MOCK TEST PAPER

FINAL 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) A Ltd. has carried out certain works on various machines in their engineering plant, which manufactures high quality metal patterns and templates for use in industry.

Determine in each case whether the costs of the improvements can be added to the existing carrying value of the assets concerned?

1. The cost of an annual machine overhaul which will maintain the originally assessed standard of performance of the machine for the coming 12 months.
2. The cost of repairs to a press machine, which was damaged by the emergency services while trying to extricate the arm of a worker who had been trapped in the press.
3. Modifications to a cutting machine which will increase its rate of output from 500 to 560 patterns per shift.
4. Modifications to a lathe which will replace the current water cooling system with an oil-based system, thereby extending the life of the lathe by a forecast 2 years.
5. The upgrading of a cutting machine with new software which will improve the accuracy of its measurement and cutting tolerances by a number of microns, thereby raising the quality of output.
6. Alterations to a production line which will allow automatic feeding from a machine to the next one in the production process, thereby removing the need for an employee to manually load the second machine.

(b) Prateek Ltd. is having the following Fixed Deposit Receipts:

	Date of FDR	*Maturity Date*	*Amount (Rs.)*
Axis Bank Limited	01 January, 2016	30 April, 2017	50,00,000
Punjab National Bank	01 January, 2016	30 June, 2016	65,00,000
State Bank of India	28 February, 2016	30 May, 2016	70,00,000
ICICI Bank	31 January, 2015	31 January, 2017	40,00,000

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Prepare 'Notes to accounts' showing the above deposits in accordance with the requirements of Schedule III.

(c) Samvit Ltd. has three business segments which are FMCG, Batteries and Sports Equipment. The Battery segment has been consistently underperforming and Samvit Ltd. after several discussions with labour unions have finally decided on closure of this segment. Under the agreement with the labour union, the employees of the Battery Segment will earn no further benefit as the arrangement is a curtailment without settlement wherein the employees of the discontinued segment will continue to receive benefits for services rendered when the segment was functioning. As a result of the curtailment, the company's obligations that were arrived on the basis of actuarial valuations before the curtailment have come down. The following information is also furnished:

(i) The value of gross obligations before the curtailment calculated on actuarial basis was Rs. 6,000 lakhs.

(ii) The value of unamortized past service costs is Rs. 150 lakhs.

(iii) The curtailment will bring down gross obligations by Rs. 750 lakhs and Samvit Ltd. anticipates a proportional decline in the value of unamortized past service costs also.

(iv) The fair value of plan assets on date is estimated at Rs. 4,875 lakhs.

You are required to calculate the gain from curtailment and also show the liability to be recognized in the Balance Sheet of Samvit Ltd. after the curtailment.

(d) From the given information, you are required to compute the deferred tax assets and deferred tax liability for Swamy Ltd. as on 31st March, 2017. The tax rate applicable is 40%.

(i) The company has charged depreciation of Rs. 3,71,450 in its books of accounts while as per income-tax computation, the depreciation available to the company is Rs. 4,32,700.

(ii) The company has made provision for doubtful debts for Rs. 27,150 during the year.

(iii) The company has debited share issue expenses of Rs. 3,11,750 which will be available for deduction under the Income-tax Act from the next year.

(iv) The expense of Rs. 3,92,250 has been charged to profit and loss account which are disallowed under the Income-tax Act.

(v) The company has made donation of Rs. 1,00,000 which has been debited to profit and loss account and only 50% thereof will be allowed as deduction as per Income-tax law. ***(4 x 5 = 20 Marks)***

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2. The summarized Balance Sheets of Feather Ltd. and its subsidiary Wing Ltd. as on 31st March, 2017 are as under:

Liabilities	*Feather Ltd.* *Rs.*	*Wing Ltd.* *Rs.*	*Assets*	*Feather Ltd.* *Rs.*	*Wing Ltd.* *Rs.*
Equity shares of Rs. 10 each	48,00,000	20,00,000	Goodwill	4,50,000	3,00,000
10% Non-convertible Preference shares of Rs. 10 each	7,00,000	3,80,000	Plant and machinery	12,00,000	5,00,000
			Motor vehicles	9,50,000	7,50,000
General reserve	5,50,000	4,20,000	Furniture and fittings	6,50,000	4,00,000
Profit and loss account	10,00,000	6,00,000			
Bank overdraft	1,20,000	70,000	Investments	26,00,000	4,50,000
Trade payables	4,30,000	6,40,000	Inventory	4,50,000	7,20,000
			Cash at bank	2,25,000	2,10,000
			Trade receivables	10,75,000	7,80,000
	76,00,000	41,10,000		76,00,000	41,10,000

Details of acquisition of shares by Feather Ltd. are as under:

Nature of shares	*No. of shares acquired*	*Date of acquisition*	*Cost of acquisition* *Rs.*
Preference shares	14,250	1.4.2014	3,10,000
Equity shares	80,000	1.4.2015	9,50,000
Equity shares	70,000	1.4.2016	8,00,000

Other information:

(i) On 1.4.2016 profit and loss account and general reserve of Wing Ltd. had credit balances of Rs. 3,00,000 and Rs. 2,00,000 respectively.

(ii) Dividend @ 10% was paid by Wing Ltd. for the year 2015-2016 out of its profit and loss account balance as on 1.4.2016. Feather Ltd. credited its share of dividend to its profit and loss account.

(iii) Wing Ltd. allotted, in 2016-2017, bonus shares out of pre-acquisition general reserve at the rate of 1 share for every 10 shares held. Accounting thereof has not yet been made.

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(iv) During the year 2016-2017, Feather Ltd. purchased goods from Wing Ltd. for Rs. 1,00,000 at a sale price of Rs. 1,20,000. 40% of these goods remained unsold at close of the year.

(v) On 1.4.2016 motor vehicles of Wing Ltd. were overvalued by Rs. 1,00,000. Applicable depreciation rate is 20%.

(vi) Dividends recommended for the year 2016-2017 in the holding and the subsidiary companies are 15% and 10% respectively. Bonus shares are not entitled for dividend.

(vii) Details of Trade payables and Trade receivables:

	Feather Ltd.	Wing Ltd.
Trade payables		
Bills Payable	–	1,60,000
Sundry creditors	4,30,000	4,80,000
	4,30,000	6,40,000
Trade receivables		
Debtors	9,30,000	7,80,000
Bills Receivables	1,45,000	–
	10,75,000	7,80,000

(viii) Bills receivable of Feather Ltd. were drawn upon Wing Ltd.

Prepare consolidated Balance Sheet as on 31st March, 2017. ***(16 Marks)***

3. The summarized Balance Sheet of Precious Limited as on 31.12.2016 is as follows:

Liabilities	*(Rs. in lakhs)*	*Assets*	*(Rs. in lakhs)*
1,00,000 equity shares of		Goodwill	5
Rs. 10 each fully paid	10	Fixed assets	15
1,00,000 equity shares of		Other tangible assets	5
Rs. 6 each, fully paid up	6	Intangible assets (market	3
Reserves and Surplus	2	value)	
Liabilities	10		
	28		28

Fixed assets are worth Rs. 24 lakhs. Other Tangible assets are revalued at Rs. 3 lakhs. The company is expected to settle the disputed bonus claim of Rs. 1 lakh not provided for in the accounts. Goodwill appearing in the Balance Sheet is purchased goodwill. It is considered reasonable to increase the value of goodwill by an amount equal to average of the book value and a valuation made at 3 years' purchase of average super-profit for

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the last 4 years.

After tax, profits and dividend rates were as follows:

Year	*PAT (Rs. in lakhs)*	*Dividend %*
2013	3.0	11%
2014	3.5	12%
2015	4.0	13%
2016	4.1	14%

Normal expectation in the industry to which the company belongs is 10%.

Akbar holds 20,000 equity shares of Rs. 10 each fully paid and 10,000 equity shares of Rs. 6 each, fully paid up. He wants to sell away his holdings.

(i) Determine the break-up value and market value of both kinds of shares.

(ii) What should be the fair value of shares, if controlling interest is being sold?

(16 Marks)

4. A new company Black & White Ltd. being incorporated on 1st September 2017 having an authorized equity capital of 2 crore shares of Rs. 10 each. Black & White Ltd. shall in turn acquire the entire equity shares of White Ltd. and Black Ltd. in consideration for issuing its equity at 25% premium on 1st October, 2017. It is also agreed that the consideration shall be based on the product of the profits available to equity shareholders of each entity, times it PE multiple. The preference shareholders & debenture holders are to be satisfied by the issue of similar instruments in Black & White Ltd. on 1-10-2017 in lieu of their existing holdings. Accordingly, the relevant information is supplied to you as under:

	White Ltd.	*Black Ltd.*
Paid up Equity shares of Rs. 10 class (Nos)	3 Lakhs	1.2 Lakhs
8% Preference Shares Rs. 10 paid (Nos)		1 Lakh
5% Redeemable Debentures 2018 of Rs. 10 each (Nos)		0.8 Lakh
Profits before Interest & Taxation (Rs.)	6,00,000	4,40,000
Price to Earnings Multiple	15	10

To augment the cash retention level of Black & White Ltd. it is decided that on 1st October, 2017 Black & White Ltd. shall collect full share application money for the issue 20,00,000 equity shares @ 40% premium under Private Placement. The allotment of the shares will be made on 31-12-2017 and such shares shall qualify for dividend from 2018 only.

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Black & White Ltd. also shall avail a 12.50% TOD of 15 lakhs to meet its preliminary expenses and cost of working which amount to Rs. 12 lakhs and Rs. 2 lakhs respectively. The TOD will be availed on 1st November, 2017 and closed on 31st December, 2017. Preliminary expenditure is tax deductible @ 20% each year.

Due to an accounting omission the opening inventory of Black Ltd. of 5 lakh (actual value) & the closing inventory of White Ltd. of 2.20 lakh was understated & overstated by 5% and 10% respectively.

The dividend schedule proposed is that all companies would pay interim dividend for equity, for the period from 1st October, 2017 to 31st December, 2017. The rates of dividend being White Ltd. @ 5%, Black Ltd. @ 2% and Black & White Ltd. @ 3.5%. The preference shareholders & debenture holders dues for the post take over period are discharged on 31.12.2017 by all the companies.

It is proposed that in the period October-December 2017, Black & White Ltd. would carry out trade in futures that would generate an absolute post tax return of 18% by using the funds generated from the Private Placement. The trades would be squared off on 31.12.2017. Proceeds from such transactions are not liable to tax deduction at source.

You are required to prepare a projected Statement of Profit and Loss for the period ended 31st December, 2017 and a Balance Sheet on that date for Black & White Ltd.

The corporation tax rate for the company is 40%. ***(16 Marks)***

5. (a) K Ltd. issued 10,00,000, 6% Convertible Debentures of Rs. 10 each on the 1st April 2016. The debentures are due for redemption on 31st March, 2020 at a premium of 10% convertible into equity shares to the extent of 50% and the balance to be settled in cash to the debenture holders. The interest rate on equivalent debentures without conversion rights was 10%. You are required to separate the debt and equity components at the time of the issue and show the accounting entry in the company's books at initial recognition.

The following present values of Rs. 1 at 6% and at 10% are supplied to you.

Interest rate	*Year 1*	*Year 2*	*Year 3*	*Year 4*
6%	0.94	0.89	0.84	0.79
10%	0.91	0.83	0.75	0.68

(b) At the beginning of year 1, an enterprise grants 300 stock options to each of its 1,000 employees, conditional upon the employees remaining in the employment of the enterprise for two years. The fair value of the stock options, at the date of grant, is Rs. 10 per option and the exercise price is Rs. 50 per share. The other relevant terms of the grant and assumptions are as below:

(i) The number of employees expected to complete two years vesting period, at the beginning of the plan, is 900. 50 employees are expected to leave during the each of the year 1 and year 2 and, consequently, the options granted to

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them are expected to be forfeited.

(ii) Actual forfeitures, during the vesting period, are equal to the expected forfeitures and 900 employees have actually completed two-years vesting period.

(iii) The profit of the enterprise for the year 1 and year 2, before amortisation of compensation cost on account of ESOPs, is Rs. 25,00,000 and Rs. 28,00,000 respectively.

(iv) The fair value of shares for these years was Rs. 57 and Rs.60 respectively.

(v) The enterprise has 5,00,000 shares of Rs. 10 each outstanding at the end of year 1 and year 2.

Compute the Basic and Diluted EPS, ignoring tax impacts, for the year 1 and year 2.

(8 + 8 =16 Marks)

6. (a) A Mutual Fund raised funds on 01.04.2017 by issuing 5 lakhs units @ 17.50 per unit. Out of this Fund, Rs. 80 lakhs invested in several capital market instruments. The initial expenses amount to Rs. 4.5 lakhs. During June, 2017, the Fund sold certain securities worth Rs. 50 lakhs for Rs. 62.5 lakhs and it bought certain securities for Rs. 45 lakhs. The Fund Management's expenses amounting to Rs. 2.5 lakhs per month. The dividend earned was Rs. 1.5 lakhs. 80% of the realised earnings were distributed among the unitholders. The market value of the portfolio was Rs. 87.5 lakhs. Determine Net Asset value (NAV) per unit as on 30.06.2017.

(b) Following information is provided in respect of Manpreet Ltd. as on 31st March, 2017:

	(Rs. in lakhs)
Turnover (including discounts and returns worth Rs. 35 lakh)	2,500
Plant and machinery (net)	785
Depreciation on plant and machinery	132
Debtors	205
Dividend to ordinary shareholders	85
Creditors	180
Stock (net) of all raw materials, WIP, finished goods	
Opening stock	180
Closing stock	240
Raw material purchased	714
Cash at bank	98

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Printing and stationery	24
Auditor's remuneration	15
Retained profit (opening balance)	998
Transfer to reserve	120
Retained profit for the year	445
Rent paid	172
Other expenses	88
Ordinary share capital (Rs. 100 each)	1700
Interest on borrowings	40
Income tax for the year	280
Wages and salaries	352
Employees state insurance	32
Provident fund contribution	26

You are required to:

(i) Prepare Value Added Statement and its application for the period 31.3.2017.

(ii) Value Added per Employee (If 87 employees work in Manpreet Ltd.)

(iii) Average Earnings per Employee (If 87 employees work in Manpreet Ltd.)

(iv) Sales per Employee (If 87 employees work in Manpreet Ltd.)

(8 + 8 = 16 Marks)

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

(a) Following is the Profit and Loss Account and Balance Sheet for Priceless Ltd.

(All figures are in Rs. Crores)

	2015-2016	2016-2017
Turnover	652	760
Pre-tax accounting profit	134	168
Taxation	46	58
Profit after tax	88	110
Dividends	30	36
Retained earnings	58	74

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Balance Sheet extracts are as follows:	2015-2016	2016-2017
Fixed Assets	240	312
Net current assets	260	320
Total	500	632
Equity Shareholders funds	390	472
Medium and long-term bank loan	110	160

The Companies performance in regard to turnover has increased by 17% alongwith increase in pre-tax profit by 25% but shareholders are not satisfied by the company's performance in the last 2 years.

You are required to calculate economic value added so that reasons of non-satisfaction can be evaluated. You are also given

	2015-2016	2016-2017
1. Pre-tax cost of debt	9%	10%
2. Cost of equity	15%	17%
3. Tax rate	35%	35%
4. Interest expense	Rs. 8	Rs. 12

(b) Explain what do you mean by Carve outs and carve ins in Ind AS from IFRS.

(c) Company X entered into an operating lease over a property several years ago. The property is now surplus to requirements and Company X has vacated it. The lease has three years to run with an associated expense of Rs. 10,000 per year.

Company X believes it may be able to find a tenant to take a sublease of the property, but that it might only receive Rs. 8,000 per year from the sublease. Alternatively, the landlord is prepared to terminate the lease and forgive the future rentals of Rs. 30,000, if Company X makes a termination payment of Rs. 5,500.

What, if any, provision should Company X recognise in relation to the operating lease?

(d) Write short note on "Market Value Added."

(e) P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd.

How would you assess the situation from the view point of AS 18 on related party disclosures? ***(4 x 4 = 16 Marks)***

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Test Series: March, 2017

MOCK TEST PAPER

FINAL COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

SUGGESTED ANSWERS/HINTS

1. (a)

1. No. This may not be capitalized as subsequent expenditure, since it merely maintains the originally assessed standard of performance of the asset.
2. Yes. An impairment loss should have been recognized when the damage occurred and any insurance payment received as compensation should have been recognized as income in the Statement of Profit and Loss when received.

   When expenditure is incurred to restore the asset, such expenditure is added to the carrying amount of the asset to the extent that it is probable that future economic benefits will flow to the enterprise.
3. Yes. The cost of such modifications may be added to the carrying amount of the asset, since it will increase its output in future.
4. Yes. Such costs may be capitalized, since it will extend the life of the lathe thereby increasing the production capacity.
5. Yes. Such costs may be capitalized, since it will raise the quality of the output.
6. Yes. Such costs may be capitalized if it increases the production capacity.

(b) Notes to Accounts

S. No.	*Particulars*		*Amount in Rs.*
1.	**Other non-current assets**		
	FDR of Axis Bank Limited		50,00,000
2.	**Current assets**		
	Cash and bank balances (See Note)		
	(a) Cash and cash equivalents		
	FDR of State Bank of India	70,00,000	
	(b) Other bank balances		
	FDR of ICICI Bank	40,00,000	
	FDR of Punjab National Bank	65,00,000	1,75,00,000

Note: The above 'Notes to Accounts' have been prepared on the basis of the Guidance Note on 'Schedule III to the Companies Act, 2013'. It states that in case

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of bank deposits having maturity of more than 3 months but upto 12 months, the heading "Cash and cash equivalents" should be changed to "Cash and bank balances" which may have two sub-headings viz "Cash and cash equivalents" and "Other bank balances". Since AS will prevail over Schedule and as per AS 3, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Therefore, even if the remaining maturity of FDR from reporting date is 3 months or less but its original maturity is more than 3 months from the date of acquisition it will be shown under the sub-heading "Other Bank Balances". It also states that bank deposits having maturity of more than 12 months should be shown under the heading "Other non-current assets".

Assumption: It is assumed that the FDR having maturity of more than 12 months from the reporting date i.e. 31.3.2017 are restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

Working Notes:

	Amount in Rs.	*Date of FDR*	*Maturity date*	*Maturity months from the reporting date i.e. 31.3.2016*
Axis Bank Limited	50,00,000	1.1.2016	30.4.2017	13
Punjab National Bank	65,00,000	1.1.2016	30.6.2016	3
State Bank of India	70,00,000	28.2.2016	30.5.2016	2
ICICI Bank	40,00,000	31.1.2015	31.1.2017	10
	2,25,00,000			

(c) Gain from curtailment

	(Rs. in lakhs
Reduction in gross obligation [(750/6,000) x 100] = 12.5%	750.00
Less: Proportion of unamortised past service cost (12.5% of Rs. 150)	(18.75)
Gain from curtailment	731.25

The liability to be recognised after curtailment in the balance sheet of Samvit Ltd. is estimated as under:

	Rs.
Reduced gross obligation (Rs. 6,000 - Rs. 750)	5,250.00
Less: Fair value of plan assets	(4,875.00)
	375.00

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Less: Unamortised past service cost (150.00 – 18.75)	(131.25)
Liability to be recognised in the balance sheet	243.75

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

S. No.	*Particulars*	*Amount of difference*	*Nature of difference*	*DTA @ 40%*	*DTL @ 40%*
		Rs.		*Rs.*	*Rs.*
(i)	Excess allowable depreciation as per income-tax law	61,250	Timing	-	24,500
(ii)	Provision for doubtful debts - disallowed as per income-tax law in the current year but reversible in future years.	27,150	Timing	10,860	-
(iii)	Share issue expenses charged in the accounting books but allowed as deduction in the income-tax law from the next year	3,11,750	Timing	1,24,700	-
(iv)	Disallowed expenses as per income tax law	3,92,250	Permanent	-	-
(v)	Donation debited to Profit & Loss Account				
	Allowed as per income tax	50,000	No difference	-	-
	Disallowed as per income tax	50,000	Permanent	-	-
				1,35,560	24,500

2. Consolidated Balance Sheet of Feather Ltd. and its subsidiary Wing Ltd.

as on 31st March, 2017

Particulars	*Note No.*	*(Rs.)*
I. **Equity and Liabilities**		
(1) Shareholder's Funds		
(a) Share Capital	1	55,00,000
(b) Reserves and Surplus	2	12,24,750
(2) **Minority Interest (W.N.3)**		9,11,000
(3) **Current Liabilities**		
(a) Short term borrowings	3	1,90,000

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			Note	Rs.
	(b)	Trade payables	4	9,25,000
	(c)	Other current liabilities	5	8,63,750
		Total		96,14,500
II.	**Assets**			
	(1)	**Non-current assets**		
	(a)	Fixed assets		
		i. Tangible assets	6	43,70,000
		ii. Intangible assets	7	9,47,500
	(b)	Non-current investments	8	9,90,000
	(2)	**Current assets**		
	(a)	Inventories	9	11,62,000
	(b)	Trade receivables	10	17,10,000
	(c)	Cash and cash equivalents	11	4,35,000
		Total		96,14,500

Notes to Accounts

			Rs.	*Rs.*
1.	**Share Capital**			
	Authorised, Issued and Paid up capital			–
	4,80,000, Equity shares of Rs. 10 each		48,00,000	
	70,000, 10% Non-convertible Preference shares of Rs. 10 each		7,00,000	55,00,000
2.	**Reserves and surplus**			
	General reserve – Feather Ltd.			
	Balance	5,50,000		
	Add: Share in Wing Ltd. [W.N. 1]	1,65,000	7,15,000	
	Profit and loss account (W.N. 4)		5,09,750	12,24,750
3.	**Short term borrowings**			
	Bank Overdraft			
	Feather Ltd.		1,20,000	
	Wing Ltd.		70,000	1,90,000
4.	**Trade payables**			
	Feather Ltd.		4,30,000	

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	Wing Ltd.	6,40,000	
	Less: Mutual debt	(1,45,000)	9,25,000
5.	**Other current liabilities**		
	Dividend payable		
	Feather Ltd.		
	Equity	7,20,000	
	Preference	70,000	7,90,000
	Wing Ltd.		
	Equity	50,000	
	Preference	23,750	73,750
			8,63,750
6.	**Tangible assets**		
	Plant and Machinery		
	Feather Ltd. Rs. 12,00,000		
	Wing Ltd. Rs. 5,00,000	17,00,000	
	Motor Vehicles		
	Feather Ltd. Rs. 9,50,000		
	Wing Ltd. (Rs.7,50,000–1,00,000+20,000) 6,70,000	16,20,000	
	Furniture & Fittings		
	Feather Ltd. Rs. 6,50,000		
	Wing Ltd. Rs. 4,00,000	10,50,000	43,70,000
7.	**Intangible assets**		
	Goodwill		
	Feather Ltd.	4,50,000	
	Wing Ltd.	3,00,000	
		7,50,000	
	Add: Goodwill on consolidation (W.N. 2)	1,97,500	9,47,500
8.	**Non-current investments**		
	Investments		
	Feather Ltd. (Rs. 26,00,000 – 20,60,000)	5,40,000	
	Wing Ltd.	4,50,000	9,90,000

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9.	**Inventories**		
	Inventory		
	Feather Ltd.	4,50,000	
	Wing Ltd.	7,20,000	
		11,70,000	
	Less: Unrealised profit	(8,000)	11,62,000
10.	**Trade receivables**		
	Feather Ltd.	10,75,000	
	Wing Ltd.	7,80,000	
	Less: Mutual Debt	(1,45,000)	17,10,000
11.	**Cash and cash equivalents**		
	Cash at Bank		
	Feather Ltd.	2,25,000	
	Wing Ltd.	2,10,000	4,35,000

Working Notes:

(1)	**Analysis of Profits of Wing Ltd.**	Rs.	*Capital Profits* Rs.	*Revenue Reserve* Rs.	*Revenue Profit* Rs.
(a)	General Reserve as on 1.4.2016	2,00,000			
	Less: Bonus issue (1/10 of Rs. 20,00,000)	(2,00,000)	–	–	
(b)	Addition to General Reserve during 2016-2017			2,20,000	
	(Rs. 4,20,000 – Rs. 2,00,000)				
(c)	Profit and Loss Account balance as on 1.4.2016	3,00,000			
	Less: Dividend paid for the year 2015-2016	(2,00,000)	1,00,000		
(d)	Profit for the year 2016-2017				
	(Rs. 6,00,000 – Rs. 1,00,000)				5,00,000
(e)	Adjustment for over valuation of motor vehicles		(1,00,000)		
(f)	Adjustment of revenue profit				

due to overcharged depreciation (20% on Rs. 1,00,000)				20,000
(g) Preference dividend for the year 2016-2017 @ 10%				(38,000)
		–	2,20,000	4,82,000
Feather Ltd.'s share (3/4)			1,65,000	3,61,500
Minority Interest (1/4)			55,000	1,20,500
			2,20,000	4,82,000

		Rs.	*Rs.*
(2)	**Cost of Control**		
	Cost of investments in Wing Ltd.		20,60,000
	Less: Paid up value of equity shares (including bonus shares) [80,000+70,000+(10% of 1,50,000)] × Rs.10	16,50,000	
	Paid-up value of preference shares	1,42,500	
	Pre-acquisition dividend*	70,000	(18,62,500)
	Cost of control/Goodwill		1,97,500
(3)	**Minority Interest**		
	Equity share capital [Rs. 5,00,000 + Rs. 50,000 (Bonus)]		5,50,000
	Preference share capital (Rs. 3,80,000 – Rs. 1,42,500)		2,37,500
	Share of revenue reserve [W.N. 1]		55,000
	Share of revenue profit [W.N. 1]		1,20,500
	Preference dividend		23,750
	Less: Unrealised gain (8,000 x ¼)		(2,000)
			9,84,750
	Less: Dividend payable		
	Equity	50,000	
	Preference	23,750	73,750
			9,11,000
(4)	**Profit and Loss Account – Feather Ltd.**		
	Balance		10,00,000
	Share in profit of Wing Ltd. [W.N. 1]		3,61,500

* The dividend on 70,000 shares only (acquired on 1.4.2016) is a pre-acquisition dividend.

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Share in preference dividend of Wing Ltd.		14,250
		13,75,750
Less: Pre-acquisition dividend credited to profit and loss account*	70,000	
Unrealised profit on inventory [(40% of Rs. 20,000) x ¾]	6,000	
Equity dividend [48,00,000 x 15%]	7,20,000	
Preference dividend [7,00,000 x 10%]	70,000	(8,66,000)
		5,09,750

3. (i) Break up value of Re. 1 of share capital $= \frac{\text{Rs. 28.98 lakhs}}{\text{Rs. 16.00 lakhs}}$ = Rs. 1.81

Break up value of Rs. 10 paid up share = Rs. 1.81 × Rs. 10 = Rs. 18.10

Break up value of Rs. 6 paid up share = Rs. 1.81 ×Rs. 6 = Rs. 10.86

Market value of shares:

$$\text{Average dividend} = \left(\frac{11\% + 12\% + 13\% + 14\%}{4}\right) = 12.5\%$$

$$\text{Market value of Rs. 10 paid up share} = \frac{12.5\%}{10\%} \times 10 = \text{Rs. } 12.50$$

$$\text{Market value of Rs. 6 paid up share} = \frac{12.5\%}{10\%} \times 6 = \text{Rs. } 7.50$$

(ii) Break up value of share will remain as before even if the controlling interest is being sold. But the market value of shares will be different as the controlling interest would enable the declaration of dividend upto the limit of disposable profit.

$$\frac{\text{Average Profit}}{\text{Paid up value of shares}} \times 100 = \frac{\text{Rs. 3.4 lakhs}}{\text{Rs.16 lakhs}} \times 100 = 21.25\%$$

Market value of shares:

$$\text{For Rs. 10 paid up share} = \frac{21.25\%}{10\%} \times 10 = \text{Rs. } 21.25$$

$$\text{For Rs. 6 paid up share} = \frac{21.25\%}{10\%} \times 6 = \text{Rs. } 12.75$$

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Fair value of shares = $\frac{\text{Breakup value + Market value}}{2}$

Fair value of Rs. 10 paid up share = $\frac{18.10 + 21.25}{2}$ = Rs. 19.68

Fair value of Rs. 6 paid up share = $\frac{10.86 + 12.75}{2}$ = Rs. 11.81

Working Notes:

(Rs. in lakhs)

(a) Calculation of average capital employed

Fixed assets		24.00
Other tangible assets		3.00
Intangible assets		3.00
		30.00
Less: Liabilities	10	
Bonus claim	1	(11.00)
		19.00
Less: ½ of profits [½ (4.1 – Bonus 1.0)]		(1.55)
Average capital employed		17.45

(b) Calculation of super profit

Average profit = ¼ (3 + 3.5 + 4 + 4.1 – Bonus 1.0) or	
= ¼ × 13.6	3.400
Less: Normal profit = 10% of Rs. 17.45 lakh	(1.745)
Super profit	1.655

(c) Calculation of goodwill

3 Years' purchase of average super-profit = 3 × 1.655 = Rs. 4.965 lakhs

Increase in value of goodwill = ½ (book value + 3 years' super profit)

= ½ (5 + 4.965)

= Rs.4.9825 lakhs

Net assets as revalued including book value of goodwill (19 + 5)	24.00
Add: Increase in goodwill (rounded-off)	4.98
Net assets available for shareholders	28.98

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Note: In the above solution, tax effect of disputed bonus and corporate dividend tax has been ignored. Also the increase in value of goodwill has been calculated on the basis of the capital employed (excluding purchased goodwill).

4. Projected Profit & Loss Account of Black & White Ltd.

for the period ended 31-12-2017

	Note No.	*Rs.*
Revenue from operations		—
Other income	6	86,04,000
Total Revenue (A)		86,04,000
Expenses:		
Finance costs	7	41,250
Other expenses	8	14,00,000
Total expenses (B)		14,41,250
Profit before tax (A-B)		71,62,750
Tax expense:		
Current tax	9	(27,87,500)
Profit for the period		43,75,250

Projected Balance Sheet of Black & White Ltd. as at 31-12-2017

Particulars	*Note No.*	*(Rs.)*
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital	1	2,63,36,000
(b) Reserves and Surplus	2	1,35,02,490
(2) **Non-Current Liabilities**		
Long-term borrowings	3	8,00,000
(3) **Current Liabilities**		
Short-term provisions	4	27,87,500
Total		4,34,25,990
II. **Assets**		
(1) **Non-current assets**		
Non-current investments	5	84,70,000

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(2) **Current assets**		
Cash and cash equivalents		3,49,55,990
Total		4,34,25,990

Notes to Accounts

				Rs.	*Rs.*
1.	Share Capital				
	Authorised share capital 2 crore Equity shares of Rs. 10 each				20,00,00,000
	Issued, subscribed & paid up				
	25,33,600 Shares of Rs. 10 each				
	(of the above 5,33,600 shares issued for consideration other than cash)			2,53,36,000	
	Preference Shares				
	1 lakh 8% Preference Shares Rs. 10 paid			10,00,000	2,63,36,000
2.	Reserves and Surplus				
	Securities Premium			93,34,000	
	Profit & Loss Account		43,75,250		
	Less: Appropriation				
		Dividends (Equity & Preference)	(2,06,760)	41,68,490	1,35,02,490
3.	Long-term borrowings				
	Secured loan				
		5% Redeemable Debentures 2018 of Rs. 10 each			8,00,000
4.	Short-term provisions				
	Provision for taxation				27,87,500
5.	Non-current investments				
	Investments in Subsidiaries				
		In Equity shares at cost		66,70,000	
		In Preference shares at cost		10,00,000	
		In 5% Redeemable Debentures 2018 of Rs. 10		8,00,000	84,70,000
6.	Other income				
		Dividends received from Subsidiaries		1,74,000	
		Debenture interest		10,000	
		Preference dividend		20,000	

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	Profits from Futures Trading	84,00,000	86,04,000
7.	Finance costs		
	Interest on TOD	31,250	
	Debenture interest	10,000	41,250
8.	Other expenses		
	Working capital expenses	2,00,000	
	Preliminary expenses	12,00,000	14,00,000
9.	Current tax		
	Provision for tax @ 40% on pre-tax profit - Rs. 69,68,750		27,87,500

Note:

1. Dividend received is exempted income and is not subject to tax in the hands of recipient. It is assumed that rate of dividend given in the question is net of tax.
2. Dividend distributed by Black and White Ltd. is subject to dividend distribution tax, if not net of tax.
3. As per para 56 of AS 26, when an expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognized, then such an expenditure is recognized as an expense when it is incurred. However, as per the Income-tax Act, only 20% is allowed as deduction in the current year. Therefore, Deferred tax asset will be created due to the temporary difference arising on account of the difference in the treatment of preliminary expense in the books of accounts and as per the Income-tax Act, 1961.

Working Notes:

1. Calculation of Rectified Profits

	White Ltd. (Rs.)	*Black Ltd. (Rs.)*
Value of inventory as given	2,20,000 (Overstated)	5,00,000 (Actual)
Adjustment therein due to incorrect valuation will be reduced from profits	2,20,000 x 10/110 = 20,000	
		5,00,000 x 5/100 = 25,000

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2. **Computation of Shares to be issued**

	White Ltd. Rs.	*Black Ltd.* Rs.
Profit before interest & tax	6,00,000	4,40,000
Less: Reduction in profit due to incorrect inventory valuation	(20,000)	(25,000)
Less: Debenture interest		(40,000)
Profit before tax	5,80,000	3,75,000
Less: Tax @ 40%	(2,32,000)	(1,50,000)
Profit after tax (PAT)	3,48,000	2,25,000
Less: Preference dividend	-	(80,000)
Profit available to equity shareholders [A]	3,48,000	1,45,000
Price Earnings Multiple [B]	15	10
Total Consideration to be given (A x B)	52,20,000	14,50,000
Equity Share Capital (Consideration x 100/125)	41,76,000	11,60,000
Securities Premium (25% of the above)	10,44,000	2,90,000

3. **Bank Account**

Date	Particulars		Rs.	Date	Particulars	Rs.
1.10.17	To Share Application Money (20,00,000 x Rs. 14)		2,80,00,000	1.10.17	By Futures Trading A/c	2,80,00,000
1.11.17	To 12.5% TOD		15,00,000	1.11.17	By Preliminary Expenses	12,00,000
31.12.17	To Future Trading A/c [(2,80,00,000 x (18/100) x (100/60) + 2,80,00,000}		3,64,00,000	31.12.17	By Working Capital expenses	2,00,000
31.12.17	To Dividend received			31.12.17	By Dividends Paid [(41,76,000 + 11,60,000) x 3.5/100]	1,86,760
	White Ltd (3,00,000 x 10 x 5%)	1,50,000		31.12.17	By TOD Interest (15,00,000 x 12.5/100 x 2/12)	31,250
	Black Ltd. (1,20,000 x 10 x	24,000	1,74,000	31.12.17	By Debenture Interest paid (80,000	10,000

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	2%)				x Rs. 10 x 5/100 x 3/12)	
31.12.17	To Debenture Interest received (80,000 x Rs. 10 x 5/100 x 3/12)		10,000	31.12.17	By Preference Dividend paid (1,00,000 x Rs. 10 x 8/100 x 3/12)	20,000
31.12.17	To Preference Dividend received (1,00,000 x Rs. 10 x 8/100 x 3/12)		20,000	31.12.17	By 12.5% TOD	15,00,000
				31.12.17	By Balance c/d	3,49,55,990
			6,61,04,000			6,61,04,000

5. (a) Computation of Debt Component of Convertible Debentures as on 1.4.2016

Particulars	*Rs.*
Present value of the principal repayable after four years [1,00,00,000 x 50% × 1.10 × 0.68 (10% Discount factor)] (a)	37,40,000
Present value of interest [6,00,000 x 3.17 (4 years cumulative 10% discount factor)] (b)	19,02,000
Total present value of debt component (I) (a + b)	56,42,000
Issue proceeds from convertible debenture (II)	1,00,00,000
Value of equity component (II – I)	43,58,000

Journal entry at initial recognition

	Dr. (Rs.)	*Cr. (Rs.)*
Cash / Bank A/c Dr.	1,00,00,000	
To 6% Debentures (Liability component) A/c		56,42,000
To 6% Debentures (Equity component) A/c		43,58,000
(Being the disbursement recorded at fair value)		

(b) (i) The stock options granted to employees are not included in the shares outstanding till the employees have exercised their right to obtain shares or stock options, after fulfilling the requisite vesting conditions. Till such time, the stock options so granted are considered as dilutive potential equity shares for the purpose of calculating Diluted EPS. At the end of each year, computations of diluted EPS are based on the actual number of options granted and not yet forfeited.

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(ii) For calculating diluted EPS, no adjustment is made to the net profit attributable to equity shareholders as there are no expense or income that would result from conversion of ESOPs to the equity shares.

(iii) For calculating diluted EPS, the enterprise assumes the exercise of dilutive options. The assumed proceeds from these issues are considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value are treated as an issue of equity shares for no consideration

(iv) As per paragraph 47 of this Guidance Note, the assumed proceeds to be included for computation, mentioned at (iii) above, include (a) the exercise price; and (b) the unamortized compensation cost related to these ESOPs, attributable to future services.

(v) **Calculation of the basic and diluted EPS**

Particulars	*Year 1*	*Year 2*
Net profit before amortisation of ESOP cost	Rs. 25,00,000	Rs. 28,00,000
Less: Amortisation of ESOP cost [(900 employees × 300 options × Rs. 10)/2]	(Rs. 13,50,000)	(Rs. 13,50,000)
Net profit attributable to equity shareholders	Rs. 11,50,000	Rs. 14,50,000
Number of shares outstanding	5,00,000	5,00,000
Basic EPS	Rs. 2.30	Rs. 2.90
Number of options outstanding (Options granted less actual forfeitures)	2,85,000 [1,000 employees× 300 options— (50 employees× 300 options)]	2,70,000 [2,85,000 options - (50 employees× 300 options)]
Unamortised compensation cost per option	Rs. 5 [Rs. 10 – Rs. 10/2]	Rs. 0
Number of dilutive potential equity shares	10,000 [2,85,000 –	45,000 [2,70,000 –

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	({(2,85,000 * 50) + (2,85,000 * 5)}/57)]	(2,70,000 * 50)/60)]
No. of equity shares used to compute diluted earnings per share	5,10,000	5,45,000
Diluted EPS	Rs. 2.255	Rs. 2.66

6. (a) **Total Funds raised by Mutual Fund = 17.5 x5 lakhs = 87.50 lakhs**

			(Rs. in lakhs)
Opening Bank Balance(87.5-80-4.5)		3	
Add: Proceeds from sale of securities		62.5	
Add: Dividend received		1.5	
Less:			67
Cost of securities purchased	45		
Management expenses (Rs. 2.5 lakhs x 3 months)	7.5		
Realised gains distributed [80% of (Rs. 62.5 lakhs – Rs. 50 lakhs)]	10		
Dividend distributed (80% of Rs. 1.5 lakhs)	1.20		(63.70)
Closing Bank Balance			3.30
Closing Market value of portfolio			87.50
Closing Net Assets			90.80

No. of Units — 5.00 lakh units

Closing NAV = Rs. 90.8 lakhs ÷ 5 lakh units = Rs. 18.16

(b) (i) **Value Added Statement of Pradeep Ltd.**

for the period ended on 31.3.2017

		(Rs. in lakhs)
Sales (net) (2,500 – 35)		2,465
Less: Cost of Bought in Materials and Services:		
Raw material consumed (180 + 714 – 240)	654	
Printing and stationary	24	
Auditors' remuneration	15	
Rent paid	172	
Other expenses	88	(953)
Value added by manufacturing and trading activities		1,512

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Application of Value Added

		(Rs. in lakh)	(Rs. in lakh)	%
To	Pay Employees:			
	Wages and salaries	352		
	Employees state insurance	32		
	Provident fund contribution	26	410	27.12
To	Pay Government:			
	Income-tax		280	18.52
To	Pay Providers of Capital:			
	Interest on borrowings	40		
	Dividend	85	125	8.27
To	Provide for maintenance and expansion of the company:			
	Depreciation	132		
	Transfer to reserve	120		
	Retained profit	445	697	46.09
			1,512	100

(ii) Value Added Per Employee = Value Added/ No. of Employees

= 1,512 \ 87 = 17.38

(iii) Average Earnings Per Employee = Average Earnings of Employee/No. of Employees

= 410/87 = 4.71

(iv) Sales Per Employee = Sales / No. of Employees

= 2,465 / 87 = 28.33

7. (a) Calculation of Return on Operating Capital

NOPAT	*2015-2016*	*2016-2017*
PBT	134	168
Add: Interest Expenses	8	12
	142	180
Less: Taxes @ 35%	(49.7)	(63)
NOPAT (A)	92.3	117

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Operating Capital	2015-2016	2016-2017
Eq. Shareholder's Funds	390	472
Long Term Debt	110	160
(B)	500	632
ROOC = A/BX 100	18.46%	18.51%
Calculation of WACC	**2015-2016**	**2016-2017**
Kd	9% (1-0.35) x 110/500 = 1.287%	10% (1-0.35) x160/632 = 1.645%
Ke	15% x 390/500 = 11.7%	17% x 472/632 = 12.7%
	12.99%	14.34%

Calculation of Economic Value Added

	2015-2016	*2016-2017*
NOPAT	92.3	117
Less: Cost of Capital	(64.95) (500 x 12.99%)	(90.63) (632 x 14.34%)
EVA	Rs. 27.35 Cr.	Rs. 26.37 Cr.

Since EVA has declined in Yr. 2016-2017 by Rs. 1 crore approx., this can be attributed as reason for non-satisfaction.

(b) While formulating IFRS-converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential. These changes have been made considering various factors, such as

Certain changes have been made considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS. These differences are due to differences in application of accounting principles and practices and economic conditions prevailing in India. These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as **'Carve-outs'.**

In Ind AS 103 "Business Combination", an additional guidance on "Accounting of Business Combinations of Entities under Common Control" is given which is over and above what is given in IFRS. This is termed as **'Carve-in'.**

(c) The property has been vacated, and the continuing rentals are not expected to be recoverable from subleasing the property. Therefore, a provision should be recognised. The provision should represent the best estimate of the expenditure required to settle the obligation at the end of the reporting period. If Company X

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subleases the property, it expects to pay Rs. 30,000 in lease rentals and receive Rs. 24,000 (8,000 x 3 years) in sublease rentals, which would leave a deficit of Rs. 6,000 to be provided. However, in this case, the amount the landlord would accept to terminate the lease is Rs. 5,500, which is lower. Accordingly, Entity X should recognise an onerous lease provision of Rs. 5,500, irrespective of whether it intends to terminate the lease or enter into a sublease.

(d) Market value added is the market value of capital employed in the firm less the book value of capital employed. Market value added is calculated by summing up the paid up value of equity and preference share capital, retained earnings, long term and short term debts and subtracting this sum from the market value of equity and debt.

Market value added (MVA) measures cumulatively the performance of corporate entity. A high market value added means that the company has created substantial wealth for shareholders. On the other hand, negative MVA means that the value of management's actions and investments are less than the value of capital contributed to the company by the capital market or that the wealth and value has been destroyed.

(e) P Ltd. has direct economic interest in R Ltd. to the extent of 14%, and through Q Ltd. (in which it is the majority shareholders) it has further control of 12% in R Ltd. (60% of Q Ltd.'s 20%). These two taken together (14% + 12%) make the total control of 26%.

AS 18 'Related Party Disclosures', defines *related party* as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

Since, P Ltd. has total control of 26% (directly and indirectly by Q Ltd.) in R Ltd. which is less than half of the voting power of R Ltd., P Ltd. is said to have significant influence over R Ltd. Also it is given in the question that R Ltd. is a listed company and regularly supplies goods to P Ltd. Therefore, related party disclosure, as per AS 18, is required by R Ltd. in its financial statements, in respect of goods supplied to P Ltd.

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FINAL 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) TMC Holding Ltd. has a portfolio of shares of diversified companies valued at Rs. 400 crore enters into a swap arrangement with None Bank on the terms that it will get 1.15% quarterly on notional principal of Rs. 400 crore in exchange of return on portfolio which is exactly tracking the Sensex which is presently 21,600.

   You are required to determine the net payment to be received/ paid if Sensex turns out to be 21,860, 21,780, 22,080 and 21,960 at the end of each quarter. ***(5 Marks)***

   (b) With the help of following information determine how sensitive is the decision advice with changes in the estimated life and annual net cash flow of the project:

Initial Outlay	£1 Million
Annual Cash inflow	£ 0.28 million
Life of the project	5 years
Applicable Discount Rate	10%

(5 Marks)

   (c) Odessa Limited has proposed to expand its operations for which it requires funds of \$ 15 million, net of issue expenses which amount to 2% of the issue size. It proposed to raise the funds though a GDR issue. It considers the following factors in pricing the issue:

   (i) The expected domestic market price of the share is Rs. 300

   (ii) 3 shares underly each GDR

   (iii) Underlying shares are priced at 10% discount to the market price

   (iv) Expected exchange rate is Rs. 60/\$

   You are required to compute the number of GDR's to be issued and cost of GDR to Odessa Limited, if 20% dividend is expected to be paid with a growth rate of 20%. ***(5 Marks)***

   (d) From the following particulars, calculate the effective interest p.a. as well as the total cost of funds to ABC Ltd., which is planning a CP issue:

Issue Price of CP	= Rs. 97,350
Face Value	= Rs. 1,00,000
Maturity period	= 3 months.
Issue Expenses:	
Brokerage:	0.125% for 3 months.
Rating Charges:	0.5% p.a.
Stamp duty:	0.125% for 3 months

(5 Marks)

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2. (a) Mr. X on 1.7.2007, during the initial offer of some Mutual Fund invested in 10,000 units having face value of Rs. 10 for each unit. On 31.3.2008, the dividend operated by the M.F. was 10% and Mr. X found that his annualized yield was 153.33%. On 31.12.2009, 20% dividend was given. On 31.3.2010, Mr. X redeemed all his balance of 11,296.11 units when his annualized yield was 73.52%. What are the NAVs as on 31.3.2008, 31.3.2009 and 31.3.2010? ***(8 Marks)***

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

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

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

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

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

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

(c) Calculate:

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

(ii) Free float market capitalization.

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

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

(b) Split the stock (share) as Rs. 5 each fully paid. ***(8 Marks)***

3. (a) Skylark Airways is planning to acquire a light commercial aircraft for flying class clients at an investment of Rs. 50,00,000. The expected cash flow after tax for the next three years is as follows: (Rs.)

Year 1		Year 2		Year 3	
CFAT	Probability	CFAT	Probability	CFAT	Probability
14,00,000	0.1	15,00,000	0.1	18,00,000	0.2
18,00,000	0.2	20,00,000	0.3	25,00,000	0.5
25,00,000	0.4	32,00,000	0.4	35,00,000	0.2
40,00,000	0.3	45,00,000	0.2	48,00,000	0.1

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The Company wishes to take into consideration all possible risk factors relating to airline operations. The company wants to know:

(i) The expected NPV of this venture assuming independent probability distribution with 6 per cent risk free rate of interest.

(ii) The possible deviation in the expected value.

(iii) How would standard deviation of the present value distribution help in Capital Budgeting decisions? ***(8 Marks)***

(b) X Ltd. is a shoe manufacturing company. It is all equity financed and has a Paid-up Capital of Rs. 10,00,000 (Rs. 10 per share).

X Ltd. has hired Swastika consultants to analyse 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)***

4. (a) Your bank's London office has surplus funds to the extent of USD 5,00,000/- for a period of 3 months. The cost of the funds to the bank is 4% p.a. It proposes to invest these funds in London, New York or Frankfurt and obtain the best yield, without any exchange risk to the bank. The following rates of interest are available at the three centres for investment of domestic funds there at for a period of 3 months.

London	5 % p.a.
New York	8% p.a.
Frankfurt	3% p.a.

The market rates in London for US dollars and Euro are as under:

London on New York

Spot	1.5350/90
1 month	15/18
2 month	30/35
3 months	80/85

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London on Frankfurt

Spot	1.8260/90
1 month	60/55
2 month	95/90
3 month	145/140

At which centre, will be investment be made & what will be the net gain (to the nearest pound) to the bank on the invested funds? ***(8 Marks)***

(b) If the rate of return and Standard Deviation of Market Portfolio (Index) is 8% and 6% respectively and the risk free rate of return is 5%, you are required to:

(i) Construct an efficient portfolio which produces expected return of 7.5%.

(ii) Calculate the risk of above portfolio.

(iii) Suppose if Mr. X has Rs.1,00,000 of his personal funds, then how he would construct his portfolio giving expected return of 10% and what will be risk of this portfolio.

(8 Marks)

5. (a) MS Stones has different divisions of home interiors products. Recently, due to economic slowdown, the Managing Director of the Company expressed it desire to divestiture its ceramic tile business. The relevant financial details of this business are as follows:

Estimated Pre Tax Cash Flow Next Year	=	Rs. 200 Crore
Book Value of Liabilities	=	Rs. 780 Crore

In an order to increase its share in the ceramic tile market, the Tripati Tiles Ltd. showed its interest in the acquisition of this unit and offered a proceed of Rs. 950 Crore for the same to MS Stones.

The other data pertaining to the business are as follows:

Tax Rate	30%
Growth Rate	4%
Applicable Discount Rate for Tile Business	12%

If market value of liabilities are Rs. 40 Crore more than book value, you are required to advice MD whether she should go for divestiture of the tile business or not. ***(8 Marks)***

(b) Following is the data regarding six securities:

	A	B	C	D	E	F
Return (%)	8	8	12	4	9	8
Risk (Standard deviation)	4	5	12	4	5	6

(i) Assuming three will have to be selected, state which ones will be picked.

(ii) Assuming returns from securities are independent, show whether it is preferable to invest 75% in A and 25% in C or to invest 100% in E. ***(8 Marks)***

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

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

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Compute the following:

(i) Portfolio beta.

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

(iii) If the PM seeks to increase the beta to 1.2, how much risk free investment should he bring in? ***(8 Marks)***

(b) X Ltd. had only one water pollution control machine in this type of block of asset with no book value under the provisions of the Income Tax Act, 1961 as it was subject to rate of depreciation of 100% in the very first year of installation.

Due to funds crunch, X Ltd. decided to sell the machine which can be sold in the market to anyone for Rs. 5,00,000 easily.

Understanding this from a reliable source, Y Ltd. came forward to buy the machine for Rs. 5,00,000 and lease it to X Ltd. for lease rental of Rs. 90,000 p.a. for 5 years. X Ltd. decided to invest the net sale proceed in a risk free deposit, fetching yearly interest of 8.75% to generate some cash flow. It also decided to relook the entire issue afresh after the said period of 5 years.

Another company, Z Ltd. also approached X Ltd. proposing to sell a similar machine for Rs. 4,00,000 to the latter and undertook to buy it back at the end of 5 years for Rs. 1,00,000 provided the maintenance were entrusted to Z Ltd. for yearly charge of Rs. 15,000. X Ltd. would utilise the net sale proceeds of the old machine to fund this machine also. Should it accept this offer?

The marginal rate of tax of X Ltd. is 34% and its weighted average cost of capital is 12%.

Which Alternative would you recommend?

Discounting Factors @ 12%

Year	1	2	3	4	5
	0.893	0.797	0.712	0.636	0.567

(8 Marks)

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

(a) Non-compete fee in mergers and acquisitions.

(b) Meaning of open interest and its relevance in the stock market.

(c) Circumstances that indicate that it is time for an investor to exit a mutual fund scheme.

(d) Exposure Netting.

(e) Inter Bank Participation Certificate. ***(4 × 4 = 16 Marks)***

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FINAL COURSE: GROUP – I

PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

SUGGESTED ANSWERS/HINTS

1. (a)

Qtrs. (1)	*Sensex* (2)	*Sensex Return (%)* (3)	*Amount Payable (Rs. Crore)* (4)	*Fixed Return (Receivable) (Rs. Crore)* (5)	*Net (Rs. Crore)* (5) – (4)
0	21,600	-		-	
1	21,860	1.2037	4.8148	4.6000	- 0.2148
2	21,780	-0.3660	-1.4640	4.6000	6.0640
3	22,080	1.3774	5.5096	4.6000	- 0.9096
4	21,960	-0.5435	-2.1740	4.6000	6.7740

(b) NPV of the Project with 5 year life

= £ 0.28 million PVAF (10%, 5) - £1 Million

= £ 0.28 million X 3.791 - £1 Million = £ 0.06148 Million

NPV of the Project with 4 year life

= £ 0.28 million PVAF (10%, 4) - £1 Million

= £ 0.28 million X 3.170 - £1 Million = - £ 0.1124 Million

Let life of the project at which NPV will be zero is y then using Interpolation Method:

$$y = 4 + \left[\frac{-0.1124}{-0.1124 - 0.06148} \times (5-4) \right] = 4.65 \text{ years}$$

Thus, the life of the project can be reduced by 0.35 year before the original advice is incorrect. Accordingly, the maximum change is

$$= \frac{0.35}{5} \times 100 = 7\%$$

Let Annual Cash Inflow at which NPV will be zero is z. Accordingly,

$$z = \frac{£1 \text{ Million}}{\text{PVAF}(10\%,5)} = \frac{£1 \text{ Million}}{3.791} = £0.2638 \text{ million}$$

Thus, the annual cash flow of the project can be reduced by £0.0162 million (£0.28 - £0.2638) before the original advice is incorrect. Accordingly, the maximum change is

$$= \frac{0.0162}{0.28} \times 100 = 5.786\%$$

(c) Net Issue Size = $15 million

$$\text{Gross Issue} = \frac{\$15 \text{ million}}{0.98} = \$15.306 \text{ million}$$

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Issue Price per GDR in Rs. (300 x 3 x 90%) Rs. 810

Issue Price per GDR in $ (Rs. 810/ Rs. 60) $13.50

Dividend Per GDR (D_1) = Rs. 2* x 3 = Rs. 6

* Assumed to be on based on Face Value of Rs. 10 each share.

Net Proceeds Per GDR = Rs. 810 x 0.98 = Rs. 793.80

(a) Number of GDR to be issued

$$\frac{\$15.306 \text{ million}}{\$13.50} = 1.1338 \text{ million}$$

(b) Cost of GDR to Odessa Ltd.

$$k_e = \frac{6.00}{793.80} + 0.20 = 20.76\%$$

(d) Nominal Interest or Bond Equivalent Yield = $\left[\frac{F-P}{P}\right] \times \frac{12}{m} \times 100$

$$= \frac{1{,}00{,}000 - 97{,}350}{97{,}350} \times \frac{12}{3} \times 100$$

= 0.02722 x 4 x 100= 10.888

= 10.89

Effective Interest $= [1 + \frac{0.1089}{4}]^4 - 1$ = 11.34% p.a.

Cost of Funds to the Company

Effective Interest	11.34%
Brokerage (0.125 x 4)	0.50%
Rating Charge	0.50%
Stamp Duty (0.125 x 4)	0.50%
Cost of funds	12.84%

2. (a) Yield for 9 months = (153.33 x 9/12) = 115%

Market value of Investments as on 31.03.2008 = 1,00,000/- + (1,00,000x 115%)

= Rs.2,15,000/-

Therefore, NAV as on 31.03.2008 = (2,15,000-10,000)/10,000= Rs.20.50

(NAV would stand reduced to the extent of dividend payout, being (10,000x10x10%) = Rs.10,000)

Since dividend was reinvested by Mr. X, additional units acquired = $\frac{\text{Rs.}10{,}000}{\text{Rs.}20.50}$ = 487.80 units

Therefore, units as on 31.03.2008 = 10, 000+ 487.80 = 10,487.80

[Alternately, units as on 31.03.2008 = (2,15,000/20.50) = 10,487.80]

Dividend as on 31.03.2009 = 10,487.80 x 10 x 0.2 = Rs.20,975.60

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Let X be the NAV on 31.03.2009, then number of new units reinvested will be Rs. 20,975.60/X. Accordingly 11296.11 units shall consist of reinvested units and 10487.80 (as on 31.03.2008). Thus, by way of equation it can be shown as follows:

$$11296.11 = \frac{20975.60}{X} + 10487.80$$

Therefore, NAV as on 31.03.2009 = 20,975.60/(11,296.11- 10,487.80)

= Rs.25.95

NAV as on 31.03.2010 = Rs. 1,00,000 (1+0.7352x33/12)/11296.11

= Rs. 26.75

(b) (a) Swap Ratio

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

Calculation of Swap Ratio

Book Value	1 : 0.12 i.e.	0.12 x 25%	0.03
EPS	1 : 0.2	0.20 x 50%	0.10
Market Price	1 : 0.08	0.08 x 25%	0.02
		Total	0.15

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

10 Lakh x 0.15 = 1.50 lakh shares

(b) Book Value, EPS & Market Price

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

Total Capital Rs. 200 Lakh + Rs. 150 Lakh = Rs. 350 Lakh

Reserves Rs. 800 Lakh + Rs. 450 Lakh = Rs. 1,250 Lakh

Book Value Rs. 350 Lakh + Rs. 1,250 Lakh = Rs. 457.14 per share

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3.5 Lakh

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

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

(c) (i) Promoter's holding

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

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

(ii) Free Float Market Capitalisation

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

(iii) (i) & (ii)

Revised Capital Rs. 350 Lakh + Rs. 175 Lakh = Rs. 525 Lakh

No. of shares before Split (F.V Rs. 100) 5.25 Lakh

No. of Shares after Split (F.V. Rs. 5) 5.25 x 20 = 105 Lakh

EPS 160 Lakh / 105 Lakh = 1.523

Book Value $\frac{\text{Cap. Rs. 525 Lakh + Rs. 1075 Lakh}}{\text{No. of Shares =105 Lakh}}$

= Rs. 15.238 per share

3. (a) (i) Expected NPV

(Rs. in lakhs)

Year I			*Year II*			*Year III*		
CFAT	*P*	*CF×P*	*CFAT*	*P*	*CF×P*	*CFAT*	*P*	*CF×P*
14	0.1	1.4	15	0.1	1.5	18	0.2	3.6
18	0.2	3.6	20	0.3	6.0	25	0.5	12.5
25	0.4	10.0	32	0.4	12.8	35	0.2	7.0
40	0.3	12.0	45	0.2	9	48	0.1	4.8
	$\bar{x}$ or $\overline{CF}$	27.0		$\bar{x}$ or $\overline{CF}$	29.3			$\bar{x}$ or $\overline{CF}$ 27.9

NPV	*PV factor @ 6%*	*Total PV*
27	0.943	25.461
29.3	0.890	26.077
27.9	0.840	23.436
	PV of cash inflow	74.974
	Less: Cash outflow	50.000
	NPV	24.974

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(ii) Possible deviation in the expected value

Year I				
$X - \bar{X}$	$X - \bar{X}$	$(X - \bar{X})^2$	P_1	$(X - \bar{X})^2 P^1$
14 – 27	-13	169	0.1	16.9
18 – 27	-9	81	0.2	16.2
25 – 27	-2	4	0.4	1.6
40 – 27	13	169	0.3	50.7
				85.4

$\sigma_1 = \sqrt{85.4} = 9.241$

Year II				
$X - \bar{X}$	$X - \bar{X}$	$(X - \bar{X})^2$	P_2	$(X - \bar{X})^2 \times P_2$
15-29.3	-14.3	204.49	0.1	20.449
20-29.3	-9.3	86.49	0.3	25.947
32-29.3	2.7	7.29	0.4	2.916
45-29.3	15.7	246.49	0.2	49.298
				98.61

$\sigma_2 = \sqrt{98.61} = 9.930$

Year III				
$X - \bar{X}$	$X - \bar{X}$	$(X - \bar{X})^2$	P_3	$(X - \bar{X})^2 \times P_3$
18-27.9	-9.9	98.01	0.2	19.602
25-27.9	-2.9	8.41	0.5	4.205
35-27.9	7.1	50.41	0.2	10.082
48-27.9	20.1	404.01	0.1	40.401
				74.29

$\sigma\sigma_3 = \sqrt{74.29} = 8.619$

Standard deviation about the expected value:

$$\sigma\sigma = \sqrt{\frac{85.4}{(1.06)^2} + \frac{98.61}{(1.06)^4} + \frac{74.29}{(1.06)^6}} = 14.3696$$

(iii) Standard deviation is a statistical measure of dispersion; it measures the deviation from a central number i.e. the mean.

In the context of capital budgeting decisions especially where we take up two or more projects giving somewhat similar mean cash flows, by calculating standard deviation in such cases, we can measure in each case the extent of variation. It can then be used to identify which of the projects is least riskier in terms of variability of cash flows.

A project, which has a lower coefficient of variation will be preferred if sizes are heterogeneous.

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Besides this, if we assume that probability distribution is approximately normal we are able to calculate the probability of a capital budgeting project generating a net present value less than or more than a specified amount.

(b) 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 (12.00 x 125%)	6.00 (4.80 x 125%)	0.756	4.536
2017	16.50 (15.00 x 110%)	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

$$\frac{Rs.9.075}{0.15 - 0.10} = Rs.181.50$$

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

4. (a) (i) If investment is made at London

Convert US$ 5,00,000 at Spot Rate (5,00,000/1.5390)		= £ 3,24,886
Add: £ Interest for 3 months on £ 324,886 @ 5%		= £ 4,061
		= £ 3,28,947
Less: Amount Invested	$ 5,00,000	
Interest accrued thereon	$ 5,000	
	= $ 5,05,000	

Equivalent amount of £ required to pay the

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above sum ($ 5,05,000/1.5430)	= £ 3,27,285
Arbitrage Profit	= £ 1,662

(ii) If investment is made at New York

Gain $ 5,00,000 (8% - 4%) x 3/12	= $ 5,000
Equivalent amount in £ 3 months ($ 5,000/ 1.5475)	£ 3,231

(iii) If investment is made at Frankfurt

Convert US$ 500,000 at Spot Rate (Cross Rate) 1.8260/1.5390	= € 1.1865
Euro equivalent US$ 500,000	= € 5,93,250
Add: Interest for 3 months @ 3%	= € 4,449
	= € 5,97,699
3 month Forward Rate of selling € (1/1.8150)	= £ 0.5510
Sell € in Forward Market € 5,97,699 x £ 0.5510	= £ 3,29,332
Less: Amounted invested and interest thereon	= £ 3,27,285
Arbitrage Profit	= £ 2,047

Since out of three options the maximum profit is in case investment is made in New York. Hence it should be opted.

(b) (i) An efficient portfolio shall consist of the market portfolio and risk free securities. Accordingly, let x be the proportion of total funds invested in market portfolio then

$E(R_p) = x\, E(R_m) + (1 - x)\, R_f$

7.5% = x X 8% + (1 – x) X 5%

7.5% = 8x + 5 – 5x

2.5 = 3x

x = 5/6 i.e. 83.33%

Thus, $83\frac{1}{3}\%$ total funds should be invested in market portfolio and balance 16.67% in Risk Free Securities.

(ii) Risk of above Portfolio

$$7.5 = 5.00 + \frac{8\% - 5\%}{6\%}\sigma_P$$

$$2.5 = \frac{3\%}{6\%}\sigma_P$$

$15\% = 3\%\ \sigma_P$

$\sigma_P = 5\%$

(iii) Let y be the proportion of investment in market portfolio then investment in risk free securities (1 – y), then

10% = y X 8% + (1 - y) 5%

10% = 8y + 5% - 5y

5% = 3y

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y = 1.66

Thus, borrow $66\frac{2}{3}$ % of owned fund i.e. 66.67% of owned funds at risk free rate of interest of 5%.

Rs. 100000 X 66.67 % = Rs. 66,670

Now invest total fund of Rs. 1,66,670 in the market portfolio.

Risk of Portfolio

$10\% = 5\% + \frac{8\% - 5\%}{6\%}\sigma p$

$5\% = \frac{3\%}{6\%}\sigma p$

$\sigma p = 10\%$

5. (a) First of all we shall compute PV of Cash Inflows as follows:

$$\text{PVCF} = \frac{200\text{ crore}\,(1-0.30)}{0.12-0.04} = \text{Rs. 1750 Crore}$$

Market Value of Liabilities = Rs. 780 Crore + Rs. 40 Crore = Rs. 820 Crore

Net Asset Value = Rs. 930 Crore

Since, the Tripati Tiles is offering Rs. 950 Crore, more than Net Asset Value of Rs. 930 Crore, the company should go further with decision of divesture of tile business.

(b) (i) Security A has a return of 8% for a risk of 4, whereas B and F have a higher risk for the same return. Hence, among them A dominates.

For the same degree of risk 4, security D has only a return of 4%. Hence, D is also dominated by A.

Securities C and E remain in reckoning as they have a higher return though with higher degree of risk.

Hence, the ones to be selected are A, C & E.

(ii) The average values for A and C for a proportion of 3 : 1 will be :

$$\text{Risk} = \sqrt{\left(\frac{3}{4}\times 4\right)^2 + \left(\frac{1}{4}\times 12\right)^2} = 4.24\%$$

$$\text{Return} = \frac{(3\times 8)+(1\times 12)}{4} = 9\%$$

Therefore:	75% A 25% C	E _
Risk	4.24	5
Return	9%	9%

For the same 9% return the risk is lower in A & C. Hence, it will be preferable.

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6. (a)

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

Portfolio beta 1.108

(i) Required Beta 0.8

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

If Rs. 12,00,000 is 72.20%, the total portfolio should be

Rs. 12,00,000 × 100/72.20 or Rs. 16,62,050

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

Revised Portfolio will be

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

(ii) To increase Beta to 1.2

Required beta 1.2

It should become 1.2 / 1.108 108.30% of present beta

If 1200000 is 108.30%, the total portfolio should be

1200000 × 100/108.30 or 1108033 say 1108030

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

Revised Portfolio will be

Security	**No. of shares (1)**	**Market Price of Per Share (2)**	**(1) × (2)**	**% to total (w)**	**ß (x)**	**wx**
VSL	10000	50	500000	0.4513	0.9	0.406
CSL	5000	20	100000	0.0903	1	0.090
SML	8000	25	200000	0.1805	1.5	0.271

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APL	2000	200	400000	0.3610	1.2	0.433
Risk free asset	-9197	10	-91970	-0.0830	0	0
			1108030	1		1.20

Portfolio beta 1.20

(b) First Option

	Rs.
Sale Proceeds	5,00,000
Tax @ 34%	1,70,000
Net Proceed	3,30,000
Interest @ 8.75% p.a.	= Rs. 28,875

NPV of this Option

	Year					
	0	**1**	**2**	**3**	**4**	**5**
Int. on Net Proceeds (Rs.)		28,875	28,875	28,875	28,875	28,875
Tax @ 34% (Rs.)		-9,818	-9,818	-9,818	-9,818	-9,818
Lease Rent (Rs.)		-90,000	-90,000	-90,000	-90,000	-90,000
Tax @34%(Rs.)		30,600	30,600	30,600	30,600	30,600
Terminal Cash Flow (Rs.)						3,30,000
Cash flow (Rs.)		-40,343	-40,343	-40,343	-40,343	2,89,657
PV Factor		0.893	0.797	0.712	0.636	0.567
PV of Cash Flows (Rs.)		-36,026	-32,153	-28,724	-25,658	1,64,236

NPV = Rs. 41,675

Second Option

	Rs.
Cost of New Machine	4,00,000
Net sale proceeds of old machine	3,30,000
Investment in Cash	70,000

NPV of this Option

	Year					
	0	**1**	**2**	**3**	**4**	**5**
Payment for new Machine (Rs.)	-70,000					
Tax saving Rs. 4,00,000 x 34%		1,36,000				
Maintenance (Rs.)		-15,000	-15,000	-15,000	-15,000	-15,000
Tax saving on above @ 34% (Rs.)		5,100	5,100	5,100	5,100	5,100
Terminal Cash Flow (Rs.)						1,00,000
Tax on above @ 34% (Rs.)						-34,000
Cash Flow (Rs.)	-70,000	1,26,100	-9,900	-9,900	-9,900	56,100
PV Factor	1	0.893	0.797	0.712	0.636	0.567
PV of Cash Flows (Rs.)	-70,000	1,12,607	-7,890	-7,049	-6,296	31,809

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NPV = Rs. 53,181

The second alternative is recommended.

7. **(a)** Non-compete fee is a fee paid by purchasing company to the promoters of the vendor company in case of mergers and acquisitions. The principle reason for paying this fee is to deter selling promoters to compete against the acquiring company in any way. In other words, non-compete fee is paid to selling promoters by the acquirer, so that they do not re-enter the business and pose serious competition to the acquired company.

The logic is that the selling promoters may have picked up considerable expertise in the course of their running the business and it is quite possible, that they may regroup, arrange money and other resources and re-enter the business.

However, certain loopholes have been observed in the way non-compete fee is handled in practical situations. SEBI Takeover Code mandates that non-compete fee should be included in the deal value. It helps minority shareholders to get a share of this fee. However, in a scheme of amalgamation, the non-compete fee is paid outside the deal value. It means that minority shareholders do not get any share of the non-compete fee.

Now, SEBI wants to fix this loophole. SEBI is mulling possibilities if such schemes of merger and amalgamation are to be included in the purview of takeover regulations and thus increase pay out to retail investors. So, SEBI plans to amend the Takeover Code to ensure that minority shareholders also get their due in the non-compete fee.

(b) Open interest is total number of outstanding futures and options that exist on a particular day. Open interest is generally associated with the futures and options markets, where the number of existing contracts changes from day to day – unlike the stock market, where the outstanding shares of a company's stock remain constant once a stock issue is completed.

For every buyer of a futures or options there is a seller also. One buyer and one seller create one contract. Therefore, the total open interest in the market for a specified futures or option market equals the total number of buyers or the total number of sellers, and not the total of both added together.

Further, increasing open interest gives an indication that more money is coming into the stock market. On the other hand, decreasing open interest gives an indication that money is going out of the stock market. Therefore, it can be said that as increasing open interest is an indication that more money is coming into the market, it also shows that existing market is gaining momentum and is likely to continue in the future. In the same way, as decrease in open interest indicates that money is going out of the market, it generally depicts that existing trend is diminishing leading to a trend change.

(c) **Circumstances that indicate that it is time for an investor to exit a mutual fund scheme**

(1) When the mutual fund consistently under performs the broad based index, it is high time that it should get out of the scheme.

(2) When the mutual fund consistently under performs its peer group instead of it being at the top. In such a case, it would have to pay to get out of the scheme and then invest in the winning schemes.

(3) When the mutual fund changes its objectives e.g. instead of providing a regular income to the investor, the composition of the portfolio has changed to a growth fund mode which is not in tune with the investor's risk preferences.

(4) When the investor changes his objective of investing in a mutual fund which no longer is beneficial to him.

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(5) When the fund manager, handling the mutual fund schemes, has been replaced by a new entrant whose image is not known.

(d) Exposure Netting refers to offsetting exposures in one currency with Exposures in the same or another currency, where exchange rates are expected to move in such a way that losses or gains on the first exposed position should be offset by gains or losses on the second currency exposure.

The objective of the exercise is to offset the likely loss in one exposure by likely gain in another. This is a manner of hedging foreign exchange exposures though different from forward and option contracts. This method is similar to portfolio approach in handling systematic risk.

For example, let us assume that a company has an export receivables of US$ 10,000 due 3 months hence, if not covered by forward contract, here is a currency exposure to US$.

Further, the same company imports US$ 10,000 worth of goods/commodities and therefore also builds up a reverse exposure. The company may strategically decide to leave both exposures open and not covered by forward, it would be doing an exercise in exposure netting.

Despite the difficulties in managing currency risk, corporates can now take some concrete steps towards implementing risk mitigating measures, which will reduce both actual and future exposures. For years now, banking transactions have been based on the principle of netting, where only the difference of the summed transactions between the parties is actually transferred. This is called settlement netting. Strictly speaking in banking terms this is known as settlement risk. Exposure netting occurs where outstanding positions are netted against one another in the event of counter party default.

(e) **Inter Bank Participation Certificate (IBPC):** The Inter Bank Participation Certificates are short term instruments to even out the short-term liquidity within the Banking system particularly when there are imbalances affecting the maturity mix of assets in Banking Book.

The primary objective is to provide some degree of flexibility in the credit portfolio of banks. It can be issued by schedule commercial bank and can be subscribed by any commercial bank.

The IBPC is issued against an underlying advance, classified standard and the aggregate amount of participation in any account time issue. During the currency of the participation, the aggregate amount of participation should be covered by the outstanding balance in account.

There are two types of participation certificates, with risk to the lender and without risk to the lender. Under 'with risk participation', the issuing bank will reduce the amount of participation from the advances outstanding and participating bank will show the participation as part of its advances. Banks are permitted to issue IBPC under 'with risk' nomenclature classified under Health Code-I status and the aggregate amount of such participation in any account should not exceed 40% of outstanding amount at the time of issue. The interest rate on IBPC is freely determined in the market. The certificates are neither transferable nor prematurely redeemable by the issuing bank.

Under without risk participation, the issuing bank will show the participation as borrowing from banks and participating bank will show it as advances to bank.

The scheme is beneficial both to the issuing and participating banks. The issuing bank can secure funds against advances without actually diluting its asset-mix. A bank having the highest loans to total asset ratio and liquidity bind can square the situation by issuing IBPCs. To the lender, it provides an opportunity to deploy the short-term surplus funds in a secured and profitable manner. The IBPC with risk can also be used for capital adequacy management.

This is simple system as compared to consortium tie up.

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Test Series: March, 2017

MOCK TEST PAPER

FINAL COURSE: GROUP – I

PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

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

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

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

1. (a) The accountant of V Ltd. has requested you, not to send balance confirmations to a particular group of trade receivables since the said balances are under dispute and the matter is pending in the Court. As a Statutory Auditor, how would you deal? ***(5 Marks)***

(b) You are the auditor of CC Ltd. The inventory as at the end of the year was Rs. 2.25 crores. Due to unavoidable circumstances, you could not be present at the time of annual physical verification. Under the above circumstances how would you ensure that the physical verification conducted by the management was in order? ***(5 Marks)***

(c) Mr. PM, a practising Chartered Accountant, has been appointed as an auditor of Truth Pvt. Ltd. What factors would influence the amount of working papers required to be maintained for the purpose of his audit? ***(5 Marks)***

(d) While compiling the accounts of Hope Ltd., you observed that few accounting standards have not been followed and there have been omission of some information which was required to be followed in the current situation. How would you deal with this? ***(5 Marks)***

2. (a) Dabloo Ltd. offered appointment as its auditor to Mr. Bee, a practicing Chartered Accountant. Later on, Mr. Dee, the step-brother of Mr. Bee, purchased securities of the company having face value of Rs. 4,99,000. Comment, whether Mr. Bee may accept the offer of appointment as an auditor? ***(5 Marks)***

(b) The Sarbanes-Oxley Act of 2002 established corporate accountability and civil and criminal penalties for white – collar crimes. State briefly eight provisions of the Sarbanes-Oxley Act of 2002, which shall, if enacted in India to Indian Corporates, get fruitful results. ***(5 Marks)***

(c) You are a member of an audit team of KRP & Associates, auditors of a Multinational Company AZ Co. Ltd. The company is working in CIS environment. The partner in-charge of KRP & Associates asked you to draw out the audit plan for evaluating the reliability of controls.

(6 Marks)

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

Discuss stating the issues examined in comprehensive audit. ***(5 Marks)***

(b) RNT Ltd. has entered into non-cash transactions with Mr. Ram, son of one of the directors of the company, which is an arrangement by which the RNT Ltd. is in process to acquire assets for consideration other than cash. Under CARO, 2016, as a statutory auditor, how would you report? ***(6 Marks)***

(c) Xcess Ltd., having two subsidiaries but did not have any holding company, is a company whose securities are not listed on any stock exchange, whether in India or outside India.

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The CEO of the Xcess Ltd says that since it is an unlisted company therefore consolidation of financial statement is not applicable. Comment on the contention of the CEO. ***(5 Marks)***

4. (a) Every member of the stock-exchange has to issue contract notes to his clients for the trades executed on their behalf. State the items contained in the SEBI's check list for auditors in respect of contract notes issued by a Stock Broker. ***(5 Marks)***

   (b) M/s. S.N. Enterprises, a manufacturing concern, sold a house property in Chennai for a consideration of Rs. 48 lakh, to Ms. Vidhi on 1.8.2016. M/s. S. N. Enterprises had purchased the house property in the year 2014 for Rs. 40 lakh. The stamp duty value on the date of transfer, i.e., 1.8.2016, is Rs. 85 lakh for the house property. As a tax auditor, how would you deal? ***(6 Marks)***

   (c) While auditing APNA Bank, you observed that a lump sum amount has been disclosed as contingent liability collectively. You are, therefore, requested by the management to guide them about the disclosure requirement of Contingent Liabilities for Banks. Kindly guide.

   (5 Marks)

5. (a) The main objective of operational auditing is to verify the fulfillment of plans, and sound business requirements. While in financial auditing, the concentration is more in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are minimized or removed.

   In the light of above, state the major differences between Financial and Operational Auditing.

   (4 Marks)

   (b) You have been appointed as an auditor of Life India Insurance Co. Ltd. Enumerate the steps you would take as an auditor for the verification of Re-insurance outward by a General Insurance Company. ***(6 Marks)***

   (c) Element Pvt. Ltd. engaged in manufacturing of chemicals is consistently recording higher sales turnover, but declining net profits since the last 4 years. As an investigator appointed to find out the reasons for the same, what are the points you would verify? ***(6 Marks)***

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

   (a) Mr. 'Zen' is a practicing Chartered Accountant working as proprietor of M/s Z & Co. He went abroad for 2 months. He delegated the authority to Mr. 'Yen', a Chartered Accountant, his employee, for taking care of routine matters of his office. During his absence, Mr. 'Yen' issued production certificate to a client under Central Excise Act, 1944 in the name of M/s Z & Co.

   (b) A letter is sent by Mr. Den, a Chartered Accountant in practice, to the Ministry of Finance inquiring whether a panel of auditors is being maintained by the Ministry and if so to include his name in the panel. He also enclosed his CV.

   (c) WRV Pvt. Ltd. appointed CA. Pratash for some professional assignments like company's ROC work, preparation of minutes, statutory register etc. For this, CA. Pratash charged his fees depending on the complexity and the time spent by him on each assignment.

   Later on, WRV Pvt. Ltd. filed a complaint against CA. Pratash to the Institute of Chartered Accountants of India (ICAI) that he has charged excessive fees for the assignments comparative to the scale of fees recommended by the Committee as well as duly considered by the Council of ICAI.

   (d) Mr. Ken, Chartered Accountant in practice as a sole proprietor at Mumbai has an office in the suburbs of Mumbai. Due to increase in the sales tax assessment work, he opens another office near the sales tax office, which is within the city and at a distance of 30 kms. from his office

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in the suburb. For running the new office, he has employed a retired Sales Tax Commissioner who is not a Chartered Accountant. ***(4 × 4 = 16 Marks)***

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

   (a) Relevant Criteria for determining Reliability of Data as per SA 520 'Analytical Procedures'.

   (b) Advantages of Cost Audit to Government.

   (c) Power of Audit Committee as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations.

   (d) Collection of Evidence by Peer Reviewer.

   (e) Importance of KYC requirements for a Chartered Accountants in practice. ***(4 × 4 = 16 Marks)***

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Test Series: March, 2017

MOCK TEST PAPER

FINAL COURSE: GROUP – I

PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

SUGGESTED ANSWERS/HINTS

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

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

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

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

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

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

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

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

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

    (i) The size and complexity of the entity.

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

    (iii) The identified risks of material misstatement.

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(iv) The significance of the audit evidence obtained.

(v) The nature and extent of exceptions identified.

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

(vii) The audit methodology and tools used.

(viii) Timely preparation of Audit Documentation.

(d) Non-Compliance with the Accounting Standards: As per SRS 4410, "Compilation Engagements", the financial information may be prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users (that is, a "general purpose financial reporting framework"). The requirements of the applicable financial reporting framework determine the form and content of the financial information. The financial reporting framework may, in some cases, be referred to as the "basis of accounting."

Commonly used general purpose financial reporting frameworks includes Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006, Indian Accounting Standards (Ind AS) issued by ICAI and Accounting Standards (AS) issued by ICAI etc.

Thus, for not following and omission of some information which was required to be followed in the current situation for Hope Ltd., we should bring this matter to the attention of the management for rectification and, if the same is not rectified by the management, we should include the same in the Notes to the Accounts and the compilation report of the accountant.

2. (a) Holding of Securities by Relative: According to section 141(3)(d)(i) of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person is disqualified to be appointed as an auditor if he, or his relative or partner holding 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.

However, as per the proviso to this section, the relative of the auditor may hold the securities or interest in the company of face value not exceeding of Rs. 1,00,000.

Further, the term "relative" as defined under the Companies Act, 2013 includes step- brother.

In the present situation, Mr. Dee, the step-brother of Mr. Bee, is holding the securities having face value of Rs. 4,99,000 in Dabloo Ltd. It may be noted that step-brother is included in the definition of the term "relative" as per the Companies Act, 2013. Thus, holding of securities in Dabloo Ltd. by Mr. Dee having face value exceeding Rs. 1,00,000, will disqualify Mr. Bee from being appointed as an auditor of Dabloo Ltd.

Therefore, Mr. Bee may not accept the offer of appointment as an auditor of Dabloo Ltd.

(b) Following are some provisions of the Sarbanes-Oxley Act of 2002, which, if enacted in India may be fruitful in respect of Indian corporate:

(i) More independence be given to Audit Committee and auditor.

(ii) Ban on personal loan to Directors / Executive Officers of a Company.

(iii) Strict reporting by an auditor on insider trading.

(iv) Additional disclosures imposed on financial reporting.

(v) If there is any conflict between company and its auditor, the Audit Committee should be empowered to resolve the same.

(vi) Higher penalties and criminal prosecution on financial frauds.

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(vii) To include effectiveness of Internal Control System in the financial reporting.

(viii) More responsibilities must be imposed on managerial personal with higher penalties and prosecutions on the breach.

(ix) Strict action against white collar crime.

(x) Disclosure of the % of shareholdings by Directors, Executive Officers and principal shareholders.

(c) Audit Plan for Evaluating the Reliability of Controls in CIS Environment: In evaluating the effects of a control, the auditor needs to assess the reliability by considering the various attributes of a control.

The auditor focuses here on-

(i) Preventive controls: Controls which stop errors or irregularities from occurring.

(ii) Detective controls: Controls which identify errors and irregularities after they occur.

(iii) Corrective controls: Controls which remove the effects of errors and irregularities after they have been identified.

The auditors are expected to see a higher density of preventive controls at the early stages of processing or conversely they expect to see more detective and corrective controls later in system processing.

Further, while evaluating the reliability of controls, the auditor should:

(i) Ensure that authorized, correct and complete data is made available for processing;

(ii) Provide for timely detection and correction of errors.

(iii) Ensure that the case of interruption in the work of the CIS environment due to power, mechanical or processing failures, the system restarts without distorting the completion of the entries and records;

(iv) Ensure that accuracy and completeness of output;

(v) Provide adequate data security against fire and other calamities, wrong processing, frauds etc.,

(vi) Prevent unauthorized amendments to the program;

(vii) Provide for safe custody of source code of application software and data files.

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

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

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

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

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

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

(vi) Are the purchase policies adequate? Or have they led to piling up of inventory resulting

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in redundancy in stores and spares?

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

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

(ix) Are procedures effective and economical?

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

(b) Non-cash Transactions with Relative of Director: As per Clause (xv) of paragraph 3 of CARO, 2016, the auditor is required to report "whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with".

Section 192 of the said Act deals with restriction on non-cash transactions involving directors or persons connected with them. The section prohibits the company from entering into such types of arrangements unless it is an arrangement by which the company acquires or is to acquire assets for consideration other than cash, from such director or person so connected.

In the instant case, RNT Ltd. has entered into non-cash transactions with Mr. Ram, son of one of the directors, which is an arrangement by which RNT Ltd. is in process to acquire assets for consideration other than cash. In the above situation, the provisions of section 192 of Companies Act, 2013 have been complied with.

However, the reporting requirements under this clause are given in two parts. The first part requires the auditor to report on whether the company has entered into any non-cash transactions with the directors or any persons connected with such director/s. The second part of the clause requires the auditor to report whether the provisions of section 192 of the Act have been complied with. Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative.

In the given situation, RNT Ltd. has entered into non-cash transactions with Mr. Ram, son of director, which is affirmative answer to the first part of the Clause (xv) of Paragraph 3 of CARO, 2016, thus, reporting is required for the same. Draft report is given below:

According to the information and explanations given to us, RNT Ltd. has entered into non-cash transactions with Mr. Ram, son of one of the directors, during the year, for the acquisition of assets, which in our opinion is covered under the provisions of section 192 of the Companies Act, 2013.

(c) Preparation of Consolidated Financial Statement: As per section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

However, the requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:

(i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;

(ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and

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(iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

Thus, all the three above-mentioned conditions need to be complied for getting exemption from preparation of consolidated financial statements. In the given case, Xcess Ltd. is itself a holding company of two subsidiaries i.e. not satisfying the condition of being wholly/partially owned subsidiary. Therefore, contention of the CEO of the company is not tenable and the company needs to prepare consolidated financial statements.

4. (a) SEBI's check list for auditors in respect of contract notes issued by a Stock Broker:

(i) Members should issue Contract Notes to his clients for all trades executed by him on their behalf.

(ii) The member should stamp his order sheets/records and the order time should be reflected in the Contract Note along with the time of execution of order.

(iii) The Contract Notes should bear SEBI Registration number of the member. It should be pre-printed with serial number and issued within 24 hours of trade execution. Appropriate stamps should be affixed on the contract Note. Duplicate copies of the contract note should be maintained.

(iv) The Contract Note should be signed by the member or his constituted attorney.

(v) Contract note issued to the clients should show the brokerage separately.

(vi) In case the broker acts as a principal, the Contract Note should be in Form B.

(vii) Consent of the client should be taken for any trade done by the broker while acting as a principal.

(viii) Brokerage should be within the limits prescribed by the exchange.

(b) Reporting Requirement Under Clause (17) of Form 3CD: In this case, M/s S.N. Enterprises is a manufacturing concern and sold the house property in Chennai for a consideration of Rs. 48 Lakh which is less than value assessed by Government i.e. Stamp Duty value of Rs. 85 Lakh.

Provisions and Explanations: As per Clause (17) of Form 3CD, the tax auditor is required to furnish detailed information in case if any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, as under:

Details of property	Consideration received or accrued	Value adopted or assessed or assessable

The auditor should obtain a list of all properties transferred by the assessee during the previous year. He may also verify the same from the statement of profit and loss or balance sheet, as the case may be. Further, the auditor has to furnish the amount of consideration received or accrued, during the relevant previous year of audit, in respect of land/building transferred during the year as disclosed in the books of account of the assessee.

For reporting the value adopted or assessed or assessable, the auditor should obtain from the assessee a copy of the registered sale deed in case, the property is registered. In case the property is not registered, the auditor may verify relevant documents from relevant authorities or obtain third party expert like lawyer, solicitor representation to satisfy the compliance of section 43CA / section 50C of the Act. In exceptional cases where the auditor is not able to obtain relevant documents, he may state the same through an observation in his report 3CA/CB.

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Conclusion: As already discussed in fact of the cases, M/s. S. N. Enterprises, has sold the house property to Ms. Vidhi which is less than stamp duty value. Hence, tax auditor is required to report on the same under Clause (17) of Form 3CD.

(c) Contingent Liabilities for Banks: The Third Schedule to the Banking Regulation Act, 1949, requires the disclosure of the following as a footnote to the balance sheet-

(A) Contingent liabilities

(i) Claims against the bank not acknowledged as debts.

(ii) Liability for partly paid investments.

(iii) Liability on account of outstanding forward exchange contracts.

(iv) Guarantees given on behalf of constituents-

(1) In India.

(2) Outside India.

(v) Acceptances, endorsements and other obligations.

(vi) Other items for which the bank is contingently liable.

(B) Bills for collection.

5. (a) Differences between Financial and Operational Auditing: The major differences between financial and operational auditing can be described as follows-

(i) **Purpose -** The financial auditing is basically concerned with the opinion that whether the historical information recorded is correct or not, whereas the operational auditing emphasizes on effectiveness and efficiency of operations for future performance.

(ii) **Area -** Financial audits are restricted to the matters directly affecting the appropriateness of the presented financial statements but the operational auditing covers all the activities that are related to efficiency and effectiveness of operations directed towards accomplishment of objectives of organization.

(iii) **Reporting -**The financial audit report is sent to all stock holders, bankers and other persons having stake in the Organisation. However, the operational audit report is primarily for the management.

(iv) **End Task -** The financial audit has reporting the findings to the persons getting the report as its end objective, however, the operational auditing is not limited to reporting only but includes suggestions for improvement also.

(b) Verification of Re-insurance Outward: The following steps may be taken by the auditor in the verification of re-insurance outward-

(i) The auditor should verify that re-insurance underwriting returns received from the operating units regarding premium, claims paid, outstanding claims tally with the audited figures of premium, claims paid and outstanding claims.

(ii) The auditor should check whether the pattern of re-insurance underwriting for outward cessions fits within the parameters and guidelines applicable to the relevant year.

(iii) The auditor should also check whether the cessions have been made as per the stipulation applicable to various categories of risk.

(iv) The auditor should verify whether the cessions have been made as per the agreements entered into with various companies.

(v) It should also be seen whether the outward remittances to foreign re-insurers have been done as per the foreign exchange regulations.

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(vi) It should also be seen whether the commission on cession has been calculated as per the terms of the agreement with the re-insurers.

(vii) The auditor should verify the computation of profit commission for various automatic treaty arrangements in the light of the periodical accounts rendered and in relation to outstanding loss pertaining to the treaty.

(viii) The auditor should examine whether the cash loss recoveries have been claimed and accounted on a regular basis.

(ix) The auditor should also verify whether the Claims Paid item appears in Outstanding Claims list by error. This can be verified at least in respect of major claims.

(x) He should see whether provisioning for outstanding losses recoverable on cessions have been confirmed by the re-insurers and in the case of major claims, documentary support should be insisted and verified.

(xi) Accounting aspects of the re-insurance cession premium, commission receivable, paid claims recovered, and outstanding losses recoverable on cessions have to be checked.

(xii) The auditor should check percentage pattern of gross to net premium, claims paid and outstanding claims to ensure comparative justification.

(xiii) The auditor should also check that the re-insurers balance on cessions and whether the sub ledger balances tallies with the general ledger balances.

(xiv) The auditor should review the individual accounts to find out whether any balance requires provisioning / write off or write back.

(xv) He should verify whether the balances with re-insurers are supported by necessary confirmation obtained from them.

(xvi) He should verify whether opening outstanding claims not paid during the year find place in the closing outstanding claims vis-a-vis the reinsurance inwards outstanding losses recoverable on cessions appears in both opening and closing list. If not, the reason for the same should be analysed.

(xvii) Any major event after the Balance Sheet date which might have wider impact with reference to subsequent changes regarding the claim recovery both paid and outstanding and also re-insurance balances will need to be brought out suitably.

(c) Decline in Net Profits despite Increasing Sales: As per the facts that there has been consistently high turnover but declining net profits is an anomalous situation. It may be attributed to one or more following reasons requiring further investigation-

(i) **Unfavourable Sales mix**: Where the company sells different chemical products with different product margins, the product with the maximum PV ratio/margin should have a higher share in the total sales. If due to revision of sales mix, more quantities of unprofitable products are sold, profits will be reduced despite an increase in sales.

(ii) **Negative Impact of Financial Leverage**: Where the company does not have sufficient own funds (equity) but has a higher debt-equity ratio, the interest commitments will be higher. As the volume of its operation increases, higher debt and interest charges would result in lower profits.

(iii) **Other Items included in Sales**: The figure of sales as per Statement of Profit and Loss may include incidental revenues, e.g., freight, excise duty, sales-tax, etc. where the amount of excise duty goes up considerably the total sales may show an increase which is not represented by a real increase in sales quantity/value.

(iv) **High Administrative and Selling Expenses**: Administrative and selling costs are

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generally period costs which are fixed in nature. Their increase is generally not proportional to sale increase. However, a reduction in profit could also be due to increase in administrative overheads and sales overheads at a rate higher than the rate of increase in sales.

(v) **Cost-Price Relationship**: If the increases in cost of raw materials and labour has not been compensated by a corresponding increase in the sales price this would also result in higher sales and declining profits. In spite of same sales quantity, for the increasing cost of raw materials and other services, per unit values of the product has been increased which is however unmatched by the increase in cost.

(vi) **Competitive Price**: Where sales have been made at cut-throat prices in order to eliminate competition from the market, the profits would be in the declining trend in the short-run.

(vii) **Additions to Fixed Assets**: Where there are heavy additions to fixed assets and consequent depreciation charges in the initial years of additions, there may be reduction in profits in spite of increased sales.

6. (a) Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA. 'Zen' proprietor of M/s Z & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Yen, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants of India.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated in the certain instances and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, etc.

However, issuance of production certificate to a client under Central Excise Act, 1944 is not a routine work. Thus, issuance of such certificate by Mr. "Yen" being an employee of M/s Z & Co. is outside his authorities. Therefore, CA. 'Zen' is guilty of professional misconduct under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949.

(b) Making Roving Inquiries: 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 judgement and may be able to command respect from their prospective clients.

In case of making an application for the empanelment for the allotment of audit and other professional work, the Council has opined that, "where the existence of such a panel is within the knowledge of the member, he is free to write to the concerned organization with a request to place his name on the panel. However, it would not be proper for the member to make roving inquiries by applying to any such organization for having his name included in any such panel."

Accordingly, Mr. Den is guilty of misconduct in terms of the above provision as he has solicited professional work from the Finance Ministry, by inquiring about the maintenance of the panel.

(c) Charging Excess Fees: The prescribed scale of fees for the professional assignments done by the chartered accountants is recommendatory in nature. Charging an excessive fee for a

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professional assignment does not constitute any misconduct in the context of the provisions of the Chartered Accountants Act, 1949 and regulation made thereunder since the matter of fixation of actual fee charged in individual cases depends upon the mutual agreement and understanding between the member and the client.

In the given case, CA. Pratash has charged excess fees comparative to the scale of fees recommended by the Committee as well as duly considered by the Council of ICAI. In this context, it may be noted that the scale of fees is the minimum prescribed scale of fees.

From the above facts and provisions, it may be concluded that CA. Pratash is not liable for any misconduct under the Chartered Accountants Act, 1949. Therefore, the contention of WRV Pvt. Ltd. is not tenable.

(d) Maintenance of Branch Office in the Same City: As per section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. However, a member can be in-charge of two offices if the second office is located in the same premises or in the same city, in which the first office is located; or the second office is located within a distance of 50 Kilometres from the municipal limits of a city, in which the first office is located.

In the given case, Mr. Ken, Chartered Accountant in practice as a sole proprietor at Mumbai has an office in suburbs of Mumbai, and due to increase in the work he opened another branch within the city near the sales tax office. He also employed a retired sales tax commissioner to run the new office and the second office is situated within a distance of 30 kms from his office in the suburb.

In view of above provisions, there will be no misconduct if Mr. Ken will be in-charge of both the offices. However, he is bound to declare which of the two offices is the main office.

7. (a) Relevant Criteria for determining Reliability of Data*:* SA 520 on 'Analytical Procedures' provides that the reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained.

Accordingly, the following are relevant criteria when determining whether data is reliable for purposes of designing substantive analytical procedures-

(i) Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity;

(ii) Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products;

(iii) Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and

(iv) Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

(b) Advantages of Cost Audit to Government:

(i) Where the Government enters into a cost-plus contract, cost audit helps government to fix the price of the contract at a reasonable level.

(ii) Cost audit helps in the fixation of ceiling prices of essential commodities and thus undue profiteering is checked.

(iii) Cost audit enables the government to focus its attention on inefficient units.

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(iv) Cost audit enables the government to decide in favour of giving protection to certain industries.

(v) Cost audit facilitates settlement of trade disputes brought to the government.

(vi) Cost audit and consequent management action can create a healthy competition among the various units in an industry. This imposes an automatic check on inflation.

(c) Power of Audit Committee: As per SEBI (Listing Obligations and Disclosure Requirements) Regulations, the Audit Committee shall have powers, which should include the following-

(1) To investigate any activity within its terms of reference.

(2) To seek information from any employee.

(3) To obtain outside legal or other professional advice.

(4) To secure attendance of outsiders with relevant expertise, if it considers necessary.

It may be noted that the powers mentioned above are only illustrative and not exhaustive.

(d) Collection of Evidence by Peer Reviewer: A Peer Reviewer collects evidence by applying the following methods-

(i) Inspection mainly consists of examination of documentation (working papers) and other records maintained by the practice unit.

(ii) Observation consists of witnessing a procedure or process being performed by others. For example, while conducting on-site review, the reviewer may review the performance of internal control.

(iii) Inquiry consists of seeking appropriate information from the partner (designated by the practice unit for the purpose)/sole proprietor or other knowledgeable persons within the practice unit. The inquiries may originate from the responses to the questions given in the questionnaire. The inquiries may also arise from the inspection of documentation maintained by the practice unit.

While observation and inquiry may be considered as external independent sources of review evidence, inspection remains the most significant method for confirming the effective observance of control procedures in the practice unit. Observation and inquiry may also corroborate the evidence provided by inspection. The reviewer, in order to carry out the review effectively, should have an understanding of the documentation maintained by the practice unit.

(e) Importance of KYC requirements for a Chartered Accountants in practice: The financial services industry globally is required to obtain information of their clients and comply with Know Your Client Norms (KYC norms). Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI recommended such norms to be observed by the members of the profession who are in practice. These Know Your Client (KYC) Norms are also important in order to ensure a healthy growth of the profession and an equitable flow of professional work among the members.

The self-regulatory measures are recommendatory. However, considering the spirit underlying these measures, it is expected that every Chartered Accountant carrying out attest function is encouraged to follow them and implementation of these measures would go a long way in ensuring equitable flow of work among the members and would also further enhance the prestige of the profession in the society.

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MOCK TEST PAPER

FINAL COURSE: GROUP –I

PAPER – 4: CORPORATE AND ALLIED LAWS

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

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

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

1. (a) State the utility of establishment of Investor Education and Protection Fund(IEPF) by the Central Government under the Companies Act, 2013. ***(5 Marks)***

(b) A Ltd. in its First General Meeting appointed six Directors whose period of office is liable to be determined by rotation. Briefly explain law regarding retirement of these directors. Will it make any difference, if A Ltd. does not carry on business for Profit? ***(5 Marks)***

(c) SEBI is of the opinion that in the interest of investors it is desirable to amend the rules of XYZ Stock Exchange prohibiting the appointment of the broker-member as President of the stock exchange. Explain with reference to the provisions of the Securities Contracts (Regulation) Act, 1956 whether it is possible for SEBI to amend the rules of the Stock Exchange, if the rules are not amended by the stock exchange. ***(5 Marks)***

(d) The Board of Directors of professional Consultants Limited, registered in Kolkata, proposes to hold the next board meeting in the month of May, 2017. They seek, your advice in respect of the following matters:

(i) Can the board meeting be held in Chennai, when all the directors of the company reside at Kolkata?

(ii) Is it necessary that the notice of the board meeting should specify the nature of business to be transacted?

Advise with reference to the relevant provisions of the Companies Act, 2013. ***(5 Marks)***

2. (a) Answer the following with reference to a scheme of amalgamation of companies explaining the relevant provisions of the Companies Act, 1956:

(i) Whether companies being amalgamated must be companies registered in India.

(ii) What is the majority required for approving the scheme of amalgamation in a meeting of members of a company called as per directions of the court? Is the scheme to be approved by preference shareholders?

(iii) When will the court order dissolution of the transferor company? ***(8 Marks)***

(b) (i) The Companies Act, 2013 has prescribed an additional duty on the Board of Directors to include in the Board's Report a 'Directors' Responsibility Statement'. Explain briefly the details to be furnished in the said statement.

(ii) XYZ Limited did not prepare its Balance Sheet as at 31st March, 2016 and the Profit and Loss Account for the year ended on that date in conformity with some of the mandatory Accounting Standards issued by the Institute of Chartered Accountants of India. You are required to state with reference to the provisions of the Companies Act, 2013, the responsibilities of directors and statutory auditor of the company in this regard. ***(8 Marks)***

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3. (a) Can a company pay compensation to its directors for loss of office? Explain briefly the relevant provisions of the Companies Act, 2013 in this regard? ***(8 Marks)***

   (b) Analyse and Advise with reference to the provisions of the Companies Act, 2013, the following situations.

      (1) There are 9 directors in a company and out of which 2 offices of the directors have fallen vacant. What will be the quorum for the Board Meeting?

      (2) There are 15 directors in a company and during discussion of a particular item, 13 of the directors are said to be 'interested' within the meaning of section 184(2) of the Companies Act, 2013. What shall be quorum of the meeting? ***(8 Marks)***

4. (a) PQR Limited is an unlisted Public company having paid up share capital of Rs. 80 crores during the preceding financial year 2015-16. The turnover of the company was Rs. 110 crores for the same period. Referring to the provisions of the Companies Act, 2013, answer the following:

      (i) Is it mandatory for the above company to appoint an internal auditor for the financial year 2016-17?

      (ii) What are the qualifications of the Internal Auditor? ***(8 Marks)***

   (b) Splendid Limited went for a public issue of Equity shares (Rs. 10 crores) of Rs. 10 each. The shares were subscribed to an extent of 95% of the total issue. The shares of the company were accepted for listing by Bombay Stock Exchange but subsequently the permission was cancelled on certain grounds. On an appeal to the Central Government by the company, the decision of the Stock Exchange was held to be valid. As a result, the application money had become refundable to the allottees. The company, had no prospects of doing any business and there was a complete deadlock among the Directors. Looking at the circumstances, certain creditors filed a petition in the court for winding up of the company on the ground that the company had become commercially insolvent. The shareholders of the company object to the petition of the creditors. Decide giving reasons:

      (i) Whether the objections of the shareholders will sustain and the court can dismiss the petition of creditors for winding up of the company

      (ii) State the provisions of the Companies Act, 1956 in this regard. ***(8 Marks)***

5. (a) A group of shareholders consisting of 25 members decide to file a petition before the Tribunal for relief against oppression and mismanagement by the Board of Directors of M/s Fly By Night Operators Ltd. The company has a total of 300 members and the group of 25 members holds one –tenth of the total paid –up share capital accounting for one-fifteenth of the issued share capital. The main grievance of the group is the due to mismanagement by the board of directors, the company is incurring losses and the company has not declared any dividends even when profits were available in the past years for declaration of dividend. In the light of the provisions of the Companies Act, 2013, advise the group of shareholders regarding the success of (i) getting the petition admitted and (ii) obtaining relief from the Tribunal. ***(8 Marks)***

   (b) SEBI received a complaint from an investor that he has not received the payment due to him from a registered stock broker. Explain the action that can be taken by SEBI against the stock broker under the provisions of Securities and Exchange Board of India Act, 1992 and the factors that will be taken into account while taking such action. ***(8 Marks)***

6. (a) Referring to the provisions of the Securitisation & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002 state the circumstances under which the Reserve Bank of India may cancel the certificate of registration granted to a Securitisation Company.

(8 Marks)

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(b) (i) 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?

(ii) 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. You are required to state, where the said company should deliver such documents.

(iii) In case, a foreign company does not deliver its documents to the Registrar of Companies as required under section 380 of the Companies Act, 2013, state the penalty prescribed under the said Act, which can be levied. ***(8 Marks)***

7. Attempt any **four:**

(a) Mr. R, citizen of India, left India for employment in U.S.A. on 1st June, 2015. Mr. Ram purchased a flat at New Delhi for Rs.15 lakhs in September, 2016. His brother, Mr. G employed in New Delhi, also purchased a flat in the same building in September, 2016 for Rs.15 lakhs. Mr. G's flat was financed by a loan from a Housing Finance Company and the loan was guaranteed by Mr. R.

Examine with reference to the provisions of the Foreign Exchange Management Act, 1999 whether purchase of flat and guarantee by Mr. R are Capital Account transactions and whether these transactions are permissible. ***(4 Marks)***

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

(i) 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'.

(ii) Whether a person purchasing goods not for personal use, but for resale can be considered as a 'consumer.' ***(4 Marks)***

(c) Anusandhan & Development Limited, a registered Company has a unique business idea emerging from research and development in a new area. However, it is a future project and the company has no significant accounting transactions and business activities at present. The company desires to obtain the status of a 'Dormant Company'. Advise the company regarding the provisions of the Companies Act, 2013 in this regard and the procedure to be followed in this regard. ***(4 Marks)***

(d) Briefly explain the meaning and application of the rule of "Harmonious Construction" in the interpretation of statutes. ***(4 Marks)***

(e) Enumerate the obligations of banking companies under the Prevention of Money Laundering Act, 2002. ***(4 Marks)***

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MOCK TEST PAPER

FINAL COURSE: GROUP –I

PAPER – 4: CORPORATE AND ALLIED LAWS

SUGGESTED ANSWERS/HINTS

1. **(a)** Section 125 of the Companies Act, 2013 deals with the provisions related to the Investor Education and Protection Fund (IEPF). Sections provides that the Central Government shall establish a Fund to be called the Investor Education and Protection Fund. The fund is established solely to protect and safeguard the interests of investors. Fund shall be utilised for the following purposes —

1. To refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;
2. For promotion of investors' education, awareness and protection;
3. For distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;
4. For reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and
5. For any other purpose incidental thereto, in accordance with such rules as prescribed under the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016.

(b) Under section 152(6) (a) unless the articles provide for the retirement of all directors at every annual general meeting, not less than two-thirds of the total number of directors of a public company shall be persons whose period of office is liable to determination by retirement of directors by rotation.

In the given case, it is assumed that the 6 directors appointed at the first general meeting of the company constitute at least two thirds of the total number of directors.

Section 152(6)(c) further states that at every annual general meeting, one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office.

Therefore, in the given case 2 directors will be liable to retire by rotation at the next AGM of the Company.

Section 152(6)(d) further states that the directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot.

In the given case, all the 6 directors were appointed on the same date. Hence, the choice of the 2 directors who would retire at the next AGM of the company will be made either mutually by these 6 directors failing which; it will be decided by lots.

It will not make any difference under the Companies Act, 2013 if the company is a non profit organization.

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(c) Power of Central Government/SEBI to direct rules to be made or to make rules: The Central Government is empowered under section 8 of the Securities Contracts (Regulation) Act, 1956 to issue written order directing all or any of the recognized stock exchanges to make any rules or to amend any rules already made within 2 months from the date of the order in respect of matters specified in section 3(2). One of the matters specified in section 3(2) is the governing body of stock exchange, its constitution and powers of management and the manner in which its business is to be transacted. Hence, the Central Government is empowered to direct the Stock Exchange in respect of prohibition of broker-member being appointed as president of the stock exchange. According to the notification issued by the Central Government under section 29A, this power is also exercisable by SEBI.

If any recognized stock exchange fails or neglects to comply with any order made by SEBI within 2 months, SEBI may itself make the rules made, either in the form prepared in the order or with such modifications thereof as may be agreed to between the stock exchange and SEBI. The amended rules should be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the recognized stock exchange is situated. After such publication, the rules will be valid, as if they had been made or amended by the stock exchange itself.

Hence, SEBI can issue directions to the recognized stock exchange to amend the rules and if the said stock exchange does not take steps for amending the rules, SEBI may amend the rules on its own by following the procedure laid down in section 8.

(d) (i) There is no provision in the Companies Act, 2013 under which the board meetings must be held at any particular place. The Companies Act lays down the provisions for holding meetings by video conferencing, sending notices, procedures at the meeting etc. Therefore, there is no difficulty in holding the board meeting at Chennai even if all the directors of the company reside at Kolkata and the registered office is situated at Kolkata provided that the requirements regarding the holding of a valid board meeting and the other provisions relating to the signing of register of contracts, taking roll calls, etc. are complied with.

(ii) Section 173 (3) of the Companies Act, 2013 provides for the giving of notice of every board meeting of not less than seven days to every director of the company. There is no provision in the Act laying down the contents of the notice. Hence, it may be construed that notice may be interpreted as intimation of the meeting and does not necessarily include the sending of the Agenda of the meeting. However, considering the importance of Board Meetings and the responsibilities placed on the directors for decisions taken at the meetings, it is inevitable for them to be properly prepared and informed about the items to be discussed at the Board Meetings. As a matter of good secretarial practice, the notice should include full details and particulars of the business to be transacted at the Board Meetings. The articles of association of the company may make it mandatory to do so in almost all cases.

2. (a) (i) A scheme of compromise or arrangement may provide for amalgamation of companies under section 394 of the Companies Act, 1956. Section 394(4)(b) defines the 'transferee' and 'transferor' companies. While the 'transferee company' does not include any company other than a company within the meaning of the Companies Act, 1956, the transferor company includes any body corporate whether a company within the meaning of the Companies Act or not. Hence the scheme of amalgamation may provide for transfer of foreign companies to Indian companies.

(ii) Majority in number representing three-fourths in value of members or class of members, as the case may be, present and voting either in person or by proxy, where proxies are allowed under the rules made under section 643 must approve the scheme

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or arrangement providing for amalgamation of companies [Section 391(2)]. Any member who though present at the meeting, does not vote for or against, but remains neutral, is not to be taken into consideration.

As the expression used is 'member', not only holders of equity shares but also preference shareholders will have to be taken into account and the value of their shares be included or, if the meeting of holders of preference shares and equity shares are ordered by the court to be held separately, the three-fourths majority of each class will have to be ascertained separately.

(iii) The scheme may provide for the dissolution, without winding up, of any transferor company [Section 394(1)]. The Court shall not order dissolution of any transferor company unless the official liquidator has, on scrutiny of the books and papers of the company, made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest [Second proviso to Section 394(2)].

(b) (i) Section 134(3)(c) of the Companies Act, 2013 provides that there shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include a number of statements as prescribed in the sub section including Directors' Responsibility Statement.

Further section 134(5) states that the Directors Responsibility Statement shall state that:

(a) In the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period;

(c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(d) that the directors had prepared the annual accounts on a going concern basis; and

(e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively; and

(f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

(ii) Sub-section (1) of the section 129 of this Act states that financial statement of the company shall comply with the accounting standards notified under section 133. As per sub – section (5), where the Financial Statements of the company do not comply with the accounting standards, such companies shall disclose in its financial statements, the following, namely:

(a) the deviation from the accounting standards;

(b) the reasons for such deviation; and

(c) the financial effect, if any, arising due to such deviation.

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Apart from the above consequence on non compliance, section 129(7) further provides that if a company contravenes the provisions of section 129 (which requires compliance with accounting standards), the managing director, whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

Moreover, the Board of directors is also required under section 134 of the Companies Act, 2013 to include a Directors Responsibility Statement indicating therein that in the preparation of the financial statements the applicable accounting standards had been followed along with proper explanation relating to material departures, if any. If such person (as above referred) fails to take all reasonable steps to secure compliance by the company, as respects any accounts laid before the company in general meeting, with the provisions of this section and with the other requirements of this Act as to the matters to be stated in the accounts, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to 1 year, or with fine not less than Rs. 50,000 but which may extend to Rs. 5,00,000 or with both.

Responsibilities of auditors: As per section 143(3) (e) of the Companies Act, 2013, the statutory auditor's responsibility is to state in his report, whether in his opinion, the profit and loss account and balance sheet comply with the accounting standards referred to in section 133 of the Companies Act, 2013.

3. (a) A company can pay compensation to its directors for loss of office as provided in sections 202 of the Companies Act, 2013. Under section 202, such compensation can be paid only to managing director, director holding the office of the manager and to a whole time director but not to others. The compensation payable shall be on the basis of average remuneration actually earned by such director for three years, or such shorter period as the case may be, immediately preceding the ceasing of holding of such office and shall be for the unexpired portion of his term or for three years whichever is shorter. No such payment can be made, if winding up of the company is commenced before or commences within 12 months after he ceases to hold office if the assets of the company on the winding up, after deducting expenses thereof, are not sufficient to repay to the shareholders the share capital (including the premium, if any) contributed by them. However, no payment of compensation can be made in the following cases:

1. where a director resigns on the ground of amalgamation or reconstruction and is appointed the office of managing director or manager or other officer of such reconstructed or amalgamated company,
2. where the director resigns his office otherwise than on the reconstruction of the company or its amalgamation as aforesaid,
3. where the director vacates office under section 167 of the Companies Act, 2013,
4. where the winding up of the company is due to the negligence of the director concerned,
5. where the director has been guilty of any fraud or breach of trust,
6. where the director has instigated or has taken part directly or indirectly in bringing about, the termination of his office.

(b) (1) According to section 174(1) of the Companies Act, 2013, quorum is one third of the total strength of Board (any fraction contained in the said one third being rounded of as one) or two directors whichever is higher. The total strength is to be derived after

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deducting the number of directors whose offices are vacant. Therefore, where total number of directors is 9 and 2 offices of the directors have fallen vacant, we find: 1/3 of (9-2) = 1/3 of 7 = 21/3 directors which will be rounded off as 3. Being higher than 2, therefore 3 directors would constitute the quorum for the Board meetings.

(2) Under section 174(3) of the Companies Act, 2013 if at any time the number of the interested directors exceeds or is equal to two thirds of the total strength of the Board of Directors, the number of the directors who are non-interested but present at the meeting, not being less than two shall constitute the quorum. Accordingly in the given problem, there are in all 15 directors and the Board meeting commences with all the 15 directors. During the meeting, an item comes up for discussion in respect of which 13 happen to be "interested" directors. In this case, in spite of the excess of the interested directors being more than two-thirds, the prescribed minimum number of non-interested directors constituting the quorum, namely, 2 are present at the meeting and can transact the particular item of business.

4. (a) (i) **Class of companies required to appoint Internal Auditor:** Section 138 of the Companies Act, 2013 and the *Companies (Accounts) Rules, 2014* prescribes the class of companies required to appoint Internal Auditor. According to it, following class of companies shall be required to appoint an internal auditor or a firm of internal auditors.

1. Every listed company;
2. Every unlisted public company having –
   (a) Paid up share capital of 50 crore rupees or more during the preceding financial year; or
   (b) Turnover of 200 crore rupees or more during the preceding financial year; or
   (c) Outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year; or
   (d) Outstanding deposits of 25 crore rupees or more at any point of time during the preceding financial year; and
3. Every private company having –
   (a) Turnover of 200 crore rupees or more during the preceding financial year; or
   (b) Outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year.

As per the facts given in the question, PQR Limited is an unlisted public company with the paid up share capital of Rs. 80 crores during the preceding financial year with the turnover of Rs. 110 crores. Since PQR Limited fulfills one of the criteria with paid up share capital of more than 50 crore rupees during the preceding financial year, it is mandatory for the PQR Limited to appoint an internal auditor for the financial year 2016-2017.

(ii) As per the section 138(1), an internal auditor shall either be a Chartered Accountant (engaged in practice on not) or a Cost Accountant, or such other professional as may be decided by the Board. Even an employee of the company may also be appointed as an Internal auditor of the company as per the Rule 13 of the *Companies (Accounts) Rules, 2014*.

(b) (i) **Commercial Insolvency of Splendid Ltd.: In this case three facts are given i.e.:**

1. Splendid Limited went for a public issue and subsequently it was required to

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refund the amount received on application.

2. As a result, the company has no prospects of doing any business.

3. There was a complete dead lock among the directors.

These three circumstances may be construed as indicators of commercial insolvency of the company.

Section 433 (e) read together with Section 434 of the Companies Act, 1956, provides that a Court may order for winding up of a company if it is unable to pay its debts or deemed to be unable to pay its debts and it is proved to the satisfaction of the Court after taking into account all the liabilities including the contingent and prospective liabilities of the company. Moreover, Section 439 gives powers to the creditors for filing an application for its petition for winding up. There are no chances for the sustainment of shareholder's objection [*Deccan Farms & Distilleries Ltd. vs. Velabai Laxmidas Bhaiji (1979)*]. The Court has got wide discretionary powers regarding winding up. It may or may not dismiss the petition of creditors for winding up. Even if a winding up petition is a proper remedy against a company which is unable to pay its debts, the Court may in its discretion refuse to put an end to the life of the company [*Jugal kishore Banarsidas vs. South India Saw Mills P. Ltd. (1975)*].

(ii) The Provisions of the Companies Act, 1956, which will apply in this case, are:

(a) A company may be wound up by the Court, if the company is unable to pay its debts. [Section 433(e)]

(b) A company shall be deemed to be unable to pay its debts, if it is proved to the satisfaction of the Court that the company is unable to pay its debts, and in determining whether a company is unable to pay its debts, the Court shall take into account the contingent and prospective liabilities of the company. [Section 434(1)(c)].

(c) An application to the Court for the winding up of a company shall be by petition presented, subject to the provisions of this section, by any creditor or creditors, including any Contingent or prospective creditor or creditors. [Section 439(1)(b)]

5. (a) Section 244 of the Companies Act, 2013 provides the right to apply to the Tribunal for relief against oppression and mis-management. This right is available only when the petitioners hold the prescribed limit of shares as indicated below:

(i) In the case of company having a share capital, not less than 100 members of the Company or not less than one tenth of the total number of its members whichever is less or any member or members holding not less than one tenth of the issued share capital of the company, provided that the applicant(s) have paid all calls and other dues on the shares.

(ii) In the case of company not having share capital, not less than one-fifth of the total number of its members.

Since the group of shareholders do not number 100 or hold $1/10^{th}$ of the issued share capital or constitute $1/10^{th}$ of the total number of members, they have no right to approach the Tribunal for relief.

However, the Tribunal may, on an application made to it waive all or any of the requirements specified in (i) or (ii) so as to enable the members to apply under section 241.

As regards obtaining relief from Tribunal, continuous losses cannot, by itself, be regarded as oppression (*Ashok Betelnut Co. P. Ltd. vs. M.K. Chandrakanth*).

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Similarly, failure to declare dividends or payment of low dividends also does not amount to oppression. (*Thomas Veddon V.J. (v) Kuttanad Robber Co. Ltd*).

Thus the shareholders may not succeed in getting any relief from Tribunal.

(b) Penalty for default in case of stock brokers: Section 15F of Securities and Exchange Board of India Act, 1992 provides for penalty for default in case of stock brokers. If any person who, is registered, as a stock broker under this Act:

(1) fails to issue contract notes in the form and in the manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to for which the contract note was required to be issued by that broker;

(2) fails to deliver any security or fails to make payment of the amount due to the investor in the manner or within the period specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme including mutual funds subject to a maximum of one crore rupees.;

(3) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

Factors for taking into account while action

While adjudging quantum of penalty under section 15J, the adjudicating officer shall have due regard to the following factors:

(1) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the defaults.

(2) the amount of loss to an investor or group of investors as a result of the default.

(3) the repetitive nature of the default.

Taking into consideration the above factors, the adjudicating officer may levy a maximum penalty as prescribed in section 15F for default by the concerned stock broker in making the payment to the investor.

6. (a) Cancellation of Certificate of Registration (Section 4 of the securitisation & reconstruction of financial assets & enforcement of Security Interest Act, 2002)

As per the section 4 of the Securitisation & Reconstruction of Financial Assets & Enforcement of security Interest Act, 2002, the Reserve Bank may cancel a certificate of registration granted to a securitization company or a reconstruction company, if such company-

(i) ceases to carry on the business of securitisation or asset reconstruction; or

(ii) ceases to receive or hold any investment from a qualified institutional buyer; or

(iii) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or

(iv) at any time fails to fulfil any of the conditions referred to in clauses (a) to (g) of sub-section (3) of section 3; or

(v) fails to-

- (a) comply with any direction issued by the Reserve Bank under the provisions of this Act; or
- (b) maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or

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(c) submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or

(d) obtain prior approval of the Reserve Bank required under sub-section (6) of section 3.

(b) (i) 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 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

(ii) The Companies Act, 2013 vide section 380 requires that every foreign company is 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.

(iii) The Companies Act, 2013 lays down the governing provisions for foreign companies in Chapter XXII which is comprised of sections 379 to 393. The penalties for non-filing or for contravention of any provision for this chapter including for non-filing of documents with the Registrar as required by section 380 and other sections in this chapter are laid down in section 392 of the Act which provides that if a foreign company contravenes the provisions of this Chapter, the foreign company shall be punishable with a fine which shall not be less than Rs. 1,00,000 but which may extend to Rs. 3,00,000 and in the case of a continuing offence, with an additional fine which may extend to Rs. 50,000 for every day after the first during which the contravention continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than Rs. 25,000 but which may extend to Rs. 5,00,000, or with both.

7. (a) Section 2(e) of Foreign Exchange Management Act, 1999 states that 'capital account transactions' means (a) a transaction which alters the assets or liabilities, including contingent liabilities, outside India of person's resident in India (b) a transaction which alters assets or liabilities in India of persons resident outside India and includes transactions referred to in section 6(3). According to the said definition, a transaction which alters the contingent liability will be considered as capital account transaction in the case of person resident in India, but it is not so in the case of person resident outside India.

Purchase of immovable property by Mr. R in India is a capital account transaction. It has also been specifically provided in section 6(3)(i) as a capital account transaction.

Guarantee will be considered as a capital account transaction in the following cases:

(1) Guarantee in respect of any debt, obligation or other liability incurred by a person resident in India and owed to a person resident outside India.

(2) Guarantee in respect of any liability, debt or other obligation incurred by a person

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resident outside India.

In this case, Mr. R, a resident outside India gives a guarantee in respect of a debt incurred by a person resident in India and owed to a person resident in India. Hence, it would appear that guarantee by Mr. R cannot be considered as a capital account transaction within the meaning of Section 2(e), particularly because it is a contingent liability.

All capital account transactions are prohibited unless specifically permitted. RBI is empowered to issue regulations in this regard [Section 6(3)]. Permissible capital account transactions by person's resident outside India are given in Schedule II to the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000. According to the said regulations both the purchase of immovable property by Mr. R and guarantee by Mr. R are permissible.

(b) (i) **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 the Competition Act, 2002.

(ii) **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.

(c) The provisions related to the Dormant companies is covered under section 455 of the Companies Act, 2013. According to provisions-

1. a company is formed and registered under this Act for the purpose of a future project or to hold an asset or intellectual property and has no significant accounting transaction.
2. Such company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.
3. The Registrar shall allow the status of a dormant company to the applicant and issue a certificate after considering of the application.
4. The Registrar shall maintain a register of dormant companies in such form as may be prescribed.

In case of a company which has not filed financial statements or annual returns for two financial years consecutively, the Register shall issue a notice to that company and enter the name of such company in the register maintained for dormant companies.

A dormant company shall have such minimum number of directors, file such documents and pay such annual fee as may be prescribed to the Registrar to retain its dormant status in the

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register and may become an active company on an application made in this behalf accompanied by such documents and fee as may be prescribed. However, the Registrar shall strike off the name of a dormant company from the register of dormant companies, which has failed to comply with the requirements of this section.

Thus, Anusandhan Development Limited may follow the above procedure to obtain the status of a 'Dormant Company'.

(d) Meaning of rule Harmonious Construction: When there is doubt about the meaning of the words of a statute, these should be understood in the sense in which they harmonise with the subject of the enactment and the object which the legislature had in view. Where there are in an enactment two or more provisions which cannot be reconciled with each other, they should be so interpreted, wherever possible, as to give effect to all of them. This is what is known as the Rule of Harmonious Construction.

It must always be borne in mind that a statute is passed as a whole and not in sections and it may well be assumed to be animated by one general purpose and intent. The Court's duty is to give effect to all the parts of a statute, if possible. But this general principle is meant to guide the courts in furthering the intent of the legislature, not overriding it.

Application of the Rule: The Rule of Harmonious Construction is applicable only when there is a real and not merely apparent conflict between the provisions of an Act, and one of them has not been made subject to the other. When after having construed their context the words are capable of only a single meaning, the rule of harmonious construction disappears and is replaced by the rule of literal construction.

(e) Section 12 of the Prevention of Money Laundering Act, 2002 provides for the obligation of Banking Companies, Financial Institutions and Intermediaries or a person carrying on a designated business or profession. According to sub-section (1), every banking company, financial institution and intermediary or a person carrying on a designated business or profession shall –

(a) maintain a record of all transactions, including information relating to transactions covered under clause (b), in such manner as to enable it to reconstruct individual transactions;

(b) furnish to the Director within such time as may be prescribed, information relating to such transactions, whether attempted or executed, the nature and value of which may be prescribed;

(c) verify the identity of its clients in such manner and subject to such conditions, as may be prescribed;

(d) identify the beneficial owner, if any, of such of its clients, as may be prescribed;

(e) maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.

Every information maintained, furnished or verified, save as otherwise provided under any law for the time being in force shall be kept confidential.

The records referred to in clause (a) of sub-section (1) shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.

The records referred to in clause (e) of sub-section (l) shall be maintained for a period of five years after the business relationship between a client and the reporting entity has ended or the account has been closed, whichever is later.

The Central Government may, by notification, exempt any reporting entity or class of reporting entities from any obligation under this chapter.

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