added Ltd. furnishes the following Profit and Loss A/c:

Profit and Loss A/c for the year ended 31st March, 20X1

Income	Notes	Rs. ('000)
Turnover	1	29,872
Other Income		1,042
		30,914
Expenditure		
Operating expenses	2	26,741
Interest on 8% Debentures		987
Interest on Cash Credit	3	151
GST		1,952
		29,831
Profit before depreciation		1,083
Less: Depreciation		(342)
Profit before tax		741
Provision for tax	4	376
Profit after tax		365
Less: Transfer to Assets Replacement Reserve		(65)
		300
Less: Dividend paid		(125)
Retained Profit		175

Notes:

(1) Turnover is based on invoice value and net of sales tax.

(2) Salaries, wages and other employee benefits amounting to Rs. 14,761 ('000) are included in operating expenses.

(3) Cash Credit represents a temporary source of finance. It has not been considered as a part of capital.

(4) Transfer of Rs. 54 ('000) to the credit of deferred tax account is included in provision for tax.

Prepare value added statement for the year ended 31st March, 20X1 and reconcile total value added with profit before taxation.

(b) Prosperous Bank has a criterion that it will give loans to companies that have an "Economic Value Added" greater than zero for the past three years on an average. The bank is considering lending money to a small company that has the economic value characteristics shown below. The data relating to the company is as follows:

(i) Average operating income after tax equals Rs. 25,00,000 per year for the last three years.

(ii) Average total assets over the last three years equals Rs. 75,00,000.

(iii) Weighted average cost of capital appropriate for the company is 10% which is applicable for all three years.

(iv) The company's average current liabilities over the last three years are Rs. 15,00,000.

Does the company meet the bank's criterion for a positive economic value added? ***(16 Marks)***

6. A Company Q is willing to sell its business. The purchaser has sought professional advice for the valuation of the goodwill of the company. He has the last audited financial statements together with some additional information. Help him to ascertain the correct price for the purpose of purchase:

The extract of the Balance Sheet as on 31.3.20X4 is as under:

Liabilities	Rs.	Assets	Rs.
Equity Share Capital (shares of Rs. 100 each)	9,50,000	Goodwill	2,75,000
8% Preference Share Capital (shares of Rs. 100 each)	2,25,000	Land & Building	5,45,000
Reserves & Surplus	10,25,500	Plant & Machinery	4,55,000
9% Debentures	5,60,000	Investments in shares	4,85,000
Current Liabilities	3,25,640	Inventories	3,80,000
		Trade Receivables (net)	4,25,620
		Cash & Bank balance	5,20,520
	30,86,140		30,86,140

(1) The purchaser wants to acquire all the equity shares of the company.

(2) The Debentures will be redeemed at a discount of 25% of the value in Balance Sheet and investments in shares will be sold at their present market value which is quoted as Rs. 4,95,200. The above will be prior to the purchase of the equity shares.

For the purpose of pricing of Goodwill:

(3) The normal rate of return on net assets for equity shares is 10%.

(4) Profits after tax for the past three years after debenture interest but before Preference Share Dividend have been as under:

31.3.20X4	Rs. 2,95,000
31.3.20X3	Rs. 4,99,000
31.3.20X2	Rs. 3,25,000

(5) Goodwill is valued at three years purchase of the adjusted average super profit.

(6) In the year 20X3, 20% of the profit mentioned above was due to non-recurring transaction resulting in increase of profit.

(7) The Land & Building has a current rental value of Rs. 62,400 and 8% return is expected from the property.

(8) On 31.3.20X4, 8% of debtors existing on the date had been written as bad and charged to Profit and Loss Account as Provision for Bad debts. The same are now recoverable. Tax is applicable at 35%.

(9) A claim of compensation long contingent of Rs. 25,000 has perspired and is to be accounted for.

(10) No Debenture interest shall be payable in future due to its redemption.

(11) Ignore tax effect on profit on sale of investments and discount on redemption of debentures.

(12) Fair value of assets and liabilities are same as its book values.

(13) Ignore additional depreciation on revaluation of property. ***(16 Marks)***

7. Answer any **four** of the following:

(a) Explain 'Bearer Plant' & 'Biological Asset' as per Ind AS 16 and Ind AS 41. Also state what are excluded from being a bearer plant as per Ind AS 41.

(b) On 1.4.20X1, a mutual fund scheme had 18 lakh units of face value of Rs. 10 each outstanding. The scheme earned Rs. 162 lakhs in 20X1-X2, out of which Rs. 90 lakhs was earned in the first half of the year. On 30.9.20X1, 2 lakh units were sold at a NAV of Rs. 70.

Pass Journal entries for sale of units and distribution of dividend at the end of 20X1-X2.

(c) The closing stock of finished goods at cost of a company amounted to Rs. 4,50,000. The following items were included at cost in the total:

(a) 100 coats, which had cost Rs. 2,200 each and normally sold for Rs. 4,000 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal selling price.

(b) 200 skirts, which had cost Rs. 50 each. These too were found to be defective. Remedial work in April cost Rs. 2 per skirt, and selling expenses for the batch totaled Rs. 200. They were sold for Rs. 55 each.

(c) Shirts which had cost Rs. 50,000, their net realizable value at Balance sheet date was Rs. 55,000. Commission @ 10% on sales is payable to agents.

What should the inventory value be according to AS 2 after considering the above items?

(d) Shrishti Ltd. contracted with a supplier to purchase machinery which is to be installed in its Department A in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were Rs. 1,41,870. These activities were supervised by a technician during the entire period, who is employed for this purpose of Rs. 45,000 per month. The technician's services were given by Department B to Department A, which billed the services at Rs. 49,500 per month after adding 10% profit margin.

The machine was purchased at Rs. 1,58,34,000 inclusive of IGST @ 12% for which input credit is available to Shrishti Ltd. Rs. 55,770 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of Rs. 30,000 to supervise machinery installation at the factory site.

Also, payment under the invoice was due in 5 months. However, the Company made the payment in 3rd month. The company operates on Bank Overdraft @ 14% p.a.

Ascertain the amount at which the Machinery should be capitalized under AS 10.

(e) Goods worth Rs. 6,62,500 were sold on 31.10.20X2 by X Ltd. to Y Ltd. Y Ltd. requested for a trade discount of 8% which was agreed by X Ltd. The sale was effected and goods were dispatched, However, on receipt of the goods, Y Ltd. found that goods worth Rs. 77,500 were damaged. Consequently, Y Ltd. returned the damaged goods to X Ltd. and made the due payment amounting to Rs. 5,32,000. The accountant of X Ltd. booked the sale for Rs. 5,32,000.

Discuss the above treatment by the accountant with reference to applicable Accounting Standard.

(4 x 4 = 16 Marks)

MOCK TEST PAPER

FINAL OLD COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

SUGGESTED ANSWERS/HINTS

1. (a) An extract of Cash Flow Statement of Gagan Ltd. for the year ended 31.3.20X2

A	**Cash Flow from Operating Activities**	
	Net Profit as per Profit & Loss A/c	-
	Add: Premium on Redemption of Debentures	1,650
	Add: Interest on 10% Debentures	11,000
	Less: Interest on 10% Investments	(35,000)
B	**Cash Flow from Investing Activities**	
	Interest on Investments [35,000-10,500]	24,500
C	**Cash Flow from Financing Activities**	
	Interest on Debentures paid [11,000 - 1,175 + 275]	(10,100)
	Redemption of Debentures [(1,10,000 - 77,000) at 5% premium]	(34,650)

Note: Debtors written off against provision for doubtful debts does not require any further adjustment in Cash Flow Statement.

(b) (i) Since, the hire-purchaser paid the first instalment due on 31.3.20X1, the notional principal outstanding on 1-4-20X2 was Rs. 50.25 lakhs (refer W.N.).

In the year ended 31.03.20X3, the instalment due of Rs.s16 lakhs has not been received. However, it was due on 31.3.20X3 i.e on the balance sheet date, and therefore, it will be classified as standard asset. Samvedan Ltd. will recognise Rs. 5.24 lakhs as interest income included in that due instalment as this should be treated as finance charge.

(ii) The net book value of the assets as on 31.3.20X2

	Rs. in lakhs
Overdue instalment	16.00
Instalments not due (Rs. 16 lakhs x 3)	48.00
	64.00
Less: Finance charge not matured and hence not credited to Profit and loss account (4.11 + 2.88 + 1.52)	(8.51)
	55.49
Less: Provision as per para 9(2)(i) of NBFC prudential norms (Refer point (iii))	(7.49)
Net book value of assets for Samvedan Ltd.	48.00

(iii) Amount of Provision

	Rs. in lakhs
Overdue instalment	16.00
Instalments not due (Rs. 16 lakhs x 3)	48.00
	64.00

Less: Finance charge not matured and hence not credited to Profit and loss account (4.11 + 2.88 + 1.52)	(8.51)
	55.49
Less: Depreciated value (cash price less depreciation for two years on SLM @ 20%*)	(48.00)
Provision to be created as per para 9(2)(i) of NBFC prudential norms	7.49

Since, the instalment of Rs. 16 lakhs not paid, was due on 31.3.20X3 only, the asset is classified as standard asset. Therefore, no additional provision has been made for it.

Working Note:

It is necessary to segregate the instalments into principal outstanding and interest components by using I.R.R. @ 10.42%. *(Rs. in lakhs)*

Time	*Opening outstanding amount (a)*	*Cash flow (b)*	*Interest @ 10.42% (c) = (a x 10.42%)*	*Principal repayment (d) = (b – c)*	*Closing outstanding (e) = (a – d)*
31-3-20X1		(60)	-----	---	60.00
31-3-20X2	60.00	16	6.25	9.75	50.25
31-3-20X3	50.25	16	5.24	10.76	39.49
31-3-20X4	39.49	16	4.11	11.89	27.60
31-3-20X5	27.60	16	2.88	13.12	14.48
31-3-20X6	14.48	16	1.52	14.48	0.00

(c) Statement showing calculation of Deferred Tax Asset (DTA) and Deferred Tax Liability (DTL)

S. No.	*Particulars*	*Amount of difference*	*Nature of difference*	*DTA @ 35%*	*DTL @ 35%*
		Rs.		*Rs.*	*Rs.*
(i)	Excess allowable depreciation as per income-tax law	1,22,500	Timing	-	42,875
(ii)	Provision for doubtful debts - disallowed as per income-tax law in the current year but reversible in future years.	54,300	Timing	19,005	-
(iii)	Share issue expenses charged in the accounting books but allowed as deduction in the income-tax law from the next year	6,23,500	Timing	2,18,225	-
(iv)	Disallowed expenses as per income tax law	7,84,500	Permanent	-	-
(v)	Donation debited to Profit & Loss Account				
	Allowed as per income tax	1,00,000	No difference	-	-
	Disallowed as per income tax	1,00,000	Permanent	-	-
				2,37,230	42,875

(d) It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other

* As per NBFC prudential norms laid down by the RBI.

titles in the customer segment, cash inflows from direct sales and advertising are identifiable for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent one from another and that each magazine title is a separate cash-generating unit.

2. Consolidated Balance Sheet of R Ltd. and its Subsidiaries

S Ltd. and T Ltd. as on 31st March 20X2

	Particulars	*Note No.*	*Rs. in lakhs*
I	Equity and Liabilities		
	(1) Shareholder's Funds		
	(a) Share Capital	1	325
	(b) Reserve and Surplus	2	1,416.80
	(2) Minority Interest		475.20
	(3) Non-current Liabilities		
	Long term borrowings	3	1,595.00
	(4) Current liabilities		
	Other-current liabilities	4	2,550.00
	Total		6,362.00
(II)	Assets:		
	(1) Non-current assets		
	(a) Fixed Assets		
	(i) Tangible assets	5	2,640.00
	(ii) Intangible assets	6	27.00
	(2) Current assets	7	3,695.00
	Total		6,362.00

Notes to Accounts:

	Particulars			*Rs. in lakhs*
1.	Share Capital			
	30,00,000, Equity Shares of Rs. 10 each fully paid		300.00	
	25,000, 10% Cumulative Preference Shares of Rs. 100 each fully paid		25.00	325.00
2.	Reserve and Surplus			
	Capital Reserve		600.00	
	General Reserve		189.00	
	Profit & Loss A/c		627.80	1,416.80
3.	Long Term Borrowings			
	Secured Loans: 5,000, 11% Mortgage Debenture Bonds of Rs. 1,000 each		50	
	Bank Loans:			
	R Ltd.	765		
	S Ltd.	355		

	T Ltd.	260	1,380	
			1430	
	Unsecured loans:			
	Deposits from public (90 + 60 + 15)		165	1,595
4.	Other Current liabilities			
	R Ltd.		1,570	
	S Ltd.		625	
	T Ltd.		355	2,550
5.	Tangible assets			
	R Ltd.		1,695	
	S Ltd.		625	
	T Ltd.		320	2,640
6.	Intangible Assets			
	Goodwill			27
7.	Current Assets			
	R Ltd.		2,365	
	S Ltd.		850	
	T Ltd.		660	
			3,875	
	Less: Mutual indebtedness:			
	Unsecured loans (75 + 60)	135		
	Inter-company balances	45	(180)	3,695

Working Notes:

1. Shareholding Pattern

	S Ltd.	*T Ltd.*
Total Shares	25,00,000	20,00,000
Held by R Ltd.	15,00,000 i.e. 60%	4,00,000 i.e. 20%
Held by S Ltd.		8,00,000 i.e. 40%
Minority Interest	10,00,000 i.e. 40%	8,00,000 i.e. 40%

S Ltd. is the subsidiary of R Ltd. since the issue of shares by S Ltd.

T Ltd. is the subsidiary of S Ltd. after acquisition of 4,00,000 shares from the market. Thereafter, both S Ltd. and T Ltd. become the subsidiary of R Ltd. Hence, capital profit will be Rs. 65 lakhs (General Reserve Rs. 25 lakhs and Profit & Loss Account Rs. 40 lakhs). 20% of Rs. 65 lakhs i.e. Rs. 13 lakhs which will be considered as Capital Profit (pre-acquisition) for T Ltd. and remaining will be revenue profit (post-acquisition).

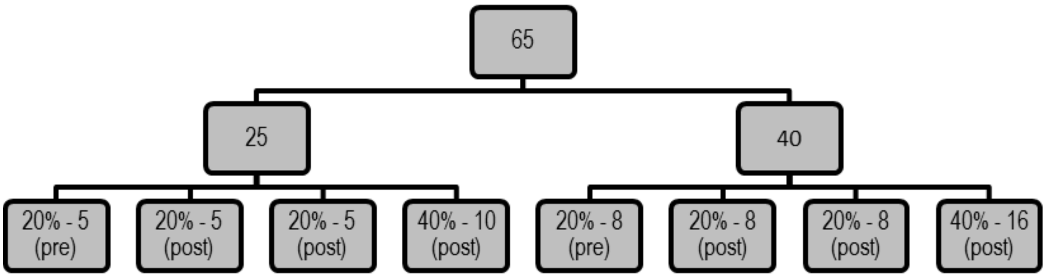
2. Profit on Debentures of R Ltd. held T Ltd.

	Rs. in lakhs
Nominal value of 7500 Debentures of Rs. 1,000 each	75.00
Less: Amount paid for Debentures	(70.00)
Profit to be transferred to Profit & Loss A/c	5.00

Therefore, the balance in Profit and Loss Account of T Ltd. will be (110+5) lakhs, i.e.115 lakhs. The post-acquisition profits will be Rs. 75 lakhs (115 - 40).

3. **Analysis of profits of T Ltd.**

			(Rs. in lakhs)
	Pre-acquisition	*Post-acquisition*	
	Capital profit	*General Reserve*	*Profit and Loss A/c*
Share of R Ltd. 20%	13	5+5 =10	8+15 =23
Share of S Ltd. 40%		5+10 = 15	8+30 =38
Share of Minority Interest 40%	___	10+10 =20	16 +30 = 46
Total	13	45	107



4. **Analysis of profits of S Ltd.**

		(Rs. in lakhs)
	Post-acquisition	
	General Reserve	*Profit & Loss A/c*
Balance on 31.3.20X2	75	170
Add: Share in post-acquisition profits from T Ltd.	15	38
Total	90	208
Share of R Ltd. (60%)	54	124.80
Share of Minority (40%)	36	83.20
Total	90	208.00

5. **Cost of Control**

			(Rs. in lakhs)
	R Ltd. in S Ltd.	*R Ltd. in T Ltd*	*S Ltd. in T Ltd*
Cost of investments	150	40	120
Less: Share Capital	(150)	(40)	(80)
Capital Profits	-	(13)	-
Capital Reserve/Goodwill	-	(13)	40
Net Goodwill			27

6. **Minority Interest**

		(Rs. in lakhs)
	S Ltd.	*T Ltd.*
Equity Share Capital	100.00	80.00

Capital profit		
General Reserves	36.00	20.00
Profit & loss Account	83.20	46.00
	219.20	146.00
Preference Share Capital	60.00	50.00
Total	279.20	196.00

Total Minority Interest = Rs. (279.20 + 196) lakhs = Rs. 475.20 lakhs.

7. General Reserve & Profit & Loss Account balances in Consolidated Balance Sheet

	General Reserve	*Profit and Loss A/c*
Balance as per books	125.00	480.00
Add: Share in post-acquisition profits from:		
S Ltd.	54.00	124.80
T Ltd.	10.00	23.00
Total	189.00	627.80

3. (a) Projected Profit and Loss Account of EF Ltd. for the period ending 31st March, 20X2

Particulars	*Rs.*
Total Revenue	
Dividend Income [50,000 + 17,600]	67,600
Interest Income	11,250
	78,850
Less: Expenses	
Finance Costs (Interest on Bank Overdraft)	(1,600)
Other Expenses [Directors Fee (7,500) + Administrative Expenses (16,000) + Preliminary expenses (8,000)]	(31,500)
Profit before tax	45,750

(b) Projected Balance Sheet of EF Ltd. as on 31st March, 20X2

	Particulars	Note No.	(Rs.)
I.	Equity and Liabilities		
	(1) Shareholders' Funds		
	(a) Share Capital	1	15,70,000
	(b) Reserves and Surplus	2	3,49,450
	(2) Non-Current Liabilities		
	(3) Current Liabilities		
	(a) Other Current Liabilities	3	23,500
	Total		19,42,950
II.	Assets		
	(1) Non-Current Assets		
	Non-Current Investments	4	14,34,000

	(2) Current Assets		
	(a) Cash and Cash Equivalents (Refer W.N.)		58,950
	(b) Other Current Assets		4,50,000
	Total		19,42,950

Notes to Accounts:

	Particulars		*(Rs.)*
1.	**Share Capital**		
	Authorised share capital		
	4,00,000 Equity shares of Rs. 10 each		40,00,000
	Issued share capital		
	1,57,000 Equity Shares of Rs. 10 each		15,70,000
	(Of the above 1,19,500 shares were issued for consideration other than cash)		
2.	**Reserves and Surplus**		
	Securities Premium [2,39,000 + 1,12,500]		3,51,500
	Profit & Loss Account	45,750	
	Less: Interim dividend (Rs. 11,95,000 x 4%)	(47,800)	(2,050)
			3,49,450
3.	**Other Current Liabilities**		
	Bank Overdraft	16,000	
	Directors Fee	7,500	23,500
4.	**Non-current investment**		
	Investment in shares of AB Ltd. @ Rs. 12	10,50,000	
	Investment in shares of CD Ltd. @ Rs. 12	3,84,000	14,34,000

(c) Computation of Number of Shares to be issued to former shareholders

Particulars	*AB Ltd.*	*CD Ltd.*
	Rs.	*Rs.*
Future Maintainable EBIT	2,30,000	1,12,000
Less: Interest on Debentures	(20,000)	-
	2,10,000	1,12,000
Less: Income tax @ 50%	(1,05,000)	(56,000)
Profit after tax	1,05,000	56,000
Less: Preference Dividend	-	(8,000)
Profit to Equity Shareholders	1,05,000	48,000
PE Ratio	10	8
Capitalised Earning	10,50,000	3,84,000
Number of shares to be exchanged in EF Ltd.		
@ Rs. 12 (including Premium of Rs. 2 each)	87,500	32,000

Working Note:

Bank Account

Particulars	*Rs.*	*Particulars*	*Rs.*
To Equity Share Capital A/c	3,75,000	By Preliminary Expenses	8,000
To Securities Premium A/c	1,12,500	By Interest on Bank Overdraft	1,600
To Dividends from AB Ltd.	50,000	By Advance to AB Ltd.	2,50,000
To Dividends from CD Ltd.	17,600	By Advance to CD Ltd.	2,00,000
To Interest Income	11,250	By Interim Dividend	47,800
		By Balance c/d (Bal. fig.)	58,950
	5,66,350		5,66,350

4. (a) (i) Calculation of initial recognition amount of loan to employees

Year end	*Cash Inflow*		*Total*	*P.V. factor @10%*	*Present value*
	Principal Rs.	*Interest @ 5% Rs.*	*Rs.*		*Rs.*
20X1	3,20,000	80,000	4,00,000	0.909	3,63,600
20X2	3,20,000	64,000	3,84,000	0.827	3,17,568
20X3	3,20,000	48,000	3,68,000	0.751	2,76,368
20X4	3,20,000	32,000	3,52,000	0.683	2,40,416
20X5	3,20,000	16,000	3,36,000	0.620	2,08,320
Present value or Fair value					14,06,272

(ii) Calculation of amortised cost of loan to employees

Year	*Amortised cost (Opening balance) [1] Rs.*	*Interest to be recognised@10% [2] Rs.*	*Repayment (including interest) [3] Rs.*	*Amortised Cost (Closing balance) [4] = [1] + [2]–[3] Rs.*
20X1	14,06,272	1,40,627	4,00,000	11,46,899
20X2	11,46,899	1,14,690	3,84,000	8,77,589
20X3	8,77,589	87,759	3,68,000	5,97,348
20X4	5,97,348	59,735	3,52,000	3,05,083
20X5	3,05,083	30,917*	3,36,000	Nil

* Rs. 3,05,083 x 10% = Rs. 30,508. The difference of Rs. 409 (Rs. 30,917 – Rs. 30,508) is due to approximation in computation.

(iii) Journal Entries in the books of Y Ltd.

For the year ended 31st December, 20X1 (regarding loan to employees)

	Amount (Rs.)	*Amount (Rs.)*
Staff loan A/c Dr.	16,00,000	
To Bank A/c		16,00,000
(Being the disbursement of loans to staff)		

Staff cost A/c* Rs. (16,00,000 –14,06,272) [Refer part (ii)] Dr.	1,93,728	
To Staff loan A/c		1,93,728
(Being the write off of excess of loan balance over present value thereof in order to reflect the loan at its present value of Rs. 14,06,272)		
Staff loan A/c Dr.	1,40,627	
To Interest on staff loan A/c		1,40,627
(Being the charge of interest @ market rate of 10% on the loan)		
Bank A/c Dr.	4,00,000	
To Staff loan A/c		4,00,000
(Being the repayment of first instalment with interest for the year)		
Interest on staff loan A/c Dr.	1,40,627	
To Profit and loss A/c		1,40,627
(Being transfer of balance of staff loan Interest account to profit and loss account)		

(b) **Employee Compensation Account**

Year		*Rs.*	*Year*		*Rs.*
20X1-X2	To Provision for Liability (W.N. 3)	1,27,200	20X1-X2	By Profit & Loss A/c	1,27,200
20X2-X3	To Provision for Liability (W.N. 3)	1,52,633	20X2-X3	By Profit & Loss A/c	1,52,633
20X3-X4	To Provision for Liability (W.N. 3)	2,02,867	20X3-X4	By Profit & Loss A/c	2,02,867

Provision for Liability Component Account

Year		*Rs.*	*Year*		*Rs.*
20X1-X2	To Balance c/d	1,27,200	20X1-X2	By Employees Compensation A/c	1,27,200
		1,27,200			1,27,200
20X2-X3	To Balance c/d	2,79,833	20X2-X3	By Balance c/d	1,27,200
				By Employees Compensation A/c	1,52,633
		2,79,833			2,79,833
20X3-X4	To Balance c/d	4,82,700	20X3-X4	By Balance c/d	2,79,833
				By Employees compensation A/c	2,02,867
		4,82,700			4,82,700

If Employee opts for Cash settlement

Provision for Liability Component Account

Year	*Particulars*	*Rs.*	*Year*	*Particulars*	*Rs.*
20X4-X5	To Bank (5,000 x Rs. 96.54)	4,82,700	20X4-X5	By Balance c/d	4,82,700

* This is a level 2 measurement and therefore should be deferred as per paragraph 5.1.2A instead of recognising on day 1.

If employee opts for Equity Settlement

Provision for Liability Component Account

Year	*Particulars*	*Rs.*	*Year*	*Particulars*	*Rs.*
20X4-X5	To ESOP outstanding A/c	4,82,700	20X4-X5	By Balance c/d	4,82,700

ESOP Outstanding Account

Year		*Rs.*	*Year*		*Rs.*
20X4-X5	To Equity Share Capital A/c (6,000 x Rs. 10)	60,000	20X4-X5	By Provision for Liability Component A/c	4,82,700
	To Securities Premium A/c	12,86,700		By Bank (6,000 x Rs. 144)	8,64,000
		13,46,700			13,46,700

Working Notes:

1. **Computation of Fair values**

Fair value of shares subject to lock in as on 1st April, 20X1	Rs. 60
% of increase in fair value of shares not subjected to lock in	20%
Fair value as on 1st April, 20X1 of shares not subjected to lock in (60 x 120%)	Rs. 72
% increase over previous value in respect of fair value on 31.03.20X2	6%
Fair value of shares not subjected to lock in restriction on 31.03.20X2 (72x106%)	Rs. 76.32
% increase over previous value in respect of fair value on 31.03.20X3	10%
Fair value of shares not subjected to lock in restriction on 31.03.20X3 (76.32 x 110%)	Rs. 83.95
@ increase over previous value in respect of fair value on 31.03.20X4	15%
Fair value of shares not subjected to lock in restriction on 31.03.20X4 (83.95 x 115%)	Rs. 96.54

2. **Expense to be recognized in respect of Equity Component**

Fair value under equity settlement option (6,000 x Rs. 60)	3,60,000
Less: Fair value under cash settlement (liability component) option (5,000 x Rs. 72)	3,60,000
Equity Component	Nil
Expenses to be recognized each year for Equity Component	Nil

3. **Expenses to be recognized for Liability Component**

	20X1-X2	*20X2-X3*	*20X3-X4*
Number of shares (A)	5,000	5,000	5,000
Fair value at the end of each year (B)	76.32	83.95	96.54
Fair value of liability component (A x B)	3,81,600	4,19,750	4,82,700
Expenses to be recognized*	1,27,200	1,52,633	2,02,867

*Expenses to be recognized each year has been calculated on the basis:

$$\frac{\text{Fair Value} \times \text{No. of years Expired}}{\text{Vesting Period}} - \text{Expenditure recognised till previous year}$$

5. (a) Value Added Ltd.

Value Added Statement for the year ended 31st March, 20X1

	Rs. ('000)	*Rs. ('000)*	%
Turnover		29,872	
Less: Cost of bought in materials and services:			
Operating expenses (26,741 –14,761)	11,980		
GST	1,952		
Interest on Cash Credit	151	(14,083)	
Value added by manufacturing and trading activities		15,789	
Add: Other income		1,042	
Total value added		16,831	
Application of value added:			
To Pay to employees:			
Salaries, wages and other employee benefits		14,761	87.70
To Pay to Government:			
Corporation tax (376 – 54)		322	1.91
To Pay to providers of capital:			
Interest on 8% Debentures	987		
Dividends	125	1,112	6.61
To Provide for maintenance and expansion of the company:			
Depreciation	342		
Assets Replacement Reserve	65		
Deferred Tax Account	54		
Retained Profit	175	636	3.78
		16,831	100

Note: Deferred tax account could alternatively be shown as an item 'To pay to government'.

Reconciliation between total value added and profit before taxation

	Rs. ('000)		*Rs. ('000)*
Profit before tax			741
Add back: Depreciation	342		
Wages, salaries and other benefits	14,761		
Debenture interest	987		16,090
Total Value Added			16,831

(b) Calculation of Economic Value Added

	Rs.
Net Operating Profit After Tax	25,00,000
Less: Cost of capital employed (Refer W.N.)	(6,00,000)
Economic Value Added	19,00,000

Economic value added is greater than zero. Therefore, the company qualifies for the loan.

Working Note:

Calculation of Cost of Capital employed	*Rs.*
Average total assets	75,00,000
Less: Average current liabilities	(15,00,000)
Capital employed	60,00,000

Cost of capital = Capital employed x Weighted average cost of capital

$$= \text{Rs. } 60,00,000 \times \frac{10}{100} = \text{Rs. } 6,00,000$$

6. Valuation of goodwill: Super profits method

Particulars	*Rs.*	*Rs.*
Net trading assets attributable to equity share holders		
As computing in (W.N.1)	23,18,506	
Less: Preference share Capital	(2,25,000)	20,93,506
Normal Rate of Return (NRR) to equity share holders		10%
Normal Profit available to equity shareholders (a x b)		2,09,351
Future Maintainable Profits (FMP) to equity share holders		
As computed in (W.N.3)	3,75,096	
Less: Preference dividend* (8% of 2,25,000)	(18,000)	3,57,096
Super profits to equity share holders (FMP – Normal profit)		1,47,745
Goodwill (1,47,745 x 3)		4,43,235

*Since, NRR is given as percentage of net assets attributable to equity shareholders, preference share capital and preference share dividend have been deducted from the net assets and future maintainable profit respectively.

Value Per Equity Share

Net Trading Assets attributable to equity shareholders	Rs. 20,93,506
Add: Goodwill	Rs. 4,43,235
	Rs. 25,36,741

Number of Equity Shares = 9,500 shares

Value per share $= \frac{25,36,741}{9,500}$ = Rs. 267 (approx.)

Working Notes:

1. **Computation of net trading assets**

Particulars		*Rs.*	*Rs.*
Sundry assets			
i	Land & Building (62,400 ÷ 8%)	7,80,000	
ii	Plant and Machinery	4,55,000	
iii	Inventory	3,80,000	
iv	Trade receivables (4,25,620 ÷ 92%)	4,62,630	
v	Bank balance (given balance 5,20,520 + Sale of investment 4,95,200 - Redemption of debentures 5,60,000 × 75%)	5,95,720	26,73,350
Less: Outside liabilities:			
i	Current Liabilities	3,25,640	
ii	Contingent Liability now to be accounted for	25,000	
iii	Tax provision (WN 2)	4,204	(3,54,844)
Net assets			23,18,506

2. **Calculation of tax provision**

	Rs.
Profit on reversal of provision for bad debts	37,010
Loss on recognizing omitted claim (assuming tax deductible)	(25,000)
Net incremental profit on which tax is payable	12,010
Tax provision 35%	4,204

3. **Computation of future maintainable profit for the year ended on 31st March**

Particulars		20X2	20X3	20X4
Profit after tax		3,25,000	4,99,000	2,95,000
Less:	Non-recurring profits (after tax) (20% of 20X3 Profit)	-	(99,800)	-
Less:	Claims not recorded (after tax) [25,000 x (1-35%)]	-	-	(16,250)
Add:	Provision no longer required (net of tax) [4,25,620 × 8/92 × (1-35%)]	-	-	24,057
Adjusted profits after tax		3,25,000	3,99,200	3,02,807

Simple average of the profits (as profits are fluctuating)		3,42,336
Adjustments for items which will not be reflected in future		
Add:	Debenture interest (net of tax) [5,60,000 × 9% × (1 – 0.35)]	32,760
Future maintainable profit [for shareholders- both preference and equity)		3,75,096

7. **(a) As per Ind AS 16 'Property, Plant and Equipment' and Ind AS 41 'Agriculture'**

<u>Bearer plant is a plant</u> that

(a) is used in the production or supply of agricultural produce;

(b) is expected to bear produce for more than one period; and

(c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

As per Ind AS 41, following are **not bearer plants**:

(i) plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber);

(ii) plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and

(iii) annual crops (for example, maize and wheat).

Biological Asset is a living animal or plant.

(b) Allocation of Earnings

	Old Unit Holders	*New Unit Holders*	*Total*
	[18 Lakh Units]	*[2 Lakh Units]*	
	Rs. in Lakhs	*Rs. in Lakhs*	*Rs. in Lakhs*
First half year (Rs. 5 per unit)	90.00	Nil	90.00
Second half year (Rs. 3.60 per unit)	64.80	7.20	72.00
	154.80	7.20	162.00
Add: Equalization payment recovered	-	-	5.00
Total available for distribution			167.00

Equalization Payment: Rs. 90 lakhs ÷ 18 Lakhs = Rs. 5 per unit.

Distribution of earning per unit	*Old Unit Holders*	*New Unit Holders*
	Rs.	*Rs.*
Dividend distributed	8.60	8.60
Less: Equalisation payment	-	(5.00)
	8.60	3.60

Journal Entries

			(*Rs. in lakhs)*
30.9.20X1	Bank A/c Dr.	150.00	
	To Unit Capital A/c		20.00
	To Reserve A/c		120.00
	To Dividend Equilisation A/c		10.00
	(Being the amount received on sale of 2 lakhs unit at a NAV of Rs. 70 per unit)		
31.3.20X2	Dividend Equalization A/c Dr.	10.00	
	To Revenue A/c		10.00
	(Being the amount transferred to Revenue Account)		

30.9.20X2	Revenue A/c Dr. To Bank A/c (Being the amount distributed among 20 lakhs unit holders @ Rs. 8.60 per unit)	172.00	 172.00

(c) Valuation of closing stock

	Rs.
Closing stock at cost	4,50,000
Less: Adjustment for 100 coats (Working Note 1)	(20,000)
Value of inventory	4,30,000

Working Notes:

1. Adjustment for Coats

	Rs.
Cost included in Closing Stock	2,20,000
NRV of Coats	(2,00,000)
Adjustment to be made as NRV is less than Cost	20,000

2. No adjustment required for skirts and shirts as their NRV is more than their cost which was included in value of inventory.

(d) Calculation of Cost of Fixed Asset (i.e. Machinery)

Particulars		***Rs.***
Purchase Price	Given (Rs. 1,58,34,000 x 100/112)	1,41,37,500
Add: Site Preparation Cost	Given	1,41,870
Technician's Salary	Specific / Attributable overheads for 3 months (See Note) (45,000 x 3)	1,35,000
Initial Delivery Cost	Transportation	55,770
Professional Fees for Installation	Architect's Fees	30,000
Total cost of asset		1,45,00,140

Note:

(i) Interest on Bank Overdraft for earlier payment of invoice is not relevant under AS 10.

(ii) Internally booked profits should be eliminated in arriving at the cost of machine.

Note: The above solution is given on the basis that IGST credit is availed by Shristhi Limited.

(e) As per AS 9 'Revenue Recognition', revenue is the gross inflow of cash, receivable or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods. However, trade discounts and volume rebates given in the ordinary course of business should be deducted in determining revenue. Revenue from sales should be recognized at the time of transfer of significant risks and rewards. If the delivery of the sales is not subject to approval from customers, then the transfer of significant risks and rewards would take place when the sale is affected and goods are dispatched.

In the given case, if trade discount allowed by X Ltd. is given in the ordinary course of business, X Ltd. should record the sales at Rs. 6,09,500 (after deducting 8% trade discount from 6,62,500) and goods returned worth Rs. 77,500 are to be recorded in the form of sales return.

However, when trade discount allowed by X Ltd. is <u>not in the ordinary course of business</u>, X Ltd. should record the sales at gross value of Rs. 6,62,500. Discount of Rs. 53,000 in price and return of goods worth Rs. 77,500 are to be adjusted by suitable provisions. X Ltd. might have sent the credit note of Rs. 1,30,500 to Y Ltd. to account for these adjustments.

In both the cases, the contention of the accountant to book the sales for Rs. 5,32,000 is not correct.

MOCK TEST PAPER 1

FINAL (OLD)COURSE: GROUP – I

PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

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

Working notes should form part of the answer.

Time Allowed – 3 Hours **Maximum Marks – 100**

1. (a) Shashi Co. Ltd has projected the following cash flows from a project under evaluation:

Year	0	1	2	3
Rs. (in lakhs)	(72)	30	40	30

The above cash flows have been made at expected prices after recognizing inflation. The firm's cost of capital is 10%. The expected annual rate of inflation is 5%. Show how the viability of the project is to be evaluated. PVF at 10% for 1-3 years are 0.909, 0.826 and 0.751. **(5 Marks)**

(b) Classic Finance, a Leasing Company, has been approached by a prospective customer intending to acquire a machine whose cash down price is Rs. 6 crores. The customer, in order to leverage his tax position, has requested a quote for a three year lease with rentals payable at the end of each year but in a diminishing manner such that they are in the ratio of 3: 2 : 1. Depreciation can be assumed to be on WDV basis at 25% and Classic Finance's marginal tax rate is 35%. The target rate of return for Classic Finance on the transaction is 10%. You are required to calculate the lease rents to be quoted for the lease for three years. **(5 Marks)**

(c) AXY Ltd. is able to issue commercial paper of Rs. 50,00,000 every 4 months at a rate of 12.5% p.a. The cost of placement of commercial paper issue is Rs. 2,500 per issue. AXY Ltd. is required to maintain line of credit Rs. 1,50,000 in bank balance. The applicable income tax rate for AXY Ltd. is 30%. What is the cost of funds (after taxes) to AXY Ltd. for commercial paper issue? The maturity of commercial paper is four months. **(5 Marks)**

(d) Following information is available in respect of dividend, market price and market condition after one year.

Market condition	Probability	Market Price Rs.	Dividend per share Rs.
Good	0.25	115	9
Normal	0.50	107	5
Bad	0.25	97	3

The existing market price of an equity share is Rs. 106 (F.V. Re. 1), which is cum 10% bonus debenture of Rs. 6 each, per share. M/s. X Finance Company Ltd. had offered the buy-back of debentures at face value.

Find out the expected return and variability of returns of the equity shares.

And also advise-Whether to accept buy back offer? **(5 Marks)**

2. (a) You as an investor had purchased a 4 month call option on the equity shares of X Ltd. of Rs.10, of which the current market price is Rs.132 and the exercise price Rs.150. You expect the price to range between Rs.120 to Rs.190. The expected share price of X Ltd. and related probability is given below:

Expected Price (Rs.)	120	140	160	180	190
Probability	.05	.20	.50	.10	.15

Compute the following:

(1) Expected Share price at the end of 4 months.

(2) Value of Call Option at the end of 4 months, if the exercise price prevails.

(3) In case the option is held to its maturity, what will be the expected value of the call option?

(8 Marks)

(b) Longitude Limited is in the process of acquiring Latitude Limited on a share exchange basis. Following relevant data are available:

		Longitude Limited	Latitude Limited
Profit after Tax (PAT)	Rs. in Lakhs	120	80
Number of Shares	Lakhs	15	16
Earning per Share (EPS)	Rs.	8	5
Price Earnings Ratio (P/E Ratio)		15	10
(Ignore Synergy)			

You are required to determine:

(i) Pre-merger Market Value per Share, and

(ii) The maximum exchange ratio Longitude Limited can offer without the dilution of

(1) EPS and

(2) Market Value per Share

Calculate Ratio/s up to four decimal points and amounts and number of shares up to two decimal points. **(8 Marks)**

3. (a) X Ltd. is a Shoes manufacturing company. It is all equity financed and has a paid-tip Capital of Rs. 10,00,000 (Rs. 10 per share). X Ltd. has hired Swastika consultants to analyze the future earnings. The report of Swastika consultants states as follows:

(i) The earnings and dividend will grow at 25% for the next two years.

(ii) Earnings are likely to grow at the rate of 10% from 3rd year and onwards.

(iii) Further, if there is reduction in earnings growth, dividend payout ratio will increase to 50%.

The other data related to the company are as follows:

Year	EPS (Rs.)	Net Dividend per share (Rs.)	Share Price (Rs.)
2010	6.30	2.52	63.00
2011	7.00	2.80	46.00
2012	7.70	3.08	63.75
2013	8.40	3.36	68.75
2014	9.60	3.84	93.00

You may assume that the tax rate is 30% (not expected to change in future) and post-tax cost of capital is 15%.

By using the Dividend Valuation Model, calculate

(i) Expected Market Price per share

(ii) P/E Ratio. **(8 Marks)**

(b) Mr. A will need Rs. 1,00,000 after two years for which he wants to make one time necessary investment now. He has a choice of two types of bonds. Their details are as below:

	Bond X	Bond Y
Face value	Rs. 1,000	Rs. 1,000
Coupon	7% payable annually	8% payable annually
Years to maturity	1	4
Current price	Rs. 972.73	Rs. 936.52
Current yield	10%	10%

Advice Mr. A whether he should invest all his money in one type of bond or he should buy both the bonds and, if so, in which quantity? Assume that there will not be any call risk or default risk.

(8 Marks)

4. (a) Merry 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 Merry 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)**

(b) AC Co. Ltd. has a turnover of Rs. 1600 Lakhs and is expecting growth of 17.90% for the next year. Average credit period is 100 days. The Bad Debt losses are about 1.50% on sales. The administrative cost for collecting receivables is Rs. 8,00,000. The AC Co. Ltd. decides to make use of Factoring Services by FS Ltd. on terms as under:

(i) that the factor will charge commission of 1.75%.

(ii) 15% Risk with recourse and

(iii) Pay an advance on receivables to AC Co. Ltd. at 14% p.a. interest after withholding 10% as reserve.

You are required to calculate the effective cost of factoring to AC Co. Ltd. for the year.

Show amount in Lakhs of Rs. with two decimal points. Assume 360 days in a year. **(8 Marks)**

5. (a) Five portfolios experienced the following results during a 7- year period:

Portfolio	Average Annual Return (R_p) (%)	Standard Deviation (S_p)	Correlation with the market returns (r)
A	19.0	2.5	0.840
B	15.0	2.0	0.540
C	15.0	0.8	0.975
D	17.5	2.0	0.750
E	17.1	1.8	0.600
Market Risk (σm)		1.2	
Market rate of Return (R_m)	14.0		
Risk-free Rate (R_f)	9.0		

Rank the portfolios using (a) Sharpe's method, (b) Treynor's method and (c) Jensen's Alpha

(8 Marks)

(b) XYZ, an Indian firm, will need to pay JAPANESE YEN (JY) 5,00,000 on 30th June. In order to hedge the risk involved in foreign currency transaction, the firm is considering two alternative methods i.e. forward market cover and currency option contract.

On 1st April, following quotations (JY/INR) are made available:

Spot	3 months forward
1.9516/1.9711	1.9726/1.9923

The prices for forex currency option on purchase are as follows:

Strike Price	JY 2.125
Call option (June)	JY 0.047
Put option (June)	JY 0.098

For excess or balance of JY covered, the firm would use forward rate as future spot rate.

You are required to recommend cheaper hedging alternative for XYZ. **(8 Marks)**

6. (a) On January 1, 2013 an investor has a portfolio of 5 shares as given below:

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

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

You are required to calculate:

(i) The beta of his portfolio.

(ii) The theoretical value of the NIFTY futures for February 2013.

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

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

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

Given: ln (1.105) = 0.0998 and $e^{(0.015858)}$ = 1.01598 **(8 Marks)**

(b) A valuation done of an established company by a well-known analyst has estimated a value of Rs. 500 lakhs, based on the expected free cash flow for next year of Rs. 20 lakhs and an expected growth rate of 5%.

While going through the valuation procedure, you found that the analyst has made the mistake of using the book values of debt and equity in his calculation. While you do not know the book value weights he used, you have been provided with the following information:

(i) Company has a cost of equity of 12%,

(ii) After tax cost of debt is 6%,

(iii) The market value of equity is three times the book value of equity, while the market value of debt is equal to the book value of debt.

You are required to estimate the correct value of the company. **(8 Marks)**

7. Write short notes on **any four** of the following:

(a) Various techniques used in economic analysis.

(b) Debt Securitization

(c) Various processes of strategic decision making.

(d) Cross Border Leasing

(e) Synergy in the context of Mergers and Acquisitions **(4 x 4 = 16 Marks)**

MOCK TEST PAPER 1

FINAL (OLD) COURSE: GROUP – I

PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

SUGGESTED ANSWERS/HINTS

1. (a) Here the given cash flows have to be adjusted for inflation. Alternatively, the discount rate can be converted into nominal rate, as follows:-

Year 1 = $\frac{0.909}{1.05}$ = 0.866; Year 2 = $\frac{0.826}{(1.05)^2}$ or $\frac{0.826}{1.1025}$ = 0.749

Year 3 = $\frac{0.751}{(1.05)^3}$ = $\frac{0.751}{1.1576}$ = 0.649

Year	Nominal Cash Flows (Rs. in lakhs)	Adjusted PVF as above	PV of Cash Flows (Rs. in lakhs)
1	30	0.866	25.98
2	40	0.749	29.96
3	30	0.649	19.47
	Cash Inflow		75.41
	Less: Cash Outflow		72.00
	Net Present Value		3.41

With positive NPV, the project is financially viable.

Alternative Solution

Assumption: The cost of capital given in the question is "Real'.

Nominal cost of capital = (1.10) (1.05) -1 = 0.155 =15.50%

DCF Analysis of the project

				(Rs. Lakhs)
	Period	PVF @15.50%	CF	PV
Investment	0	1	-72	-72.00
Operation	1	0.866	30	+25.98
---do---	2	0.750	40	+30.00
---do---	3	0.649	30	+19.47
NPV				+3.45

The proposal may be accepted as the NPV is positive.

(b) Calculation of depreciation tax shield

(Rs. Lakhs)

Year	Cost / WDV	Dep. @ 25 %	Tax shield @ 0.35	PVF	PV of dep. tax shield
1	600.00	150.00	52.50	0.909	47.72
2	450.00	112.50	39.38	0.826	32.53
3	337.50	84.38	29.53	0.751	22.18
					102.43

Capital sum to be placed on lease	(Rs. Lakhs)
Cash down price	600.00
Less: PV of depreciation tax shield	102.43
To be placed on lease	**497.57**

Let the normal annual lease rent were to be "*x*" then

Year	**Post tax**	**PVF**	**PV of cash flow**
1	3 x (1-0.35) or 1.95 *x*	0.909	1.773 *x*
2	2x (1-0.35) or 1.30*x*	0.826	1.074*x*
3	1x (1-0.35) or 0.65*x*	0.751	0.488*x*
			3.335 *x*

Value of *x* = Rs. 497.57 lakhs / 3.335 i.e. Rs. 149.196 lakhs

Year wise lease rental will be

		Rs.lakhs
Year 1	3 × 149.196	447.59
Year 2	2 × 149.196	298.39
Year 3	1 × 149.196	149.20

(c)

	Rs.
Issue Price	50,00,000
Less: Interest @ 12.5% for 4 months	2,08,333
Issue Expenses	2,500
Minimum Balance	1,50,000
	46,39,167

$$\text{Cost of Funds} = \frac{2,10,833(1-0.30)}{46,39,167} \times \frac{12}{4} \times 100 = 9.54\%$$

Alternatively

	Rs.
Issue Price	50,00,000
Less: Interest @ 12.5% for 4 months	2,08,333
Issue Expenses	2,500
Minimum Balance	1,50,000
	46,39,167
Opportunity Cost @ 12.5% of Rs. 1,50,000 for 4 months	6,250

$$\text{Cost of Funds} = \frac{2{,}10{,}833(1-0.30)+6{,}250}{46{,}39{,}167} \times \frac{12}{4} \times 100 = 9.95\%$$

Alternatively

Since Commercial Paper is a discount instrument it can also be presumed same shall be issued at discounted price. Accordingly, answer shall be as follows:

$$\text{Issue Price} = \frac{50{,}00{,}000}{1+12.5 \times \frac{4}{12}} = \text{Rs. } 48{,}00{,}000$$

	Rs.
Issue Price	50,00,000
Less: Interest @ 12.5% for 4 months	2,00,000
Issue Expenses	2,500
Minimum Balance	1,50,000
	46,47,500
Opportunity Cost @ 12.5% of Rs. 1,50,000 for 4 months	6,250

$$\text{Cost of Funds} = \frac{2{,}02{,}500(1-0.30)}{46{,}47{,}500} \times \frac{12}{4} \times 100 = 9.15\%$$

or

$$\text{Cost of Funds} = \frac{2{,}02{,}500(1-0.30)+6{,}250}{46{,}47{,}500} \times \frac{12}{4} \times 100 = 9.55\%$$

(d) The Expected Return of the equity share may be found as follows:

Market Condition	Probability	Total Return	Cost (*)	Net Return
Good	0.25	Rs. 124	Rs. 100	Rs. 24
Normal	0.50	Rs. 112	Rs. 100	Rs. 12
Bad	0.25	Rs. 100	Rs. 100	Rs. 0

Expected Return $= (24 \times 0.25) + (12 \times 0.50) + (0 \times 0.25)$

$$= \left(\frac{12}{100}\right) \times 100 = 12\%$$

The variability of return can be calculated in terms of standard deviation.

VSD $= 0.25\ (24 - 12)^2 + 0.50\ (12 - 12)^2 + 0.25\ (0 - 12)^2$

$= 0.25\ (12)^2 + 0.50\ (0)^2 + 0.25\ (-12)^2$

$= 36 + 0 + 36$

SD $= \sqrt{72}$

SD = 8.485 or say 8.49

(*) The present market price of the share is Rs. 106 cum bonus 10% debenture of Rs. 6 each; hence the net cost is Rs. 100 (There is no cash loss or any waiting for refund of debenture amount).

M/s X Finance company has offered the buyback of debenture at face value. There is reasonable 10% rate of interest compared to expected return 12% from the market. Considering the dividend rate and market price the creditworthiness of the company seems to be very good. The decision regarding buy-back should be taken considering the maturity period and opportunity in the market. Normally, if the maturity period is low say up to 1 year better to wait otherwise to opt buy back option.

2. (a) (1) Expected Share Price

= Rs.120X 0.05 + Rs.140X 0.20 + Rs.160X 0.50 + Rs.180X 0.10 + Rs.190X 0.15

= Rs.6 + Rs.28 + Rs.80 + Rs.18 + Rs.28.50 = Rs.160.50

(2) Value of Call Option

= Rs.150 - Rs.150 = Nil

(3) If the option is held till maturity the expected Value of Call Option

Expected price (X)	Value of call (C)	Probability (P)	CP
Rs. 120	0	0.05	0
Rs. 140	0	0.20	0
Rs. 160	Rs. 10	0.50	Rs. 5
Rs. 180	Rs. 30	0.10	Rs. 3
Rs. 190	Rs. 40	0.15	Rs. 6
Total			Rs. 14

Alternatively, it can also be calculated as follows:

Expected Value of Option

(120 – 150) X 0.1	Not Exercised*
(140 – 150) X 0.2	Not Exercised*
(160 – 150) X 0.5	5
(180 – 150) X 0.1	3
(190 – 150) X 0.15	6
	14

* If the strike price goes below Rs. 150, option is not exercised at all.

(b) (i) Pre Merger Market Value of Per Share

P/E Ratio X EPS

Longitude Ltd. Rs. 8 X 15 = Rs. 120.00

Latitude Ltd. Rs. 5 X 10 = Rs. 50.00

(ii) (1) Maximum exchange ratio without dilution of EPS

Pre Merger PAT of Longitude Ltd.	Rs. 120 Lakhs
Pre Merger PAT of Latitude Ltd.	Rs. 80 Lakhs
Combined PAT	Rs. 200 Lakhs
Longitude Ltd. 's EPS	Rs. 8
Maximum number of shares of Longitude after merger (Rs. 200 lakhs / Rs. 8)	25 Lakhs
Existing number of shares	15 Lakhs
Maximum number of shares to be exchanged	10 Lakhs

Maximum share exchange ratio 10:16 or 5:8

(2) Maximum exchange ratio without dilution of Market Price Per Share

Pre Merger Market Capitalization of Longitude Ltd. (Rs. 120 × 15 Lakhs)	Rs. 1800 Lakhs
Pre Merger Market Capitalization of Latitude Ltd. (Rs. 50 × 16 Lakhs)	Rs. 800 Lakhs
Combined Market Capitalization	Rs. 2600 Lakhs
Current Market Price of share of Longitude Ltd.	Rs. 120
Maximum number of shares to be exchanged of Longitude (surviving company) (Rs. 2600 Lakhs/Rs. 120)	21.67 Lakhs
Current Number of Shares of Longitude Ltd.	15.00 Lakhs
Maximum number of shares to be exchanged (Lakhs)	6.67 Lakhs

Maximum share exchange ratio 6.67:16 or 0.4169:1

3. (a) (i) The formula for the Dividend valuation Model is

$$P_0 = \frac{D_1}{K_e - g}$$

K_e = Cost of Capital

g = Growth rate

D_1= Dividend at the end of year 1

On the basis of the information given, the following projection can be made:

Year	*EPS (Rs.)*	*DPS (Rs.)*	*PVF @15%*	*PV of DPS (Rs.)*
2015	12.00 (9.60 x 125%)	4.80 (3.84 x 125%)	0.870	4.176
2016	15.00	6.00	0.756	4.536

2017	(12.00 x 125%) 16.50 (15.00 x 110%)	(4.80 x 125%) 8.25* (50% of Rs. 16.50)	0.658	5.429
				14.141

*Payout Ratio changed to 50%.

After 2017, the perpetuity value assuming 10% constant annual growth is:

D_1= Rs. 8.25 × 110% = Rs. 9.075

Therefore P_o from the end of 2017

$$\frac{₹\ 9.075}{0.15-0.10} = ₹\ 181.50$$

This must be discounted back to the present value, using the 3 year discount factor after 15%.

	Rs.
Present Value of P_0 (Rs. 181.50 × 0.658)	119.43
Add: PV of Dividends 2015 to 2017	14.14
Expected Market Price of Share	133.57

(ii) P/E Ratio

$$\text{P/E Ratio} = \frac{\text{Expected Market Price of Share } (P_1)}{\text{EPS}}$$

$$= \frac{₹\ 133.57}{₹\ 9.60} = \text{Rs. } 13.91$$

(b) (a) Duration of Bond X

Year	*Cash flow*	*P.V. @ 10%*		*Proportion of bond value*	*Proportion of bond value x time (years)*
1	1070	.909	972.63	1.000	1.000

Duration of the Bond is 1 year

Duration of Bond Y

Year	*Cash flow*	*P.V. @ 10%*		*Proportion of bond value*	*Proportion of bond value x time (years)*
1	80	.909	72.72	0.077	0.077
2	80	.826	66.08	0.071	0.142
3	80	.751	60.08	0.064	0.192
4	1080	.683	737.64	0.788	3.152
			936.52	1.000	3.563

Duration of the Bond is 3.563 years

Let x_1 be the investment in Bond X and therefore investment in Bond Y shall be $(1 - x_1)$. Since the required duration is 2 year the proportion of investment in each of these two securities shall be computed as follows:

$2 = x_1 + (1 - x_1)\ 3.563$

$x_1 = 0.61$

Accordingly, the proportion of investment shall be 61% in Bond X and 39% in Bond Y respectively.

Amount of investment

Bond X	*Bond Y*
PV of Rs. 1,00,000 for 2 years @ 10% x 61% = Rs. 1,00,000 (0.826) x 61% = Rs. 50,386 No. of Bonds to be purchased = Rs. 50,386/Rs. 972.73 = 51.79 i.e. approx. 52 bonds	PV of Rs. 1,00,000 for 2 years @ 10% x 39% = Rs. 1,00,000 (0.826) x 39% = Rs. 32,214 No. of Bonds to be purchased = Rs. 32,214/Rs. 936.52 = 34.40 i.e. approx. 34 bonds

Note: The investor has to keep the money invested for two years. Therefore, the investor can invest in both the bonds with the assumption that Bond X will be reinvested for another one year on same returns.

Further, in the above computation, Modified Duration can also be used instead of Duration.

4. (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.

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 =	22,581
Total	1,312,904

(iv) Sell DEM at 3-months forward to obtain CAD = (1,312,904 x 0.780) = 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	22,500
Total	1,022,500

Net arbitrage gain = CAD 1,024,065 – CAD 1,022,500 = CAD 1,565

(b) Expected Turnover = Rs. 1600 lakhs + Rs. 286.40 = Rs. 1886.40 lakhs

	Rs. in Lacs	**Rs. in Lacs**
Advance to be given:		
Debtors Rs.1886.40 lakhs x 100/360	524.00	
Less: 10% withholding	52.40	
		471.60
Less: Commission 1.75%		9.17
Net payment		462.43
Less: Interest @14% for 100 days on Rs. 462.43 lacs		17.98
		444.45

Calculation of Average Cost:		
Total Commission Rs.1886.40 lakhs x 1.75%		33.01
Total Interest Rs. 17.98 lacs x 360/100		64.73
		97.74
Less: Admin. Cost	8.00	
Saving in Bad Debts (Rs.1886.40 lacs x 1.50% x 85%)	24.05	32.05
		65.69
Effective Cost of Factoring = 65.69/444.45 x 100		14.78%

5. (a) Let portfolio standard deviation be σ_p

Market Standard Deviation = σ_m

Coefficient of correlation = r

Portfolio beta (β_p) $= \dfrac{\sigma_p r}{\sigma_m}$

Required portfolio return (R_p) = $R_f + \beta_p (R_m - R_f)$

Portfolio	Beta	Return from the portfolio (R_p) (%)
A	1.75	17.75
B	0.90	13.50
C	0.65	12.25
D	1.25	15.25
E	0.90	13.50

Portfolio	Sharpe Method		Treynor Method		Jensen's Alpha	
	Ratio	Rank	Ratio	Rank	Ratio	Rank
A	4.00	IV	5.71	V	1.25	V
B	3.00	V	6.67	IV	1.50	IV
C	7.50	I	9.23	I	2.75	II
D	4.25	III	6.80	III	2.25	III
E	4.50	II	9.00	II	3.60	I

(b) (i) Forward Cover

3-month Forward Rate = $\frac{1}{1.9726}$ = Rs. 0.5070/JY

Accordingly, INR required for JY 5,00,000 (5,00,000 X Rs. 0.5070) Rs. 2,53,500

(ii) Option Cover

To purchase JY 5,00,000, XYZ shall enter into a Put Option @ JY 2.125/INR

Accordingly, outflow in INR $\left(\frac{\text{JY } 5,00,000}{2.125}\right)$	Rs. 2,35,294
Premium $\left(\frac{\text{INR } 2,35,294 \times 0.098}{1.9516}\right)$	Rs. 11,815
	Rs. 2,47,109

Since outflow of cash is least in case of Option same should be opted for. Further if price of INR goes above JY 2.125/INR the outflow shall further be reduced.

6. (a) (i) Calculation of Portfolio Beta

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

Portfolio Beta = 0.849

(ii) Calculation of Theoretical Value of Future Contract

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

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

Further F= Se^{rt}

F= Rs. $5{,}900e^{(0.0998)(0.1589)}$

F= Rs. $5{,}900e^{0.015858}$

F= Rs. 5,900X1.01598 = Rs. 5,994.28

Alternatively, it can also be taken as follows:

= Rs. 5900 $e^{0.105 \times 58/365}$

= Rs. 5900 $e^{0.01668}$

= Rs. 5900 x 1.01682 = Rs. 5,999.24

(iii) When total portfolio is to be hedged:

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

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

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

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

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

(b) Cost of capital by applying Free Cash Flow to Firm (FCFF) Model is as follows:-

Value of Firm = V_0 = $\frac{FCFF_1}{K_c - g_n}$

Where –

$FCFF_1$ = Expected FCFF in the year 1

K_c = Cost of capital

g_n = Growth rate forever

Thus, Rs. 500 lakhs = Rs. 20 lakhs /(K_c-g)

Since g = 5%, then K_c = 9%

Now, let X be the weight of debt and given cost of equity = 12% and cost of debt = 6%, then 12% (1 – X) + 6% X = 9%

Hence, X = 0.50, so book value weight for debt was 50%

∴ Correct weight should be 150% of equity and 50% of debt.

∴ Cost of capital = K_c = 12% (0.75) + 6% (0.25) = 10.50%

and correct firm's value = Rs. 20 lakhs/(0.105 – 0.05) = Rs. 363.64 lakhs.

7. (a) 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.

(b) Debt Securitization is a method of recycling of funds. This method is mostly used by finance companies to raise funds against financial assets such as loan receivables, mortgage backed receivables, credit card balances, hire purchase debtors, lease receivables, trade debtors, etc. and thus beneficial to such financial intermediaries to support their lending volumes. Thus, assets generating steady cash flows are packaged together and against this assets pool market securities can be issued. Investors are usually cash-rich institutional investors like mutual funds and insurance companies.

The process can be classified in the following three functions:

1. **The origination function –** A borrower seeks a loan from finance company, bank, housing company or a financial institution. On the basis of credit worthiness repayment schedule is structured over the life of the loan.
2. **The pooling function –** Many similar loans or receivables are clubbed together to create an underlying pool of assets. This pool is transferred in favour of a SPV (Special Purpose Vehicle), which acts as a trustee for the investor. Once the assets are transferred they are held in the organizers portfolios.
3. **The securitization function –** It is the SPV's job to structure and issue the securities on the basis of asset pool. The securities carry coupon and an expected maturity, which can be asset base or mortgage based. These are generally sold to investors through merchant bankers. The investors interested in this type of securities are generally institutional investors like mutual fund, insurance companies etc. The originator usually keeps the spread available (i.e. difference) between yield from secured asset and interest paid to investors.

Generally, the process of securitization is without recourse i.e. the investor bears the credit risk of default and the issuer is under an obligation to pay to investors only if the cash flows are received by issuer from the collateral.

(c) Capital investment is the springboard for wealth creation. In a world of economic uncertainty, the investors want to maximize their wealth by selecting optimum investment and financial opportunities that will give them maximum expected returns at minimum risk. Since management is ultimately responsible to the investors, the objective of corporate financial management should implement investment and financing decisions which should satisfy the shareholders by placing them all in an equal, optimum financial position. The satisfaction of the interests of the shareholders should be perceived as a means to an end, namely maximization of shareholders' wealth. Since capital is the limiting factor, the problem that the management will face is the strategic allocation of limited funds between alternative uses in such a manner, that the companies have the ability to sustain or increase investor returns through a continual search for investment opportunities that generate funds for their business and are more favourable for the investors. Therefore, all businesses need to have the following three fundamental essential elements:

- A clear and realistic strategy,
- The financial resources, controls and systems to see it through and

The right management team and processes to make it happen.

(d) In case of cross-border or international lease, the lessor and the lessee are situated in two different countries. Because the lease transaction takes place between parties of two or more countries, it is called cross-border lease. It involves relationships and tax implications more complex than the domestic lease. When the lease transactions take place between three parties manufacturer/vendor, lessor and lessee in three different countries, this type of cross border leasing is called foreign to foreign lease. The lease may be routed through a third nation known as "convenient country" for tax or equipment registration purposes. Fourth nation may be involved for debt in a particular currency required to give effect to the equipment purchase and lease transaction. Thus more nations involved in cross border lease would mean more complications in terms of different legal, fiscal, credit and currency requirements and risk involved.

Cross border lease benefits are more or less the same as are available in domestic lease viz. 100% funding off-balance sheets. Financing, matching of expenditure with earnings from the assets, the usual tax benefits on leasing, etc. In addition to these benefits, the following are the more crucial aspects which are required to be looked into: (i) appropriate currency requirements can be met easily to match the specific cash flow needs of the lessee;(ii) funding for long period and at fixed rate which may not be available in the lessee home market may be obtained internationally;(iii) maximum tax benefits in one or more regions could be gained by structuring the lease in a convenient fashion;(iv) tax benefits can be shared by the lessee or lessor accordingly by pricing the lease in the most beneficial way to the parties;(v) choice of assets for cross border lease is different than domestic lease because those assets may find here attractive bargain which are internationally mobile , have adequate residual value and enjoy undisputed title.

(e) Synergy may be defined as follows:

V (AB) > V (A) + V (B)

In other words the combined value of two firms or companies shall be more than their individual value. Synergy is the increase in performance of the combined firm over what the two firms are already expected or required to accomplish as independent firms. This may be result of complimentary services economics of scale or both.

A good example of complimentary activities can be that one company may have a good networking of branches and the other company may have efficient production system. Thus, the merged companies will be more efficient than individual companies.

On similar lines, economics of large scale is also one of the reasons for synergy benefits. The main reason is that, the large scale production results in lower average cost of production e.g. reduction in overhead costs on account of sharing of central services such as accounting and finances, office executives, top level management, legal, sales promotion and advertisement etc.

These economies can be "real" arising out of reduction in factor input per unit of output, or pecuniary economics are realized from paying lower prices for factor inputs for bulk transactions.

Generally positive value of synergy forms the basis of rationale for the merger and acquisition decision. However, before such decision, cost attached with such merger and acquisition should be evaluated in this light. Accordingly, the net gain from merger and acquisition is as follows:

Net Gain = Value of Synergy – Costs associated with Merger and Acquisition.

Test Series: October, 2019

MOCK TEST PAPER -1

FINAL (OLD) 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 companyand 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. Kindly guide. **(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)**

Test Series: October, 2019

MOCK TEST PAPER 1

FINAL (OLD) 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):**

i. 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.

ii. Verify whether the NBFC has not advanced any loans against the security of its own shares.

iii. 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:

(i) 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?

(ii) Does the practice unit communicate these policies and the expected standards of professional behaviour to all staff?

(iii) Does the practice unit monitor compliance with policies and procedures relating to independence?

(iv) Does the practice unit periodically review the practice unit's association with clients to ensure objectivity and independence?

Test Series: October, 2019

MOCK TEST PAPER 1

FINAL (OLD) COURSE: GROUP – I

PAPER – 4: CORPORATE AND ALLIED LAWS

Time Allowed – 3 Hours **Maximum Marks – 100**

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

Instructions: All questions are compulsory.

(Questions nos. 1-10 are of 2 marks each and from 11- 20 are of 1 marks each)

1. Three directors, namely Samiksha, Santosh and Samita 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. Rachna, Riddhi, 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 (F.V. Rs. 10 per share) being the final call in respect of shares held by them latest by 30th June, 2019. 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, 2019. 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, 2019; 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, 2019; 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, 2019, she incurs no disqualification regarding her directorship in the company irrespective of whether the remaining 50% is received by the company or not.

3. Kumar Ltd. filed a complaint to conduct an inquiry against the past employees 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 was necessaited 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 employees 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 employees (officers who were earlier in employment of the company) and they are bound to furnish information and explanation to the best of their knowledge.

   (b) No enquiry can be conducted as central government is authorised to look into the matter.

4. ABC & Co., Chartered Accountants, is a partnership firm, who is auditor of one of the listed company Z Ltd. for the financial year 2018-19. Mr. B is engaging partner of that audit with a team of 15 members. While doing audit of the financial statement of the company, two members of the team, who are Chartered Accountant, passed the information to their friends and relatives that this year company's profit is increasing by 25% as compared to last audited financial year, before this information came in to public domain through the company. They made profit from this information by purchase at low price and after financial statements came in public domain and share prices raised, they sold shares at enhanced price. Please state whether it is a case of insider trading. If yes, then how much penalty for this act, under SEBI Act, 1992.

   (a) No, it is not insider trading, because that these persons are not restricted to use the information to benefit themselves.

   (b) No, it is not insider trading, because it is not price sensitive information.

   (c) Yes, it is insider trading and penalty u/s 15G would be minimum Rs. 10 lacs which may extend upto Rs. 25 cr. or 3 times of profit derived, whichever is higher.

   (d) Yes, it is insider trading and penalty u/s 12A would be Rs. 25 cr. or 3 times of profit derived, whichever is lower.

5. 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

6. Infra Ltd. was winded 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

7. 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 in any office 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.

8. State the required majority in the case where a company wants to file an application to the registrar for removal of name 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

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 unsatisfactory 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 company does not require in Singapore, 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. 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

11. 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

12. 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%

13. One Person Company shall file a copy of the duly adopted financial statements to the Registrar in:

(a) 30 days of the date of meeting in which it was adopted

(b) 90 days of the date of meeting in which it was adopted

(c) 90 days from the closure of the financial statement

(d) 180 days from the closure of the financial statement

14. As per the audited financial statements of immediately preceding Financial Year, the paid-up capital of Aastha Metal Products Limited was Rs. seventy-five crores (much below the threshold limit) which did not require appointing a woman director. However, the turnover during the same period was Rs. 334 crores i.e. above the threshold limit which required appointing a woman director. Advise the company whether to bring on the Board a woman director or not.

(a) The company is not required to appoint a woman director since only one of the parameters have crossed the threshold limit.

(b) The company is required to appoint a woman director since any one parameter out of the two exceeding the threshold limit shall necessitate such appointment.

(c) The requirement of appointing a woman director arises only when paid up capital exceeds the threshold limit and therefore, the company is not required to appoint a woman director.

(d) In a situation where one parameter is below and the other is above the threshold limit, the company, as per its discretion, may or may not appoint a woman director.

15. A highly reputed construction company of Mumbai, decided to launch an ultra modern residential project in Goa especially for non-resident HN1Indians. 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 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) 300000 USD

16. 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. A manager of Mr. X knew about all the transaction. He 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. Who all are liable in this transaction?

(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

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. Reserve Bank of India may check the condition that the asset reconstruction company has not incurred any loss in the _______ preceding financial years.

(a) 1

(b) 2

(c) 3

(d) 8

19. Under what circumstances the meeting of the creditors may be dispensed by the NCLT?

(a) if 70% of the creditors in value agree and confirm to the scheme by way of affidavit

(b) if 80% of the creditors in value agree and confirm to the scheme by way of affidavit

(c) if 90% of the creditors in value agree and confirm to the scheme by way of affidavit

(d) None of the above

20. Astistav Private Limited is a company with ten shareholders. A member holding less than one-tenth of the share capital of the company apply to the Tribunal for relief against oppression and mismanagement? State whether a member have a right to apply to the tribunal in above situation:

(a) A single Member cannot apply to the Tribunal for relief against oppression and mismanagement

(b) A member cannot apply as he is holding less than one-tenth of the share capital of the company

(c) A member can apply being one-tenth of the total number of members.

(d) A member cannot apply as the requirement of atleast hundred members is not complied with.

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 Annual General Meeting.

   (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. 18th July, 2019.

   Following are the relevant extracts from latest audited financial statements;

   1. Authorised Share capital is INR 390 crores, out of which paid up share capital is INR 215 crores; company was in process of FPO, hence had balance of INR 15 crores in share application money account.

   2. Balance of reserve and surplus is INRs 170 crores, out of which INR 150 crores is general reserve and INRs 20 crores is revaluation reserve.

   3. Outstanding amount for long term loans is INR 200 crores

   4. Company had investment of INR 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 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:

Eligibility of the members to file a complaint.

Where if the management dispose of the certain assets in contravention to the order of the Tribunal.

(8 Marks)

(b) (i) Mr. Vivaan is having 400 shares of Travel Everywhere Limited and the current price of these shares in the market is Rs. 100. Vivaan'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, Vivaan 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. Vivaan protect his security and reduce the risk of loss on the share price under the Securities Contract (Regulation) Act, 1956? **(3 Marks)**

(ii) Mr. Raman, an investor is not satisfied with the dealings of his stock broker who is registered with Delhi Stock Exchange. Mr. Raman approaches you to guide him regarding the avenues available to him for making a complaint against the stock broker under Securities and Exchange Board of India Act, 1992 and also the grounds on which such complaint can be made. You are required to briefly explain the answer to his queries. **(3 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) 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 terms of the FEMA, 1999? **(3 Marks)**

(ii) Examine with reference to the relevant provisions of the Competition Act, 2002 the following:

(a) Whether a Government Department supplying water for irrigation to the Agriculturists after levying charges for water supplied (and not a water tax) can be considered as an 'Enterprise'.

(b) Whether a person purchasing goods not for personal use, but for resale can be considered as a 'consumer.' **(3 Marks)**

4. (a) X Ltd. was intending to initiate voluntarily liquidation proceedings. A declaration was made with an 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 situations, 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. **(5 Marks)**

(b) 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 tine, 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)**

(c) (i) 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 and also explain the effect of such takeover on certain rights of the shareholders of the company. **(3 Marks)**

(ii) The Central Government acquired a Banking Company. The scheme of acquisition, apart from other matters, provided for the quantum of compensation payable to the shareholders of acquired bank. Some shareholders are not satisfied with the amount of compensation fixed under the scheme of acquisition.

Is there any remedy available to the shareholders under the provisions of the Banking Regulation Act, 1949? **(3 Marks)**

5. (a) (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) (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 of Sohan Lal in the light of the Prevention of Money Laundering Act, 2002. **(3 Marks)**

6. (a) (i) YZ Ltd. is a manufacturing company and has proposed a dividend @ 10% for the year 2018-19 out of the current year profits. The company has earned a profit of Rs. 910 crores during 2018-19. YZ Ltd. does not intend to transfer any amount to the general reserves of the company out of current year profit. Is YZ Ltd. allowed to do so? Comment.

(ii) Karan was holding 5000 equity shares of Rs. 100 each of Future Ltd. A final call of Rs. 10 per share was not paid by Karan. Future Ltd. declared dividend of 10%. Examine with reference to relevant provisions of the Companies Act, 2013, the amount of dividend Karan should receive. **(4 Marks)**

(b) Examine the following situations in the light of the Companies Act, 2013:

(i) Mr. Ayush, a Chartered Accountant, has been appointed as an auditor of X Ltd. in the Annual General Meeting of the company held in September 2018, in which he accepted the assignment. Subsequently, in January 2019 he joined B, as a partner in the consultancy firm of Mr. B. Mr. B is also working as a Finance Executive of X Ltd.

(ii) "Mr. Abhi", a practicing Chartered Accountant, is holding securities of Abhiman Ltd. having face value of Rs. 1000/-. Whether Mr. Abhi is qualified for appointment as an Auditor of Abhiman Ltd.? **(4 Marks)**

(c) (i) Referring to the provisions of the Foreign Exchange Management Act, 1999, state the kind of approval required for the following transactions:

(A) M requires U.S. $ 5,000 for remittance towards hire charges of transponders.

(B) P requires U.S. $ 2,000 for payment related to call back services of telephones.

(3 Marks)

(ii) Explain the usefulness of following terms in interpreting / construing a statute:

(A) Preamble

(B) Use of Foreign Decisions. **(3 Marks)**

Test Series: October, 2019

MOCK TEST PAPER 1

FINAL (OLD) COURSE: GROUP – I

PAPER – 4: CORPORATE AND ALLIED LAWS

SUGGESTED ANSWERS

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

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

Descriptive Answers (70 Marks)

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 MCA vide Notification No. 463(E) dated 13th June, 2017, 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 provision.

(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 INRs. 250 crores or more then, yearly remuneration per person payable shall not exceed by INRs 120 lakh plus 0.01% of the effective capital in excess of INRs. 250 crores.

The maximum remuneration that may be paid to each managerial person will be [120 lakh+ (0.01% x 250 cr)] = 122.5 lakh.

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

2. (a) (i) Section 244 of the Companies Act, 2013 provides the eligibility of members who hold the right to file an application under section 241 for oppression and mismanagement with the Tribunal. These qualification 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 1/5th of the total number of its members of the company (1/5x 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) In this case, Mr. Vivaan 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 Vivaan bought a put option.

Now, if after three months, the current price of the shares is Rs. 210, Mr. Vivaan 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. Vivaan 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.

(ii) Securities and Exchange Board of India (SEBI) was established for regulating the various aspects of stock market. One of its functions is to register and regulate the stock brokers. In the light of this, Mr. Raman is advised that the complaint against the erring stock broker may be submitted to SEBI.

The grounds on which or the defaults for which complaints may be made to SEBI are as follows:

(a) Any failure on the part of the stock broker to issue contract notes in the form and manner specified by the stock exchange of which the stock broker is a member.

(b) Any failure to deliver any security or any failure to make payment of the amount due to the investor in the manner within the period specified in the regulations.

(c) Any collection of charges by way of brokerage which is in excess of the brokerage specified in the regulations.

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(1)(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) Toy Ltd. being a Japanese company would be a person resident outside India. [Section 2(w) of the FEMA, 1999]. Section 2(u) defines 'person'. Under clause (vii) of section 2(u) 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 (vi). 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) of section 2(v), '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) Enterprise: The term 'enterprise' is defined in section 2(h) of Competition Act, 2002. Accordingly, 'enterprise' means a person or a department of the Government, who or which is engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services of any kind. But the term does not include any activity of the Government relatable to sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

Certain specific activities of Government departments like dealing with atomic energy, etc. and sovereign functions of the Government (like police, defence, etc.) are excluded from the purview of the said terms. Hence, a Government department engaged in the activity of providing service in the form of supply of water for irrigation to the agriculturists after levying charges can be considered as an 'enterprise' within the meaning of section 2(h) of Competition Act, 2002.

Consumer: The term 'consumer' is defined in section 2(f) of Competition Act, 2002. Accordingly, 'consumer' means any person who buys any goods for a consideration, which has been paid or promised or partly paid and partly promised, whether such purchase of goods is for resale or for any commercial purpose or for personal use.

Hence, it is not necessary that a person must purchase the goods for personal use in order to be considered as a 'consumer' under Competition Act, 2002. Even a person purchasing goods for resale or for any commercial purpose will also be considered as a 'consumer' within the meaning of Section 2(f) of Competition Act, 2002.

4. (a) 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.

(b) 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 accurred. 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.

(c) **(i)** 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.

Effect of takeover on rights of the shareholders:

Where the management of the business of a borrower, being a company as defined in the Companies Act is taken over by the secured creditor, then, notwithstanding anything contained, such borrower- in the said Act or in the memorandum or articles of association of such company -

(1) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;

(2) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;

(3) no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.

The secured creditor is under an obligation to restore the management of the business of the borrower, on realisation of his debt in full, in case of takeover of the management of the business of a borrower by such secured creditor.

"Provided that if any secured creditor jointly with other secured creditors or any asset reconstruction company or financial institution or any other assignee has converted part of its debt into shares of a borrower company and thereby acquired controlling interest in the borrower company, such secured creditors shall not be liable to restore the management of the business to such borrower."

(ii) Compensation to shareholders of the acquired bank: Under section 36AE of the Banking Regulation Act, 1949, the Central Government has power to acquire the undertaking of Banking Companies. When a bank is acquired by the Central Government, a scheme for the acquired bank is made in consultation with the Reserve Bank of India.

Such Scheme also provides for compensation payable to the registered shareholders of the acquired Bank (Section 36AF).

Section 36AG of the Banking Regulation Act, 1949 states that compensation is paid to the registered shareholders in accordance with the principles provided in section 5 of the said Act.

Any shareholder aggrieved with the amount of compensation may request the Central Government to refer the matter to Tribunal to be constituted under section 36AH of the Act. If the number of representation received is not less than one-fourth of the total number of shareholders holding not less than one-fourth of the paid-up share capital of the acquired Bank, the Central Government shall constitute a Tribunal for the purpose. Thus, such matters can be resolved through the Tribunal by the Central Government and the amount of compensation determined by the Tribunal is final and binding on all concerned 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 of the Companies Act, 2013, where there are more special courts than one for such area, all offences shall be triable 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 trail 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 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) (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

6. (a) (i) Transfer to reserves (Section 123 of the Companies Act, 2013): A company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company. Therefore, the company may transfer such percentage of profit to reserves before declaration of dividend as it may consider necessary. Such transfer is not mandatory and the percentage to be transferred to reserves is at the discretion of the company.

As per the given facts, YZ Limited has earned a profit of Rs. 910 crores for the financial year 2018-19. It has proposed a dividend @ 10%. However, it does not intend to transfer any amount to the reserves of the company out of current year profit.

As per the provisions stated above, the amount to be transferred to reserves out of profits for a financial year is at the discretion of the YZ Ltd. acting vide its Board of Directors.

(ii) As per the proviso to section 127 of the Companies Act, 2013, no offence will be said to have been committed by a director for adjusting the calls in arrears remaining unpaid or any other sum due from a member from the dividend as is declared by a company.

Thus, as per the given facts, Future Ltd. can adjust the sum of Rs. 50,000 unpaid call money against the declared dividend of 10%, i.e. 5,00,000 x 10/100 = 50,000. Hence, Karan's unpaid call money (Rs. 50,000) can be adjusted fully from the entitled dividend amount of Rs. 50,000/-.

(b) (i) Provisions and Explanation: Section 141(3) (c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor.

Conclusion: In the present case, Ayush, an auditor of X Ltd., joined as partner with consultancy firm where B is also a partner and B is also the Finance executive of X Ltd. Hence Ayush has attracted clause (3)(c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of X Limited.

(ii) As per section 141(3)(d)(i), an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holds any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

In the present case, Mr. Abhi. is holding security of Rs. 1000 in the Abhiman Ltd, therefore, he is not eligible for appointment as an auditor of Abhiman Ltd.

(c) (i) Under section 5 of the Foreign Exchange Management Act, 1999, and Rules relating thereto, some current account transactions require prior approval of the Central Government, some others require the prior approval of the Reserve Bank of India, some are free transactions and some others are prohibited transactions. Accordingly,

(A) It is a current account transaction, where M is required to take approval of the Central Government for drawal of foreign exchange for remittance of hire charges of transponders.

(B) Withdrawal of foreign exchange for payment related to call back services of telephone is a prohibited transaction. Hence, Mr. P will not succeed in acquiring US $ 2,000 for the said purpose.

(ii) (A) Preamble: The preamble expresses the scope, object and purpose of the Act more comprehensively than the Long Title. The preamble may recite the ground and the cause of making a statute and the evil which is sought to be remedied by it.

Like the Long Title, the preamble of a Statute is a part of the enactment and can legitimately be used for construing it. However, the preamble does not override the plain provision of the Act but if the wording of the statute gives rise to doubts as to its proper construction, e.g. where the words or phrase has more than one meaning and a doubt arises as to which of the two meanings is intended in the Act, the preamble can and ought to be referred to in order to arrive at the proper construction.

In short, the preamble to an Act discloses the primary intention of the legislature but can only be brought in as an aid to construction if the language of the statute is not clear. However, it cannot override the provisions of the enactment.

(B) Use of Foreign Decisions: Foreign decisions of countries following the same system of jurisprudence as ours and given on laws similar to ours can be legitimately used for construing our own Acts. However, prime importance is always to be given to the language of the Indian statute. Further, where guidance can be obtained from Indian decisions, reference to foreign decisions may become unnecessary.