Test Series : September, 2015

MOCK TEST PAPER – 1

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.

Questions

1. (a) From the information furnished you are required to compute the Basic and Diluted EPS (earnings per share) for accounting year 01-04-2014 to 31-03-2015 and adjusted EPS for the year 01-04-2013 to 31-03-2014.

Net profit for year ended 31-03-2014	Rs. 75,50,000
Net profit for year ended 31-03-2015	Rs. 1,00,25,000
No. of equity shares as on 01-04-2014	50,00,250
Bonus issue on 01-01-2015	1 share for every 2 held
No. of 12% Convertible Debentures of Rs. 100 each issued on 01-01-2015	1,00,000
Conversion ratio of Debentures	10 shares per debenture
Tax rate	30 percent

(b) The following particulars are stated in the Balance Sheet of M/s GM Ltd. as on 31.03.2013:

	(Rs. in Lakhs)
Deferred Tax Liability (Cr.)	20.00
Deferred Tax Assets (Dr.)	10.00

The following transactions were reported during the year 2013-14:

(i)	Tax Rate	50%
(ii)	Depreciation – As per Books	50.00
	Depreciation – for Tax purposes	30.00
	There were no additions to Fixed Assets during the year.	
(iii)	Items disallowed in 2012-13 and allowed for Tax purposes in 2013-14	10.00

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(iv)	Interest to Financial Institutions accounted in the Books on accrual basis, but actual payment was made on 30.09.2014	20.00
(v)	Donations to Private Trusts made in 2013-14	10.00
(vi)	Share issue expenses allowed under 35(D) of the I.T. Act, 1961 for the year 2013-14 (1/10th of Rs. 50.00 lakhs incurred in 2009-2010)	5.00
(vii)	Repairs to Plant and Machinery Rs. 100.00 lakhs was spread over the period 2013-14 and 2014-15 equally in the books. However, the entire expenditure was allowed for Income-tax purposes.	

Indicate clearly the impact of above items in terms of Deferred Tax liability/Deferred Tax Assets.

(c) Ginger Ltd. has initiated a lease for three years in respect of an equipment costing Rs. 1,50,000 with expected useful life of 4 years. The asset would revert to Ginger Limited under the lease agreement. The other information available in respect of lease agreement is:

(i) The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at Rs. 20,000.

(ii) The implicit rate of interest is 10%.

(iii) The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of asset.

Ascertain in the hands of Ginger Ltd.

(i) The annual lease payment.

(ii) The unearned finance income.

(iii) The segregation of finance income, and also,

(d) Kunal Ltd. has been in the business of sale of Wines for the last 12 years and is an extremely cash rich company. In FY 2013-14 the Board of the company decided to venture into new areas of business and identified the activity of acquiring Properties such as old Bungalows, Heritage buildings and the like at prime locations and after carrying out renovation and refurbishment of the same to let out these properties on lease to willing parties. The new business was commenced as a separate division of the company in FY 2014-15 during which the company managed to identify 19 such properties of which 17 were acquired and 9 given on lease. Being the initial year of operations and also since some of the lease arrangements were entered into at the end of the year the income from leasing was only a paltry amount. After the acquisition of the properties as aforesaid very attractive offers for sale of 14 of the properties were received. Kunal Ltd. after negotiation accepted 12 of the offers and sold these 12 properties making large profits in the bargain. The accountant of

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Kunal Ltd. has accounted the acquisition and disposals of properties as 'Purchases' and 'Sales' in the Profit & Loss account of the Property Division and treated the lease incomes as part of the other income of the company. The contention of the accountant of Kunal Ltd., was that since a majority of the properties were disposed off within a short span of time, the properties are to be considered as stock in trade only. Further since the lease income was insignificant it does not become the main source of income and hence considered as part of other income. You are required to examine the correctness of the contentions of the accountant of Kunal Ltd. considering the relevant Accounting Standards and provisions of Schedule III of Companies Act, 2013. *(4 x 5 = 20 Marks)*

2. Shine Co. Ltd. carried on manufacturing business. Its products were sold to wholesalers and the company had its own retail shop. Bhawna & Co., Private Ltd. carried on similar manufacturing business, but all goods produced were sold through the company's own retail shops.

The summarised balance sheets of the two companies as at 31st March, 2015 were as follows:

	Shine Co. Ltd. Rs.	Bhawna Co. (P) Ltd. Rs.		Shine Co. Ltd. Rs.	Bhawna Co. (P) Ltd. Rs.
Share Capital			Fixed Assets :		
Authorised Equity Shares of Rs. 10	40,00,000	6,00,000	Freehold Properties at cost	10,00,000	2,50,000
Issued & fully paid up	25,00,000	6,00,000	Plant & Machinery at cost less depreciation	13,00,000	1,00,000
P & L A/c	3,40,000	90,000	Total Fixed Assets	23,00,000	3,50,000
Trade payables	4,20,000	70,000	Current Assets :		
			Inventory	4,80,000	1,20,000
			Trade receivables	2,30,000	80,000
			Bank	2,50,000	2,10,000
	32,60,000	7,60,000		32,60,000	7,60,000

The original cost of Plant and Machinery was:

Shine Co. Ltd. Rs. 26,00,000

Bhawna Co. (P) Ltd. Rs. 2,00,000

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The following arrangements were made and carried out on April 1, 2015:

(1) Shine Co. Ltd purchased from the shareholders of Bhawna Co. (P) Ltd. all the issued shares @ Rs. 14 per share.

(2) The shareholders of Bhawna Co. (P) Ltd. took over one of the freehold properties of Bhawna Co. (Private) Ltd. for Rs. 60,000, at the book value of the same. It was agreed that the amount should be set off against the amount due to them under (1) above and the balance due to them to be satisfied by the issue of an appropriate number of equity shares in Shine Co. Ltd. at Rs. 19.50 per share.

The necessary transfer in regard to the setting off the price of the property taken over by the shareholders against the amount due to them from Shine Co. Ltd. were made in the books of the two companies.

(3) All manufacturing was to be carried on by Shine Co. Ltd. and all retail business is to be carried on by Bhawna Co. (Private) Ltd. in this connection.

(i) Shine Co. Ltd. purchased the whole of Bhawna Co. (P) Ltd.'s plant and machinery for Rs. 1,50,000 and certain of their free-hold property (cost Rs. 1,00,000) at Rs. 1,20,000.

(ii) Bhawna Co. (P) Ltd. purchased Shine Co. Ltd's. freehold retail shop buildings (cost to Shine Co. Ltd, Rs. 75,000) at Rs. 60,000 and took over the retail inventory at Rs. 80,000 at the book value.

(4) Shine Co. Ltd. drew a cheque in favour of Bhawna Co. (P) Ltd. for the net amount due, taking into account all the matters mentioned above.

(5) Immediately after the transfer of shares in (1) above, Bhawna Co. (P) Ltd. declared and paid a dividend of Rs. 60,000 (ignore Dividend Distribution Tax).

You are required to prepare the Balance Sheets of Shine Co. Ltd. and Bhawna Co. (P) Ltd. immediately after the completion of the above transaction. *(16 Marks)*

3. The following information has been extracted from the Books of 'A' Limited group (as at 31st March, 2015):

	A Ltd. *Rs.*	*B Ltd.* *Rs.*	*C Ltd.* *Rs.*		*A Ltd.* *Rs.*	*B Ltd.* *Rs.*	*C Ltd.* *Rs.*
Share capital				*Fixed Assets less depreciation*	*4,20,000*	*3,76,000*	*5,22,000*
(Fully paid equity shares of Rs. 10 each)	*8,00,000*	*6,00,000*	*4,00,000*	*Investment at cost*	*6,30,000*	*4,00,000*	*--*
				Current Assets	*1,20,000*	*60,000*	*40,000*
Profit and Loss Account	*2,10,000*	*1,90,000*	*1,28,000*				

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Dividend received:							
From B Ltd. in 2013-2014	*60,000*						
From B Ltd. in 2014-2015	*60,000*						
From C Ltd. in 2014-2015		*36,000*					
Current Liabilities	*40,000*	*10,000*	*34,000*				
	11,70,000	*8,36,000*	*5,62,000*		*11,70,000*	*8,36,000*	*5,62,000*

All the companies pay dividends of 12 percent of paid-up share capital in June following the end of the financial year. The receiving companies account for the dividends in their books when they are received.

'A' Limited acquired 50,000 equity shares of B Ltd. on 31st March, 2013.

'B' Limited acquired 30,000 equity shares of C Ltd. on 31st March, 2014.

The detailed information of Profit and Loss Accounts is as follows:

	A Ltd. Rs.	B Ltd. Rs.	C Ltd. Rs.
Balance of Profit and Loss Account on 31st March, 2013 after dividends of 12% in respect of financial year 2012-2013, but excluding dividends received	86,000	78,000	60,000
Net profit earned in 2013-2014	1,20,000	84,000	56,000
	2,06,000	1,62,000	1,16,000
Less – Dividends of 12% (paid in 2014-2015)	96,000	72,000	48,000
	1,10,000	90,000	68,000
Net profit earned in 2014-2015 (Before taking into account proposed dividends of 12% in respect of financial year 2014-2015)	1,00,000	1,00,000	60,000
	2,10,000	1,90,000	1,28,000

Taking into account the transactions from 2012-2013 to 2014-2015 and ignoring taxation, you are required to prepare:

(i) The Consolidated Balance Sheet of A Limited group as at 31st March, 2015.

(ii) Cost of control.

(iii) Minority shareholders interest. *(16 Marks)*

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4. Umeed Ltd. is engaged in the business of design and construction of Product A that are supplied exclusively to the Processing Department. The core component of such is outsourced by Umeed Ltd. from Pure Ltd. the sole manufacturer of this item. Umeed Ltd. wants to gain leadership in this industry and seeks to take over Pure Ltd. Umeed Ltd. estimates that its Goodwill in the industry will increase by a minimum of Rs. 300 crores consequent on the acquisition. Umeed Ltd. has made the following calculation of the economic benefits presently available and that foreseen as a result of the acquisition.

(i) Projected Cash Flows of Umeed Ltd. for the next 5 years:

Year	1	2	3	4	5
Cash flow (Rs. in crores)	1,000	1,500	2,000	2,500	3,000

(ii) Projected Cash Flow of Pure Ltd. for the next 5 years.

Year	1	2	3	4	5
Cash flow (Rs. in crores)	400	400	600	800	1,000

(iii) Audited net worth of Pure Ltd.

	Rs. in Crores
Fixed assets	2,000
Investments (non-trade)	1,000
Current assets	1,000
Total	4,000
Current liabilities	1,000
Net worth	3,000

(iv) Other information:

(a) 10% of the fixed assets of Pure Ltd. will not be required in the event of the acquisition and the same has ready buyers for Rs. 100 crore.

(b) Current Assets include surplus inventory of Rs. 20 crore that can realize Rs. 30 crore.

(c) Investments have a ready marked for Rs. 1,500 crore.

(d) The current liabilities are to be paid off immediately; Rs. 510 crores are payable on account of a compensation claim awarded against Pure Ltd., which has been treated as a contingent liability in the accounts on which 20 percent was provided for.

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(v) Umeed Ltd. has estimated the combined cash flows post merger as under:

Year	1	2	3	4	5
Cash flow (Rs. in crores)	1,500	2,000	2,500	3,000	3,500

You are required to advise Umeed Ltd. the maximum value it can pay for takeover of Pure Ltd.; also show the current valuation of Pure Ltd. as a 'Stands Alone' entity. The Discount rate of 15% is advised appropriate, values for which are given below:

Year	P.V
1	0.870
2	0.756
3	0.658
4	0.572
5	0.497

(16 Marks)

5. (a) Given below is the summarised Profit and Loss Account of Lal Ltd.:

Summarised Profit and Loss Account
for the year ended 31st March, 2014

	Notes	Amount (Rs. '000)
Income		
Sales	1	28,525
Other Income		756
		29,281
Expenditure		
Operating cost	2	25,658
Excise duty		1,718
Interest on Bank overdraft	3	93
Interest on 10% Debentures		1,157
		28,626
Profit before Depreciation		655
Less: Depreciation		(255)
Profit before tax		400
Provision for tax	4	(275)
Profit after tax		125

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Less: Transfer to Fixed Asset Replacement Reserve		(25)
		100
Less: Dividend paid and payable		(45)
Retained profit		55

Notes:

1. This represents the invoice value of goods supplied after deducting discounts, returns and sales tax.
2. Operating cost includes Rs. ('000) 10,247 as wages, salaries and other benefits to employees.
3. The bank overdraft is treated as a temporary source of finance.
4. The charge for taxation includes a transfer of Rs. ('000) 45 to the credit of deferred tax account.

You are required to:

(i) Prepare a value added statement for the year ended 31st March, 2014.

(ii) Reconcile total value added with profit before taxation.

(b) Naman Ltd. granted 500 options to each of its 500 employees in 2009 at an exercise price of Rs. 50 when the market price was the same. The contractual life (vesting and exercise period) of the options granted is 6 years with the vesting period and exercise period being 3 years each. The expected life is 5 years and the expected annual forfeitures are estimated at 3 per cent. The fair value per option is arrived at Rs. 15. Actual forfeitures in 2009 were 5 per cent. However at the end of 2009 the management of Naman Ltd. still expects that the actual forfeitures would average only 3 per cent over the entire vesting period. During 2010 the management revises its estimated forfeiture rate to 10 per cent per annum. Of the 500 employees 380 employees have completed the 3 year vesting period. 200 employees exercise their right to obtain shares vested in them in pursuance of ESOP at the end of 2013 and 100 employees exercise their right at the end of 2014. The rights of the remaining employees expire unexercised at the end of 2014. The face value per share is Rs. 10. Show the necessary journal entries with suitable narrations. Workings should form part of the answer. *(8 + 8 = 16 Marks)*

6. (a) Investors Mutual Fund is registered with SEBI and having its registered office at Pune. The fund is in the process of finalizing the annual statement of accounts of one of its open ended mutual fund schemes. From the information furnished below you are required to prepare a statement showing the movement of unit holders' funds for the financial year ended 31st March, 2015.

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	Rs. '000
Opening Balance of net assets	*12,00,000*
Net Income for the year (Audited)	*85,000*
8,50,200 units issued during 2014-15	*96,500*
7,52,300 units redeemed during 2014-15	*71,320*
The par value per unit is Rs. 100	

(b) Jindal Ltd. furnishes the following information from which you are required to calculate the prevailing Economic Value Added of the company and also explain the reason for the difference, if any, between the EVA as calculated by you and the MVA (Market Value Added) of LIL amounting to Rs. 14005 crores.

Common shares of Rs. 1,000 face value	1,58,200 units
12% Debentures Rs. 10 face value	50,00,000 units
Current tax rate	30%
Financial Leverage	1.1 times
Securities Premium Account (Rupees in lakhs)	155
Free Reserves (Rupees in lakhs)	154
Capital Reserve (Rupees in lakhs)	109

It is a prevailing practice for companies in the industry to which Jindal Ltd. belongs to pay at least a dividend of 15% p.a. to its common shareholders.*(6 + 10 = 16 Marks)*

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

(a) Who are related parties under AS 18? What are the related party disclosure requirements?

(b) Bane Ltd. on 1-1-2015 had made an investment of Rs.600 lakhs in the equity shares of Grant Ltd. of which 50% is made in the long term category and the rest as temporary investment. The realizable value of all such investment on 31-3-2015 became Rs. 200 lakhs as Grant Ltd. lost a case of copyright. How will you recognize the reduction in financial statements for the year ended on 31-3-2015.

(c) A Ltd. entered into agreement with B Ltd. for sale of goods of Rs. 8 lakhs at a profit of 20% on cost. The sale transaction took place on 1st February, 2014. On the same day B Ltd. entered into another agreement with A Ltd. to resell the same goods at Rs. 10.80 lakhs on 1st August, 2014. State the treatment of this transaction in the financial statements of A Ltd. as on 31.03.14. The pre-determined re-selling price covers the holding cost of B Ltd. Give the Journal Entries as on 31.03.14 in the books of A Ltd.

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(d) A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?

(e) The original cost of the machine shown in the books of Sun Ltd. as on 1st Jan., 2012 is Rs. 180 lakhs which they revalued upward by 20% during 2012. In the year 2014, it appears that a 5% downward revaluation should be made to arrive at the true value of the asset in the changed economic and industry conditions. They charged 15% depreciation on W.D.V. of the asset.

Show the value of the asset at which it should appear in the Balance Sheet dated 31st Dec. 2014 and show the Revaluation Reserve Account. *(4 x 4 = 16 Marks)*

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Test Series : September, 2015

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 1: FINANCIAL REPORTING

SUGGESTED ANSWERS/HINTS

1. (a) No. of Bonus shares issued as on 1.1.2015

On existing shares (50,00,250 x ½)	25,00,125 shares
On convertible debentures as per SEBI Guidelines on Bonus Issue	
(1,00,000 debentures x 10 shares x ½)	5,00,000 shares

Basic Earnings per share for the year 2014-15=

$$\frac{\text{Net profit for the year ended 31.3.2015}}{\text{Weighted average number of equity share as on 31.3.2015}}$$

$$\frac{\text{Rs.}1,00,25,000}{(50,00,250 + 25,00,125 + 5,00,000)} = \text{Rs. } 1.25$$

Adjusted earnings per share for the year 2013-14

$$= \frac{\text{Rs. } 75,50,000}{(50,00,250 + 25,00,125 + 5,00,000)} = \text{Rs.}0.94$$

For Diluted EPS

Interest expense for the current year = Rs. 12,00,000

Tax relating to interest expense (30%) = Rs. 3,60,000

Adjusted net profit for the current year = Rs. 1,00,25,000 + (12,00,000 -3,60,000) x 3/12

= Rs. 1,02,35,000

No. of equity shares resulting from conversion of debentures

= 1,00,000 x 10 shares = 10,00,000

No. of equity shares used to compute diluted earnings per share

= 50,00,250 + 25,00,125 + 5,00,000 + (10,00,000 x 3/12)

= 50,00,250 + 25,00,125 + 5,00,000 + 2,50,000

= 82,50,375 shares

Diluted earnings per share = 1,02,35,000/82,50,375 = Rs. 1.24

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Note: As per AS 20, bonus shares issued to existing shareholders and to convertible debenture holders (on conversion of debentures into shares) are an issue without consideration. Therefore, it is treated as if it had occurred prior to the beginning of the year 2013-14, the earliest period reported.

(b) Impact of various items in terms of deferred tax liability/deferred tax asset.

Transactions	*Analysis*	*Nature of difference*	*Effect*	*Amount*
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	Rs. 20 lakhs $\times$ 50% = Rs. 10 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	Rs. 10 lakhs $\times$ 50% = Rs. 5 lakhs
Interest to financial institutions	It is allowed as deduction under section 43B of the IT Act, if the payment is made before the due date of filing the return of income.	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure	Permanent difference	Not applicable	Not applicable

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Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	Rs. 5 lakhs × 50% = Rs. 2.5 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	Rs. 50 lakhs × 50% = Rs. 25 lakhs

(c) (i) Calculation of Annual Lease Payment*

	Rs.
Cost of the equipment	1,50,000
Unguaranteed Residual Value	20,000
PV of residual value for 3 years @ 10% (Rs. 20,000 x 0.751)	15,020
Fair value to be recovered from Lease Payment (Rs. 1,50,000 – Rs. 15,020)	1,34,980
PV Factor for 3 years @ 10%	2.487
Annual Lease Payment (Rs. 1,34,980 / PV Factor for 3 years @ 10% i.e. 2.487)	54,275

(ii) Unearned Financial Income

Total lease payments [Rs. 54,275 x 3]	1,62,825
Add: Residual value	20,000
Gross Investments	1,82,825
Less: Present value of Investments (Rs. 1,34,980 + Rs. 15,020)	1,50,000
Unearned Financial Income	32,825

* Annual lease payments are considered to be made at the end of each accounting year.

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(iii) Segregation of Finance Income

Year	Lease Rentals Rs.	Finance Charges @ 10% on outstanding amount of the year Rs.	Repayment Rs.	Outstanding Amount Rs.
0	-	-	-	1,50,000
I	54,275	15,000	39,275	1,10,725
II	54,275	11,073	43,202	67,523
III	74,275**	6,752	67,523	--
	1,82,825	32,825	1,50,000	

(d) As per para 3 of AS 2 "Valuation of Inventories", inventories are assets that are (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. The properties acquired by Kunal Ltd. should not be construed as stock in trade in spite of the fact that they are being sold within a short span of time.

As per the definition of Fixed asset given in para 6 of AS 10 'Accounting for Fixed Assets', a fixed asset is one which is held with the intention of being used for the purpose of producing goods or services and is not held for sale in the normal course of business. In the given question the acquisition of the heritage properties is done by the company with the intention to provide the service of leasing of such properties. Hence the intention of the company was to use such property for generating revenue for the company by leasing out such properties. The sale of 12 properties can't be considered as part of normal business operations of the company. Hence the treatment of the properties as 'Stock-in- Trade' is incorrect as the properties are to be considered only as Fixed Assets of the company. The purchase and sale in short span of time to make huge profit will require disclosure as per AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'. The lease income from these properties will be considered as main business income and cannot be considered as part of other income. Such income will be disclosed under the head Revenue from operations.

Thus the contentions of the accountant regarding accounting the acquisition and sale of these properties as sale and purchase, treating them as stock in trade, considering lease income as other income are incorrect in line with provisions of relevant accounting standards.

** Rs. 74,275 includes unguaranteed residual value of equipment amounting Rs. 20,000.

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2. Balance Sheet of Shine Co. Ltd. as on 31st March, 2015

Particulars	*Note No.*	*(Rs.)*
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital	1	29,00,000
(b) Reserves and Surplus	2	7,05,000
(2) **Current Liabilities**		
Trade Payables		4,20,000
Total		40,25,000
II. **Assets**		
(1) **Non-current assets**		
(a) Fixed assets		
(b) Tangible assets	4	24,95,000
(c) Non-current Investments	5	7,80,000
(2) **Current assets**		
(a) Inventories (4,80,000 – 4,00,000)		4,00,000
(b) Trade Receivables		2,30,000
(c) Cash & Cash equivalents		1,20,000
Total		40,25,000

Notes to Accounts

			(Rs.)	*(Rs.)*
1.	**Share Capital**			
	2,90,000 Shares of Rs.10 each fully paid up of which 40,000 shares were issued pursuant to a contract without payment being received in cash			29,00,000
2.	**Reserves and surplus**			
	Securities Premium Account		3,80,000	
	Profit & Loss Account (3,40,000 – 15,000)		3,25,000	7,05,000
3.	**Tangible Assets**			
	Freehold Properties			
	As per last balance sheet	10,00,000		
	Addition during the year	1,20,000		
		11,20,000		
	Less: Sold during the year	(75,000)	10,45,000	
	Plant & Machinery			
	As per last balance sheet	13,00,000		

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	Addition during the year	1,50,000		
		14,50,000	14,50,000	24,95,000
4.	**Non current Investment**			
	Shares in subsidiary company			7,80,000

Working Notes :

(1) Calculation of shares to be issued by Shine Co Ltd. to the shareholders of Bhawna Co. (P) Ltd. [Basis Point (1) and (2) of the question]

	Rs.
60,000 shares @ Rs. 14 per share	8,40,000
Less : Value of freehold property	(60,000)
Net amount due	7,80,000
No of shares issued 7,80,000 / Rs. 19.5 = 40,000 shares	
Amount credited to Share Capital	4,00,000
Amount credited to Securities Premium	3,80,000
	7,80,000

(2) Net Amount Payable to Bhawna Co. (P) Ltd.

Particulars	Amount
Assets taken over by Shine Co. Ltd.	
Plant & Machinery	Rs. 1,50,000
Free-hold Property	Rs. 1,20,000
Total (A)	Rs. 2,70,000
Assets sold to Bhawna Co. (P) Ltd.	
Freehold Retail shop building	Rs. 60,000
Retail Stock	Rs. 80,000
Total (B)	Rs. 1,40,000
Net Payable (A-B)	Rs. 1,30,000
Add: Freehold properties taken over by the shareholders of Bhawna Co. (P) Ltd (Para 2 of point 2)	Rs. 60,000
Net Amount Payable	Rs. 1,90,000

(3) Rs. 15,000 loss on the sale of Building to Bhawna Co. (P) Ltd., has been debited to the Profit & Loss Account of Shine Co.

(4) Investment A/c has been credited by dividend received Rs. 60,000 out of pre-acquisition profit from Bhawna Co.

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(5) Bank Balance:

As given	2,50,000
Ad: Dividend received	60,000
	3,10,000
Less: Paid to Bhawna Co. Ltd. including Rs. 60,000 for assets taken over by its erstwhile shareholders	(1,90,000)
	1,20,000

Balance Sheet of Bhawna Co. (P) Ltd. as on 31st March, 2015

Particulars	*Note No.*	*(Rs.)*
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital	1	6,00,000
(b) Reserves and Surplus	2	1,00,000
(2) **Current Liabilities**		
Trade Payables		70,000
Total		7,70,000
II. **Assets**		
(1) **Non-current assets**		
Fixed assets		
Tangible assets	4	1,50,000
(2) **Current assets**		
(a) Inventories		2,00,000
(b) Trade Receivables		80,000
(c) Cash & Cash equivalents		3,40,000
Total		7,70,000

Notes to Accounts

		(Rs.)	*(Rs.)*
1.	**Share Capital**		
	60,000 Shares of Rs.10 each fully paid		6,00,000
2.	**Reserves and surplus**		
	Profit & Loss Account		1,00,000
3.	**Tangible Assets**		

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	Freehold Properties			
	As per last balance sheet	2,50,000		
	Addition during the year	60,000		
		3,10,000		
	Less: Sold during the year	(1,60,000)	1,50,000	
	Plant & Machinery			
	As per last Balance Sheet	1,00,000		
	Less: Sold during the year (cost)	(1,00,000)	-	1,50,000

Working Notes:

		Rs.
(1)	Profit & Loss Account (given)	90,000
	Add: Profit on sale of machinery and freehold property	70,000
		1,60,000
	Less: Dividend paid	(60,000)
		1,00,000

(2) Freehold properties have been reduced by Rs. 1,00,000 transferred to Shine Co. & Rs. 60,000 taken over by the shareholders of Bhawna Co. (P) Ltd.

(3)	Cash at Bank :	*Rs.*
	Balance as given.	2,10,000
	Add: Received from Shine Co	1,90,000
		4,00,000
	Less : Dividend Paid	(60,000)
		3,40,000

3. (i) Consolidated Balance Sheet of A Ltd. and its subsidiaries B Ltd. and C Ltd. as on 31st March, 2015

Particulars	*Note No.*	*(Rs.)*
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital	1	8,00,000
(b) Reserves and Surplus	2	3,04,833
(2) **Minority Interest** [Refer (iii)]		2,71,167
(3) **Current Liabilities**		

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(a) Trade payables	3	84,000
(b) Short term provisions	4	96,000
Total		15,56,000
II. **Assets**		
(1) **Non-current assets**		
Fixed assets		
i. Tangible assets	5	13,18,000
ii. Intangible assets	6	18,000
(2) **Current assets**		2,20,000
Total		15,56,000

Notes to Accounts

			(Rs.)	*(Rs.)*
1.	Share Capital			
	80,000 Equity shares of Rs.10 each fully paid			8,00,000
2.	**Reserves and surplus**			
	Profit and Loss Account			
	Opening balance	Rs.		
	A Ltd	2,06,000		
	B Ltd	1,62,000		
	C Ltd	1,16,000	4,84,000	
	Add: Dividend received in 2013-2014 (for 2012-2013)			
	A Ltd	60,000		
	B Ltd	-----		
	C Ltd	-----	60,000	
			5,44,000	
	Less: Dividend paid for 2013-2014			
	A Ltd	96,000		
	B Ltd	72,000		
	C Ltd	48,000		
	Less: Adjustments	(96,000)	(1,20,000)	
			4,24,000	

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Add: Dividend received in 2014-2015 (for 2013-14)			
A Ltd	60,000		
B Ltd	36,000		
C Ltd	-----		
Less: Adjustments	(96,000)	-	
		4,24,000	
Add: Profit for the year			
A Ltd	1,00,000		
B Ltd	1,00,000		
C Ltd	60,000	2,60,000	
		6,84,000	
Less: Minority Interest			
A Ltd	___		
B Ltd	39,167		
C Ltd	32,000	(71,167)	
		6,12,833	
Less: Capital reserve (cost of control)			
A Ltd	65,000		
B Ltd	51,000		
C Ltd	----	(1,16,000)	
		4,96,833	
Less: Dividend received out of capital profit			
A Ltd	60,000*		
B Ltd	36,000*		
C Ltd	-----	(96,000)	
		4,00,833	
Less: Proposed dividend			
A Ltd	96,000		
B Ltd	-----		
C Ltd	-----	(96,000)	
Closing balance of Profit (Bal fig)		3,04,833	
Share of A Ltd. (Bal fig)	1,74,000		

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	Share of B Ltd(Bal fig)	85,833		
	Share of C Ltd(Bal fig)	45,000		3,04,833
3.	Trade Payables			84,000
4.	Short term provisions			
	Proposed Dividend of A Ltd.			96,000
5.	**Tangible Assets**			
	Fixed Assets less depreciation			13,18,000
6.	**Intangible assets**			
	Goodwill [Refer (ii)]			18,000

Notes:*

(1) A Ltd. receives from B Ltd., dividend amounting to Rs. 60,000 for the year 2012-2013 in the year 2013-2014 for shares acquired in 2012-2013. It is a capital profit, therefore it has been transferred to cost of control to reduce the cost of investment.

(2) B Ltd. receives a dividend of Rs. 36,000 from C Ltd. for the year 2013-2014 in the year 2014-2015. The shares were acquired by B Ltd on 31st March, 2014. The entire amount is therefore, a capital profit and hence transferred to cost of control to reduce the cost of investment.

(ii) Cost of Control:

	Rs.	*Rs.*
Cost of Investment in B Ltd. on 31st March, 2013	6,30,000	
Less: Dividend of the year 2012-2013 received in 2013-2014 out of Pre-acquisition profit	(60,000)	5,70,000
Cost of Investment in C Ltd.	4,00,000	
Less: Dividend of the year 2013-2014 received in 2014-2015 out of Pre-acquisition Profit	(36,000)	3,64,000
		9,34,000
Less: Paid up value of shares in B Ltd.	5,00,000	
Paid up value of shares in C Ltd.	3,00,000	
Capital Profits in B Ltd. (Refer W.N. 2)	65,000	
Capital Profits in C Ltd. (Refer W.N. 2)	51,000	(9,16,000)
Goodwill		18,000

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(iii) Minority shareholders' interest:

	B Ltd. *Rs.*	*C Ltd.* *Rs.*
Share Capital (B Ltd. – 1/6 and C Ltd. – 1/4)	1,00,000	1,00,000
Capital Profits (Refer W.N. 2)	13,000	17,000
Revenue Profits (Refer W.N. 2)	26,167	15,000
	1,39,167	1,32,000
Total (1,39,167 + 1,32,000)		2,71,167

Working Notes:

1. Shareholding Pattern

	Number of shares	*share of holding*
In B Ltd.		
A Ltd.	50,000	5/6
Minority Interest	10,000	1/6
In C Ltd.		
B Ltd.	30,000	3/4
Minority Interest	10,000	1/4

2. Analysis of Profits

	Pre - acquisition Capital Profit	*Post - acquisition Revenue Profit*
C Ltd.	*Rs.*	*Rs.*
Balance on 31st March, 2014 after dividend for 2013-2014 (*Rs.* 1,16,000 – *Rs.* 48,000)	68,000	-
Profit for the year ending 31st March, 2015 before proposed dividends for 2014-2015	-	60,000
	68,000	60,000
Share of B Ltd. (3/4)	51,000	45,000
Minority Interest (1/4)	17,000	15,000
B Ltd.		
Balance on 31st March, 2013	78,000	-
Profit for the year 2013-2014 after payment of	-	12,000

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dividend for 2013-2014 (*Rs.* 84,000 – *Rs.* 72,000)		
Profit for the year 2014-2015 (before payment of dividend of the year 2014-2015)	-	1,00,000
Revenue Profit from C Ltd.	-	45,000
	78,000	1,57,000
Share of A Ltd. (5/6)	65,000	1,30,833
Share of Minority Shareholders' Interest (1/6)	13,000	26,167

Note: This problem has been solved by following 'direct approach'.

4. (1) Calculation of operational synergy expected to arise out of merger

(Rs. in crores)

Year	1	2	3	4	5
Projected cash flows of Umeed Ltd. after merger with Pure Ltd.	1,500	2,000	2,500	3,000	3,500
Less: Projected cash flows of Umeed Ltd. without merger	(1,000)	(1,500)	(2,000)	(2,500)	(3,000)
	500	500	500	5,00	500

(2) Valuation of Pure Ltd. in case of merger

Year	Cash Flows from operations (Rs. in crores)	Discount Factor	Discounted Cash Flow (Rs. in crores)
1	500	0.870	435.00
2	500	0.756	378.00
3	500	0.658	329.00
4	500	0.572	286.00
5	500	0.497	248.50
			1,676.50

(3) Maximum value to be quoted

	Rs. in crores	Rs. in crores
Value as per discounted cash flows from operations		1,676.50
Add: Increase in goodwill of Umeed Ltd. on acquisition of Pure Ltd.		300
		1,976.50

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Add: Cash to be collected immediately by disposal of assets:		
Fixed Assets	100	
Investments	1,500	
Inventory	30	1,630.00
		3,606.50
Less: Current liabilities (1,000 – 102) (See Note below)	898	
Compensations claim	510	(1,408.00)
		2,198.50

So, Umeed Ltd. can quote as high as Rs. 2,198.50 crores for taking over the business of Pure Ltd.

Note: As per adjustment (d) given in point (iv), Provision of Rs.102 crores (i.e. 20% on Rs.510 crores) was made for contingent liabilities. It implies that this provision is included in the current liabilities covered under point (iii). Therefore, payment of current liabilities has been paid after deduction of the provision amount of Rs.102 crores and full payment of contingent liability of Rs.510 crores has been made to avoid double payment of same item.

(4) Valuation of Pure Ltd. ignoring merger (as a 'Stand Alone' entity)

Year	Cash Flows	Discount Factor	Discounted Cash Flow
	(Rs. in crores)		(Rs. in crores)
1	400	0.870	348.00
2	400	0.756	302.40
3	600	0.658	394.80
4	800	0.572	457.60
5	1,000	0.497	497.00
			1,999.80

5. (a) (i) Lal Ltd.

VALUE ADDED STATEMENT
for the year ended March 31, 2014

	Rs. ('000)	Rs. ('000)	%
Sales		28,525	
Less: Cost of bought in material and services:			
Operating cost	15,411		
Excise duty	1,718		

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Interest on bank overdraft	93	(17,222)	
Value added by manufacturing and trading activities		11,303	
Add: Other income		756	
Total value added		12,059	
Application of value added:			
To pay employees:			
Wages, salaries and other benefits		10,247	84.97
To pay government:			
Corporation tax		230	1.91
To pay providers of capital:			
Interest on 10% Debentures	1,157		
Dividends	45	1,202	9.97
To provide for the maintenance and expansion of the company:			
Depreciation	255		
Fixed Assets Replacement Reserve	25		
Deferred Tax Account	45		
Retained profit	55	380	3.15
		12,059	100.00

(ii) Reconciliation between Total Value Added and Profit Before Taxation

	Rs. ('000)	*Rs. ('000)*
Profit before tax		400
Add back:		
Depreciation	255	
Wages, salaries and other benefits	10,247	
Debenture interest	1,157	11,659
Total Value Added		12,059

Notes:

(1) Deferred tax could alternatively be shown as a part of 'To pay government'.

(2) Bank overdraft, being a temporary source of finance, has been considered as the provision of a banking service rather than of capital. Therefore, interest on bank overdraft has been shown by way of deduction from sales and as a part of 'cost of bought in material and services'.

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(b) **Journal Entries**

Year 2009		*Rs.*	*Rs.*
Employee Compensation Expense A/c	Dr.	11,40,840	
To Employee Stock Options Outstanding A/c			11,40,840
(Being the compensation expenses recognized in respect of the ESOP)			
Profit and Loss A/c	Dr.	11,40,840	
To Employee Compensation Expense A/c			11,40,840
(Being Expenses of the year transferred to P & L A/c)			
Year 2010			
Employee Compensation Expense A/c	Dr.	6,81,660	
To Employee Stock Options Outstanding A/c			6,81,660
(Being the compensation expenses recognized in respect of the ESOP)			
Profit and Loss A/c	Dr.	6,81,660	
To Employee Compensation Expense A/c			6,81,660
(Being Expenses of the year transferred to P & L A/c)			
Year 2011			
Employee Compensation Expense A/c	Dr.	10,27,500	
To Employee Stock Options Outstanding A/c			10,27,500
(Being the compensation expenses recognized in respect of the ESOP)			
Profit and Loss A/c	Dr.	10,27,500	
To Employee Compensation Expense A/c			10,27,500
(Being Expenses of the year transferred to P & L A/c)			
Year 2013			
Bank A/c	Dr.	50,00,000	
Employee Stock Options Outstanding A/c	Dr.	15,00,000	
To Share Capital A/c			10,00,000
To Securities Premium			55,00,000
(Being shares issued to employees against options vested in them in pursuance of the ESOP)			

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Year 2014			
Bank A/c	Dr.	25,00,000	
Employee Stock Options Outstanding A/c	Dr.	7,50,000	
To Share Capital A/c			5,00,000
To Securities Premium A/c			27,50,000
(Being shares issued to employees against options vested in them in pursuance of the ESOP)			
Employee Stock Options Outstanding A/c	Dr.	60,00,000	
To General Reserve A/c			60,00,000
(Being the balance standing to the credit of stock options outstanding account, in respect of vested options expired unexercised, transferred to general reserve account)			

Working Notes:

1. Fair value of options recognized as expense in the year 2009

   Number of options expected to vest = 500 x 500 x .97 x .97 x .97= 2,28,168 options.

   Fair value of options expected to vest = 2,28,168 × Rs. 15 = Rs. 34,22,520.

   One third of fair value recognized as expense = Rs. 34,22,520 / 3 = Rs. 11,40,840.

Year 2010	
Fair Value of options revised in the year = 500 × 500 × 0.90 × 0.90 × 0.90 x Rs.15	Rs. 27,33,750
Revised cumulative expenses in year 2010 = $27{,}33{,}750 \times \frac{2}{3}$	Rs. 18,22,500
Less: Already recognized in year 2009	Rs.(11,40,840)
Expenses to be recognized in year 2010	Rs. 6,81,660
Year 2011	
Number of options actually vested = 380 × 500 = 1,90,000	
Fair Value of options actually vested = 1,90,000 x Rs. 15	Rs. 28,50,000
Less: Expense recognized till year 2010	Rs. (18,22,500)
Balance amount to be recognized	Rs. 10,27,500

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2. **Amount recorded in share capital account and securities premium account upon issue of shares**

Particulars	*Year 2013*	*Year 2014*
Number of employees exercising option	200	100
Number of shares issued upon exercise of option @ 500 per employee	1,00,000	50,000
Exercise price received @ Rs.50 per share	50,00,000	25,00,000
Corresponding amount recognized in the 'Employee stock options outstanding A/c' @ Rs.15 per option	15,00,000	7,50,000
Total consideration	65,00,000	32,50,000
Amount to be recorded in 'Share capital A/c' @ Rs.10 per share	10,00,000	5,00,000
Amount to be recorded in 'Securities premium A/c' @ Rs.55 (i.e. 65 –10) per share	55,00,000	27,50,000
	65,00,000	32,50,000

6. (a) Statement showing the Movement of Unit Holders' Funds for the year ended 31st March, 2015

	(Rs. '000)
Opening balance of net assets	12,00,000
Add: Par value of units issued (8,50,200 × Rs. 100)	85,020
Net Income for the year	85,000
Transfer from Reserve/Equalisation fund (Refer working note)	15,390
	13,85,410
Less: Par value of units redeemed (7,52,300 × Rs. 100)	(75,230)
Closing balance of net assets (as on 31st March, 2015)	13,10,180

Working Note:

Particulars	*Issued*	*Redeemed*
Units	8,50,200	7,52,300
	Rs.' 000	*Rs.' 000*
Par value	85,020	75,230
Sale proceeds/Redemption value	96,500	71,320
Profit transferred to Reserve / Equalisation Fund	11,480	3,910
Balance in Reserve/Equalisation Fund (Issued & Redeemed)	15,390	

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(b) Computation of Economic Value Added

	Rs. in lakhs
Profit after tax	420
Add: Interest net of tax = 60 x $\left(\frac{100-30}{100}\right)$	42
Return to providers of funds	462
Less: Cost of Capital	(342)
Economic Value Added	120

MVA of Rs. 14005 crore:

The MVA of Rs. 14005 crore is the difference between the current Market Value of Jindal Ltd. and the capital contributed by the fund providers. While EVA measures current earning efficiency of the company, MVA takes into consideration the EVA from not only the assets in place but also from the future projects/activities of the company. The difference between MVA over EVA thus represents the value attributed to the future potential of the company & may change from time to time based on market sentiments. In short the MVA is the net present value of all future EVA's.

Working Notes:

1. Calculation of Net Profit after interest and tax

   Interest on Debentures = 50,00,000 units x 10 x 12% = Rs. 60,00,000

   Therefore, Financial Leverage = $\frac{\text{Profit before Interest \& taxes (PBIT)}}{\text{PBIT less Interest}}$

   $1.10 = \frac{\text{PBIT}}{\text{PBIT - Rs. 60,00,000}}$

   1.10 (PBIT – Rs. 60,00,000) = PBIT

   1.10 PBIT – Rs. 66,00,000 = PBIT

   1.10 PBIT – PBIT = Rs. 66,00,000

   0.10 PBIT = Rs. 66,00,000

   PBIT = Rs. 6,60,00,000

   Profit after interest but before tax = Rs. 6,60,00,000 – Rs. 60,00,000

   = Rs. 6,00,00,000

   Less: Income Tax @ 30% (Rs. 1,80,00,000)

   Profit After Interest & Tax Rs. 4,20,00,000

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2. **Calculation of Weighted Average Cost of Capital (WACC)**

	Rs. in lakhs	*Amount (Rs.)* *(1)*	*Weight* *(2)*	*Cost%* *(3)*	*WACC%* *(4)=2x3*
Equity Shareholders' fund					
Common Shares	1,582				
Securities Premium	155				
Free Reserves	154				
Capital Reserves	109				
		2,000	0.80	15	12.00
Debentureholders' fund		500	0.20	8.4*	1.68
		2,500	1.00		13.68

Cost of Capital = Capital Employed x WACC%

= Rs. 2,500 lakhs x 13.68%

= Rs. 342 lakhs

7. (a) Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

(i) the name of the transacting related party;

(ii) a description of the relationship between the parties;

(iii) a description of the nature of transactions;

(iv) volume of the transactions either as an amount or as an appropriate proportion;

(v) any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and

(vii) amounts written off or written back in the period in respect of debts due from or to related parties.

* Rate of interest on debentures is taken net of tax of 30%.

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(b) Bane limited invested Rs. 600 lakhs in the equity shares of Grant Ltd. Out of the same, the company intends to hold 50% shares for long term period i.e. Rs. 300 lakhs and remaining as temporary (current) investment i.e. Rs. 300 lakhs. Irrespective of the fact that investment has been held by Bane Limited only for 3 months (from 1.1.2015 to 31.3.2015), AS 13 lays emphasis on intention of the investor to classify the investment as current or long term even though the long term investment may be readily marketable.

In the given situation, the realizable value of all such investments on 31.3.2015 became Rs. 200 lakhs i.e. Rs. 100 lakhs in respect of current investment and Rs. 100 lakhs in respect of long term investment.

As per AS 13, 'Accounting for Investment', the carrying amount for current investments is the lower of cost and fair value. In respect of current investments for which an active market exists, market value generally provides the best evidence of fair value.

Accordingly, the carrying value of investment held as temporary investment should be shown at realizable value i.e. at Rs. 100 lakhs. The reduction of Rs. 200 lakhs in the carrying value of current investment will be included in the profit and loss account.

Standard further states that long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of long term investment, the carrying amount is reduced to recognise the decline.

Here, Grant Limited lost a case of copyright which drastically reduced the realisable value of its shares to one third which is quiet a substantial figure. Losing the case of copyright may affect the business and the performance of the company in long run. Accordingly, it will be appropriate to reduce the carrying amount of long term investment by Rs. 200 lakhs and shown the investments at Rs. 100 lakhs, considering the downfall in the value of shares as decline other than temporary. The reduction of Rs. 200 lakhs in the carrying value of long term investment will be included in the profit and loss account.

Alternatively for treatment of long term investment.

If one assumes that the decline in the value of long term investment is temporary and Grant Limited will overcome this downfall in short period by filing a case against this decision of government, with strong arguments. In such a case, long term investment will be shown at cost.

(c) In the given case, A Ltd. concurrently agreed to repurchase the same goods from B Ltd. on 1st Feb., 2014. Also the re-selling price is pre-determined and covers purchasing and holding costs of B Ltd. Hence, the transaction between A Ltd. and B Ltd. on 1st Feb., 2014 should be accounted for as financing rather than sale. The

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resulting cash flow of Rs. 9.60 lakhs received by A Ltd., cannot be considered as revenue as per AS 9 "Revenue Recognition".

Journal Entries in the books of A Ltd.

				(Rs. in lakhs)
1.02.14	Bank Account	Dr.	9.60	
	To Advance from B Ltd*.			9.60
	(Being advance received from B Ltd amounting [Rs. 8 lakhs + 20% of Rs. 8 lakhs = 9.60 lakhs] under sale and re-purchase agreement)			
31.03.14	Financing Charges Account	Dr.	0.40	
	To B Ltd.			0.40
	(Financing charges for 2 months at Rs. 1.20 lakhs [10.80 – 9.60] i.e. 1.2 lakhs x 2/6)			
31.03.14	Profit and Loss Account	Dr.	0.40	
	To Financing Charges Account			0.40
	(Being amount of finance charges transferred to P& L Account)			

(d) AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

(e) (1) **Determination of Cost**

	Rs. in lakhs
W.D.V as on 1.1.2012	180.00
Add: Revaluation profit	36.00
	216.00
Less: Depreciation for 2012	(32.40)
W.D.V as on 1.1.2013	183.60
Less: Depreciation for 2013	(27.54)

*The balance of B Ltd. account will be disclosed as an advance under the heading liabilities in the balance sheet of A Ltd. as on 31st March, 2014.

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W.D.V as on 1.1.2014	156.06
Less: Revaluation loss	(7.80)
	148.26
Less: Depreciation for 2014	22.24
W.D.V as on 31.12.2014	126.02

(2) **Revaluation Reserve Account**

		Rs. in lakhs			*Rs. in lakhs*
31.12.12	To Balance c/d	36.00	31.12.12	By Machinery A/c	36.00
31.12.13	To Balance c/d	36.00	01.01.13	By Balance b/d	36.00
31.12.14	To Machinery A/c	7.80	01.01.14	By Balance b/d	36.00
	To Balance c/d	28.20			
		36.00			36.00

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MOCK TEST PAPER – 1

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) The NAV of per unit of XYZ Mutual Fund (a Close Ended Funds) on 1.1.2014 was Rs. 28. The value on 31.12.2014 comes to Rs. 28.80. On the same date unit was trading in market at a premium of 3% though on 1.1.2014 same was trading at a discount at 5%. On 31.12.2014, XYZ distributed a sum of Rs. 2.80 as incomes and capital gains. You are required to compute rate of return to the investor during the year. *(5 Marks)*

(b) There is a 9% 5-year bond issue in the market. The issue price is Rs. 90 and the redemption price Rs. 105. For an investor with marginal income tax rate of 30% and capital gains tax rate of 10% (assuming no indexation), what is the post-tax yield to maturity? *(5 Marks)*

(c) On 30th June 2015 PNB Bank proposes to borrow a certain sum of money from CB Bank for a period of 14 days @ 12% p.a. against 13.5% GOI Securities having a face value of Rs. 400 crore currently trading at Rs. 410 crore maturing on 30th September 2015. The coupon dates are 30 April and 30 September. You are required to determine the amount of borrowing and buy-back price of securities.

(5 Marks)

(d) From the following details relating to a project, analyse the sensitivity of the project to changes in initial project cost, annual cash inflow and cost of capital:

Initial Project Cost (Rs.)	1,20,000
Annual Cash Inflow (Rs.)	45,000
Project Life (Years)	4
Cost of Capital	10%

To which of the three factors, the project is most sensitive using 10% as discounting rate and 15% as adversely varying factor? *(5 Marks)*

2. (a) Ramesh owns a plot of land on which he intends to construct apartment units for sale. No. of apartment units to be constructed may be either 10 or 15. Total construction costs for these alternatives are estimated to be Rs. 600 lakhs or Rs. 1025 lakhs respectively. Current market price for eachapartment unit is Rs. 80

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lakhs. The market price after a year for apartment units will depend upon the conditions of market. If the market is buoyant, each apartment unit will be sold for Rs. 91 lakhs, if it is sluggish, the sale price for the same will be Rs. 75 lakhs. Determine the current value of vacant plot of land. Should Ramesh start construction now or keep the land vacant? The yearly rental per apartment unit is Rs. 7 lakhs and the risk free interest rate is 10% p.a. Assume that the construction cost will remain unchanged. *(8 Marks)*

(b) An investor has decided to invest to invest Rs. 1,00,000 in the shares of two companies, namely, ABC and XYZ. The projections of returns from the shares of the two companies along with their probabilities are as follows:

Probability	ABC(%)	XYZ(%)
.20	12	16
.25	14	10
.25	-7	28
.30	28	-2

You are required to

(i) Comment on return and risk of investment in individual shares.

(ii) Compare the risk and return of these two shares with a Portfolio of these shares in equal proportions.

(iii) Find out the proportion of each of the above shares to formulate a minimum risk portfolio. *(8 Marks)*

3. (a) Sundaram Ltd. discounts its cash flows at 16% and is in the tax bracket of 35%. For the acquisition of a machinery worth Rs.10,00,000, it has two options – either to acquire the asset by taking a bank loan @ 15% p.a. repayable in 5 yearly installments of Rs.2,00,000 each plus interest or to lease the asset at yearly rentals of Rs.3,34,000 for five (5) years. In both the cases, the instalment is payable at the end of the year. Depreciation is to be applied at the rate of 15% using 'written down value' (WDV) method. You are required to advise which of the financing options is to be exercised and why.

Year	*1*	*2*	*3*	*4*	*5*
P.V factor @16%	*0.862*	*0.743*	*0.641*	*0.552*	*0.476*

(8 Marks)

(b) An investor is holding 1,000 shares of Fatlass Company. Presently the rate of dividend being paid by the company is Rs. 2 per share and the share is being sold at Rs. 25 per share in the market. However, several factors are likely to change during the course of the year as indicated below:

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	Existing	Revised
Risk free rate	12%	10%
Market risk premium	6%	4%
Beta value	1.4	1.25
Expected growth rate	5%	9%

In view of the above factors whether the investor should buy, hold or sell the shares? And why? *(8 Marks)*

4. (a) Your bank's London office has surplus funds to the extent of £ 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
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? *(10 Marks)*

(b) Mr. FedUp wants to invest an amount of Rs. 520 lakhs and had approached his Portfolio Manager. The Portfolio Manager had advised Mr. FedUp to invest in the following manner:

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Security	Moderate	Better	Good	Very Good	Best
Amount (in Rs. Lakhs)	60	80	100	120	160
Beta	0.5	1.00	0.80	1.20	1.50

You are required to advise Mr. FedUp in regard to the following, using Capital Asset Pricing Methodology:

(i) Expected return on the portfolio, if the Government Securities are at 8% and the NIFTY is yielding 10%.

(ii) Advisability of replacing Security 'Better' with NIFTY. *(6 Marks)*

5. (a) RST Ltd.'s current financial year's income statement reported its net income as Rs. 25,00,000. The applicable corporate income tax rate is 30%.

Following is the capital structure of RST Ltd. at the end of current financial year:

	Rs.
Debt (Coupon rate = 11%)	40 lakhs
Equity (Share Capital + Reserves & Surplus)	125 lakhs
Invested Capital	165 lakhs

Following data is given to estimate cost of equity capital:

	Rs.
Beta of RST Ltd.	1.36
Risk –free rate i.e. current yield on Govt. bonds	8.5%
Average market risk premium (i.e. Excess of return on market portfolio over risk-free rate)	9%

Required:

(i) Estimate Weighted Average Cost of Capital (WACC) of RST Ltd.; and

(ii) Estimate Economic Value Added (EVA) of RST Ltd. *(8 Marks)*

(b) An exporter is a UK based company. Invoice amount is $ 3,50,000. Credit period is three months. Exchange rates in London are :

Spot Rate ($/£) 1.5865 – 1.5905

3-month Forward Rate ($/£) 1.6100 – 1.6140

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Rates of interest in Money Market :

	Deposit	Loan
$	7%	9%
£	5%	8%

Compute and show how a money market hedge can be put in place. Compare and contrast the outcome with a forward contract. *(8 Marks)*

6. (a) Personal Computer Division of Distress Ltd., a computer hardware manufacturing company has started facing financial difficulties for the last 2 to 3 years. The management of the division headed by Mr. Smith who is interested in a buyout on 1 April 2013. However, to make this buy-out successful there is an urgent need to attract substantial funds from venture capitalists.

VenCap, a European venture capitalist firm has shown its interest in the proposed buy-out. Distress Ltd. is interested to sell the division for Rs. 180 crore and Mr. Smith is of opinion that an additional amount of Rs. 85 crore shall be required to make this division viable. The expected financing pattern shall be as follows:

Source	Mode	Amount (Rs. Crore)
Management	Equity Shares of Rs. 10 each	60.00
VenCap VC	Equity Shares of Rs. 10 each	22.50
	9% Debentures with attached warrant of Rs. 100 each	22.50
	8% Loan	160.00
Total		265.00

The warrants can be exercised any time after 4 years from now for 10 equity shares @ Rs. 120 per share.

The loan is repayable in one go at the end of 8th year. The debentures are repayable in equal annual installment consisting of both principal and interest amount over a period of 6 years.

Mr. Smith is of view that the proposed dividend shall not be kept more than 12.5% of distributable profit for the first 4 years. The forecasted EBIT after the proposed buyout is as follows:

Year	2013-14	2014-15	2015-16	2016-17
EBIT (Rs. crore)	48	57	68	82

Applicable tax rate is 35% and it is expected that it shall remain unchanged at least for 5-6 years. In order to attract VenCap, Mr. Smith stated that book value of equity shall increase by 20% during the above 4 years (2013-17). Although, VenCap has

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shown their interest in investment but are doubtful about the projections of growth in the value as per projections of Mr. Smith. Further VenCap also demanded that warrants should be convertible in 18 shares instead of 10 as proposed by Mr. Smith.

You are required to determine whether or not the book value of equity is expected to grow by 20% per year. Further if you have been appointed by Mr. Smith as advisor to then whether you would suggest to accept the demand of VenCap of 18 shares instead of 10. *(10 Marks)*

(b) ABC Ltd. has 50,000 outstanding shares. The current market price per share is Rs. 100 each. It hopes to make a net income of Rs. 5,00,000 at the end of current year. The Company's Board is considering a dividend of Rs. 5 per share at the end of current financial year. The company needs to raise Rs. 10,00,000 for an approved investment expenditure. The company belongs to a risk class for which the capitalization rate is 10%. Show, how the M-M approach affects the value of firm if the dividends are paid or not paid. *(6 Marks)*

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

(a) Capital Rationing

(b) Treasury Bill

(c) Elliot Wave Theory

(d) Main functions of Investment Bank

(e) Equity Curve Outs Vs. Spin Off *(4 ×4 = 16 Marks)*

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Test Series : September, 2015

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

SUGGESTED ANSWERS/HINTS

1. (a) Price of each unit on 1.1.2014 = Rs. 28 x 0.95 = Rs. 26.60

Price of each unit on 31.12.2014 = Rs. 28.80 x 1.03 = Rs. 29.66

The price of fund increase by = Rs. 3.06 (29.66 – 26.60)

Rate of Return = $\frac{2.80+3.06}{26.60}$ x100 = 22.03%

(b) Calculation of yield to Maturity (YTM)

$$YTM = \frac{\text{Coupon} + \text{Pro-rated discount}}{(\text{Redemption price} + \text{Purchase Price})/2}$$

After tax coupon = 9 × (1 – .30) = 6.3%

After tax redemption price = 105 – (15 × .10) or Rs. 103.5

After tax capital gain = 103.50 – 90 = Rs. 13.50

$$YTM = \frac{6.3 + (13.5/5)}{(103.5 + 90)/2} \text{ or } \frac{9.00}{96.75} = 9.30\%$$

(c) PNB Bank sells 13.50% GOI Securities of face value of Rs. 400 crore at current market price of Rs. 410 crore.

Cash Outflow to CB Bank on 30.04.2015 (Amount of Borrowing)

Value of Security Interest for the period 30.4.15 to 29.6.15 $\left(\frac{61}{360} \times 0.135 \times 400\right)$	Rs.410.00 crore Rs. 9.15 crore
	Rs. 419.15

Buyback Price of Securities

Amount of Loan *Add:* Interest for 14 days @ 12% $\left(\frac{14}{360} \times 0.12 \times 419.15\right)$	Rs. 419.15 crore Rs. 1.9560 crore
	Rs. 421.106 crore

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Less: Interest for the period 30.4.15 to 13.7.15 $\left(\frac{75}{360} \times 0.135 \times 400\right)$	Rs. 11.250 crore
	Rs. 409.856 crore

(d) CALCULATION OF NPV

PV of cash inflows (Rs. 45,000 x 3.169)	1,42,605
Initial Project Cost	1,20,000
NPV	22,605
If initial project cost is varied adversely by 15%	
NPV (Revised) (Rs. 1,42,605 - Rs. 1,38,000)	Rs. 4,605
Change in NPV (Rs. 22,605 – Rs. 4,605)/ Rs. 22,605 i.e	79.63 %
If annual cash inflow is varied adversely by 15%	
Revised annual inflow	Rs. 40,500
NPV (Revised) (Rs. 38,250 x 3.169) – (Rs. 1,20,000)	(+) Rs. 1,214
Change in NPV (Rs. 22,605 – Rs. 1,214) / Rs. 22,605	94.63 %
If cost of capital is varied adversely by 15% i.e. new cost of capital 11.5%	
NPV (Revised) (Rs. 45,000 x 3.072) – Rs. 1,20,000	(+) Rs. 18,240
Change in NPV (Rs. 22,605 – Rs. 18,240) / Rs. 22,605	19.31 %

Conclusion: Project is most sensitive to 'annual cash inflow'.

2. (a) Presently 10 units apartments shall yield a profit of Rs. 200 lakh (Rs. 800 lakhs – Rs. 600 lakhs) and 15 unit apartment will yield a profit of Rs. 175 lakh (Rs. 1200 lakhs – Rs. 1025 lakhs). Thus 10 units apartment is the best alternative if Ramesh has to construct now.

However, Ramesh waits for 1 year his pay-off will be as follows:

	Market Conditions	
	Buoyant Market	*Sluggish Market*
10 units apartments	Rs. 91 lakhs X 10 – Rs. 600 lakhs = Rs. 310 lakhs	Rs. 75 lakhs X 10 – Rs. 600 lakhs = Rs. 150 lakhs
15 units apartments	Rs. 91 lakhs X 15 – Rs. 1025 lakhs = Rs. 340 lakhs	Rs. 75 lakhs X 15 – Rs. 1025 lakhs = Rs. 100 lakhs

Thus if market conditions turnout to be buoyant the best alternative is 15 units apartments and net pay-off will be Rs. 340 lakhs and if market turnout to be

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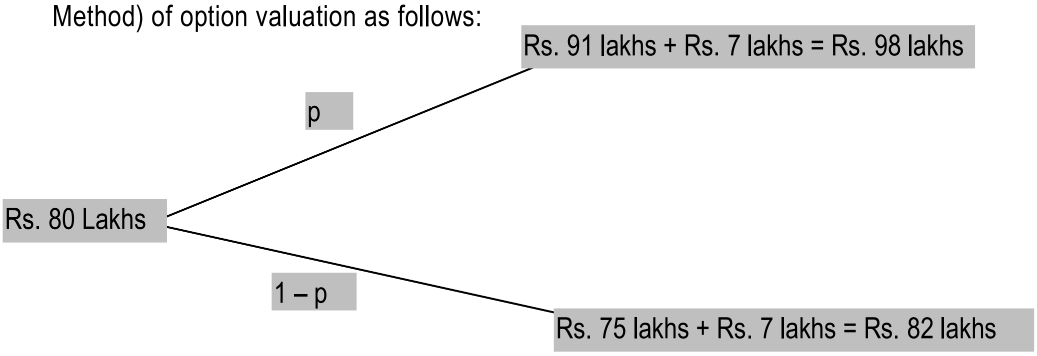
sluggish the best alternative is the 10 units apartments and net pay-off shall be Rs. 150 lakhs.

To determine the value of vacant plot we shall use Binomial Model (Risk Neutral Method) of option valuation as follows:



Alternatively student can calculate these values as follows (Sale Value + Rent):

If market is buoyant then possible outcome = Rs. 91 lakh + Rs. 7 lakh = Rs. 98 lakhs

If market is sluggish then possible outcome = Rs. 75 lakh + Rs. 7 lakh = Rs. 82 lakhs

Let p be the probability of buoyant condition then with the given risk-free rate of interest of 10% the following condition should be satisfied:

Rs. 80 lakhs = $\frac{[(p \times ₹\ 98\,\text{lakhs}) + (1\text{-}p) \times ₹\ 82\,\text{lakhs}]}{1.10}$

p= $\frac{3}{8}$ i.e. 0.375

Thus 1-p = 0.625

Expected cash flow next year

0.375 × Rs. 340 lakhs + 0.625 X Rs. 150 lakhs = Rs. 221.25 lakhs

Present Value of expected cash flow:

Rs. 221.25 lakhs (0.909) = Rs. 201.12 lakhs

Thus the value of vacant plot is Rs. 201.12 lakhs

Since the current value of vacant land is more than profit from 10 units apartments now the land should be kept vacant.

(b) (i)

Probability	ABC (%)	XYZ (%)	1X2 (%)	1X3 (%)
(1)	(2)	(3)	(4)	(5)
0.20	12	16	2.40	3.2

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0.25	14	10	3.50	2.5
0.25	-7	28	-1.75	7.0
0.30	28	-2	8.40	-0.6
Average return			12.55	12.1

Hence the expected return from ABC = 12.55% and XYZ is 12.1%

Probability	$(ABC-\overline{ABC})$	$(ABC-\overline{ABC})^2$	1X3	$(XYZ-\overline{XYZ})$	$(XYZ-\overline{XYZ})^2$	(1)X(6)
(1)	(2)	(3)	(4)	(5)	(6)	
0.20	-0.55	0.3025	0.06	3.9	15.21	3.04
0.25	1.45	2.1025	0.53	-2.1	4.41	1.10
0.25	-19.55	382.2025	95.55	15.9	252.81	63.20
0.30	15.45	238.7025	71.61	-14.1	198.81	59.64
			167.75			126.98

$\sigma^2_{ABC} = 167.75(\%)^2$; $\sigma_{ABC} = 12.95\%$

$\sigma^2_{XYZ} = 126.98(\%)^2$; $\sigma_{XYZ} = 11.27\%$

(ii) In order to find risk of portfolio of two shares, the covariance between the two is necessary here.

Probability	$(ABC-\overline{ABC})$	$(XYZ-\overline{XYZ})$	2X3	1X4
(1)	(2)	(3)	(4)	(5)
0.20	-0.55	3.9	-2.145	-0.429
0.25	1.45	-2.1	-3.045	-0.761
0.25	-19.55	15.9	-310.845	-77.71
0.30	15.45	-14.1	-217.845	-65.35
				-144.25

$\sigma^2_P = (0.5^2 \times 167.75) + (0.5^2 \times 126.98) + 2 \times (-144.25) \times 0.5 \times 0.5$

$\sigma^2_P = 41.9375 + 31.745 – 72.125$

$\sigma^2_P = 1.5575$ or $1.56(\%)$

$\sigma_P = \sqrt{1.56} = 1.25\%$

$E(R_p) = (0.5 \times 12.55) + (0.5 \times 12.1) = 12.325\%$

Hence, the return is 12.325% with the risk of 1.25% for the portfolio. Thus the portfolio results in the reduction of risk by the combination of two shares.

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(iii) For constructing the minimum risk portfolio the condition to be satisfied is

$$X_{ABC} = \frac{\sigma_X^2 - r_{AX}\sigma_A\sigma_X}{\sigma_A^2 + \sigma_X^2 - 2r_{AX}\sigma_A\sigma_X} \text{ or } = \frac{\sigma_X^2 - Cov._{AX}}{\sigma_A^2 + \sigma_X^2 - 2Cov._{AX}}$$

σ_X = Std. Deviation of XYZ

σ_A = Std. Deviation of ABC

r_{AX}= Coefficient of Correlation between XYZ and ABC

$Cov._{AX}$ = Covariance between XYZ and ABC.

Therefore,

$$\% \text{ ABC} = \frac{126.98 - (-144.25)}{126.98 + 167.75 - [2 \times (-144.25)]} = \frac{271.23}{583.23} = 0.46 \text{ or } 46\%$$

% ABC = 46%, XYZ = 54%

(1 – 0.46) =0.54

3. (a) Alternative I: Acquiring the asset by taking bank loan:

	Years	1	2	3	4	5
(a)	Interest (@15% p.a. on opening balance)	150,000	120,000	90,000	60,000	30,000
	Depreciation (@15%WDV)	150,000	127,500	108,375	92,119	78,301
		300,000	247,500	198,375	152,119	108,301
(b)	Tax shield (@35%)	105,000	86,625	69,431	53,242	37,905
	Interest less Tax shield (a)-(b)	45,000	33,375	20,569	6,758	(-)7,905
	Principal Repayment	2,00,000	2,00,000	2,00,000	2,00,000	2,00,000
	Total cash outflow	2,45,000	2,33,375	2,20,569	2,06,758	1,92,095
	Discounting Factor @ 16%	0.862	0.743	0.641	0.552	0.476
	Present Value	2,11,190	1,73,398	1,41,385	1,14,130	91,437

Total P.V of cash outflow = Rs.731,540

Alternative II: Acquire the asset on lease basis

Year	Lease Rentals Rs.	Tax Shield @35%	Net Cash Outflow	Discount Factor	Present Value
1	3,34,000	1,16,900	2,17,100	0.862	1,87,140
2	3,34,000	1,16,900	2,17,100	0.743	1,61,305

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3	3,34,000	1,16,900	2,17,100	0.641	1,39,161
4	3,34,000	1,16,900	2,17,100	0.552	1,19,839
5	3,34,000	1,16,900	2,17,100	0.476	1,03,340
Present value of Total Cash out flow					7,10,785

Advice -By making Analysis of both the alternatives, it is observed that the present value of the cash outflow is lower in alternative II by Rs.20,755 (i.e.Rs.731,540 – Rs.7,10,785) Hence, it is suggested to acquire the asset on lease basis.

(b) On the basis of existing and revised factors, rate of return and price of share is to be calculated.

Existing rate of return

= R_f + Beta (R_m – R_f)

= 12% + 1.4 (6%) = 20.4%

Revised rate of return

= 10% + 1.25 (4%) = 15%

Price of share (original)

$$P_o = \frac{D(1+g)}{K_e - g} = \frac{2(1.05)}{.204 - .05} = \frac{2.10}{.154} = \text{Rs. } 13.63$$

Price of share (Revised)

$$P_o = \frac{2(1.09)}{.15 - .09} = \frac{2.18}{.06} = \text{Rs. } 36.33$$

In case of existing market price of Rs. 25 per share, rate of return (20.4%) and possible equilibrium price of share at Rs. 13.63, this share needs to be sold because the share is overpriced (Rs. 25 – 13.63) by Rs. 11.37. However, under the changed scenario where growth of dividend has been revised at 9% and the return though decreased at 15% but the possible price of share is to be at Rs. 36.33 and therefore, in order to expect price appreciation to Rs. 36.33 the investor should hold the shares, if other things remain the same.

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

Amount of investment		= £ 5,00,000
Add: £ Interest for 3 months on £ 5,00,000 @ 5%		= £ 6,250
		= £ 5,06,250
Less: Amount Invested	£ 5,00,000	
Cost of Funds	£ 5,000	

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= £ 5,05,000

Arbitrage Profit = £ 1,250

(ii) If investment is made at New York

Convert £5,00,000 at Spot Rate (£5,00,000 x 1.5350) = \$ 7,67,500

Add: \$ Interest for 3 months on \$ 7,67,500 @ 8% = \$ 15,350

= \$ 7,82,850

Amount realized in £ (\$ 7,82,850/1.5475) = £ 5,05,880

Less: Amount Invested £ 5,00,000

Cost of Funds £ 5,000

= £ 5,05,000

Arbitrage Profit = £ 880

(iii) If investment is made at Frankfurt

Convert £ 5,00,000 at Spot Rate (£ 5,00,000 x 1.8260)= EUR 9,13,000

Add: EUR Interest for 3 months on \$ 7,67,500 @ 3% = EUR 6,847

= EUR 9,19,847

Amount realized in £ (EUR 9,19,847/1.8150) = £ 5,06,803

Less: Amount Invested £ 5,00,000

Cost of Funds £ 5,000

= £ 5,05,000

Arbitrage Profit = £ 1,803

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

(b) (i) Computation of Expected Return from Portfolio

Security	Beta (β)	Expected Return (r) as per CAPM	Amount (Rs. Lakhs)	Weights (w)	wr
Moderate	0.50	8%+0.50(10% - 8%) = 9%	60	0.115	1.035
Better	1.00	8%+1.00(10% - 8%) = 10%	80	0.154	1.540
Good	0.80	8%+0.80(10% - 8%) = 9.60%	100	0.192	1.843
Very Good	1.20	8%+1.20(10% - 8%) = 10.40%	120	0.231	2.402
Best	1.50	8%+1.50(10% - 8%) = 11%	160	0.308	3.388
Total			520	1	10.208

Thus Expected Return from Portfolio 10.208% say 10.21%.

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(ii) As computed above the expected return from Better is 10% same as from Nifty, hence there will be no difference even if the replacement of security is made. The main logic behind this neutrality is that the beta of security 'Better' is 1 which clearly indicates that this security shall yield same return as market return.

5. (a) Cost of Equity as per CAPM

$$k_e = R_f + \beta \text{ x Market Risk Premium}$$
$$= 8.5\% + 1.36 \text{ x } 9\%$$
$$= 8.5\% + 12.24\% = 20.74\%$$

Cost of Debt $k_d = 11\%(1 - 0.30) = 7.70\%$

WACC $(k_o) = k_e \text{ x } \frac{E}{E+D} + k_d \text{ x } \frac{D}{E+D}$

$$= 20.74 \text{ x } \frac{125}{165} + 7.70 \text{ x } \frac{40}{165}$$

$$= 15.71 + 1.87 = 17.58\%$$

Taxable Income = Rs. 25,00,000/(1 - 0.30)

= Rs. 35,71,429 or Rs. 35.71 lakhs

Operating Income = Taxable Income + Interest

= Rs. 35,71,429 + Rs. 4,40,000

= Rs. 40,11,429 or Rs. 40.11 lacs

EVA = EBIT (1-Tax Rate) – WACC x Invested Capital

= Rs. 40,11,429 (1 – 0.30) – 17.58% x Rs. 1,65,00,000

= Rs. 28,08,000 – Rs. 29,00,700 = - Rs. 92,700

(b) **Identify:** Foreign currency is an asset. Amount \$ 3,50,000.

Create: \$ Liability.

Borrow: In \$. The borrowing rate is 9% per annum or 2.25% per quarter.

Amount to be borrowed: 3,50,000 / 1.0225 = \$ 3,42,298.29

Convert: Sell \$ and buy £. The relevant rate is the Ask rate, namely, 1.5905 per £,

(**Note:** This is an indirect quote). Amount of £s received on conversion is 2,15,214.27 (3,42,298.29/1.5905).

Invest: £ 2,15,214.27 will be invested at 5% for 3 months and get £ 2,17,904.45

Settle: The liability of \$3,42,298.29 at interest of 2.25 per cent quarter matures to \$3,50,000 receivable from customer.

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Using forward rate, amount receivable is = 3,50,000 / 1.6140 = £2,16,852.54

Amount received through money market hedge = £2,17,904.45

Gain = 2,17,904.45 – 2,16,852.54 = £1,051.91

So, money market hedge is beneficial for the exporter

6. (a) Working Notes

Calculation of Interest Payment on 9% Debentures

PVAF (9%,5) = 4.486

Annual Installment = $\frac{\text{Rs. 22.50 crore}}{4.486}$ = Rs. 5.0156 crore

Year	Balance Outstanding (Rs. Crore)	Interest (Rs. Crore)	Installment (Rs. Crore)	Principal Repayment (Rs. Crore)	Balance (Rs. Crore)
1	22.5000	2.025	5.0156	2.9906	19.5094
2	19.5094	1.756	5.0156	3.260	16.2494
3	16.2494	1.462	5.0156	3.554	12.6954
4	12.6954	1.143	5.0156	3.8726	8.8228

Statement showing Value of Equity

Particulars	**2013-14** (Rs. Crore)	**2014-15** (Rs. Crore)	**2015-16** (Rs. Crore)	**2016-17** (Rs. Crore)
EBIT	48.0000	57.0000	68.0000	82.0000
Less: Interest on 9% Debentures	2.0250	1.7560	1.4620	1.1430
Interest on 8% Loan	12.8000	12.8000	12.8000	12.8000
EBT	33.1750	42.4440	53.7380	68.0570
Tax @ 35%	11.6113	14.8554	18.8083	23.8200
EAT	21.5637	27.5886	34.9297	44.2370
Dividend @ 12.5% of EAT	2.6955	3.4490	4.3660	5.5300
	18.8682	24.1396	30.5637	38.7070
Balance b/f	Nil	18.8682	43.0078	73.5715
Balance c/f	18.8682	43.0078	73.5715	112.2785
No. of Shares (Crore)	82.5000	82.5000	82.5000	82.5000
Value of Equity	101.3682	125.5078	156.0715	194.7785

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In the beginning of 2013-14 equity was Rs. 82.5000 crore which has been grown to Rs. 194.7785 over a period of 4 years. In such case the compounded growth rate shall be as follows:

$(194.7785/82.5000)^{¼} - 1 = 23.96\%$

This growth rate is slightly higher than 20% as projected by Mr. Smith.

If the condition of VenCap for 18 shares is accepted the expected share holding after 4 years shall be as follows:

No. of shares held by Management	6.00 crore
No. of shares held by VenCap at the starting stage	2.25 crore
No. of shares held by VenCap after 4 years	4.05 crore
Total holding	6.30 crore

Thus, it is likely that Mr. Smith may not accept this condition of VenCap as this may result in losing their majority ownership and control to VenCap. Mr. Smith may accept their condition if management has further opportunity to increase share ownership through other forms.

(b) When dividends are paid

$100 = (5 + P_1)/(1 + 0.10)$

Therefore, P_1 = Rs.105/-.

Value of firm

$$P_0 = \frac{D_1 + P_1}{1 + k}$$

$$= \frac{50000 \times 5 + 50000 \times 105}{1 + 0.10} = \frac{250000 + 5250000}{1.10} = \text{Rs. } 50,00,000$$

When dividend is not paid

$100 = 1/1.1 \times P_1$

Therefore, P_1 = Rs.110/-.

Value of firm

$$= \frac{50000 \times 0 + 50000 \times 110}{1 + 0.10} = \frac{0 + 5500000}{1.10} = \text{Rs. } 50,00,000/-$$

M.M. Approach indicates that the value of the firm in both the situations will be the same.

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7. **(a)** When there is a scarcity of funds, capital rationing is resorted to. Capital rationing means the utilization of existing funds in most profitable manner by selecting the acceptable projects in the descending order or ranking with limited available funds. The firm must be able to maximize the profits by combining the most profitable proposals. Capital rationing may arise due to (i) external factors such as high borrowing rate or non-availability of loan funds due to constraints of Debt-Equity Ratio; and (ii) Internal Constraints Imposed by management. Project should be accepted as a whole or rejected. It cannot be accepted and executed in piecemeal.

IRR or NPV are the best basis of evaluation even under Capital Rationing situations. The objective is to select those projects which have maximum and positive NPV. Preference should be given to interdependent projects. Projects are to be ranked in the order of NPV. Where there is multi-period Capital Rationing, Linear Programming Technique should be used to maximize NPV. In times of Capital Rationing, the investment policy of the company may not be the optimal one.

In nutshell Capital Rationing leads to:

(i) Allocation of limited resources among ranked acceptable investments.

(ii) This function enables management to select the most profitable investment first.

(iii) It helps a company use limited resources to the best advantage by investing only in the projects that offer the highest return.

(iv) Either the internal rate of return method or the net present value method may be used in ranking investments.

(b) Treasury bills are short-term debt instruments of the Central Government, maturing in a period of less than one year. Treasury bills are issued by RBI on behalf of the Government of India for periods ranging from 14 days to 364 days through regular auctions. They are highly liquid instruments and issued to tide over short-term liquidity shortfalls.

Treasury bills are sold through an auction process according to a fixed auction calendar announced by the RBI. Banks and primary dealers are the major bidders in the competitive auction process. Provident Funds and other investors can make non-competitive bids. RBI makes allocation to non-competitive bidders at a weighted average yield arrived at on the basis of the yields quoted by accepted competitive bids. These days the treasury bills are becoming very popular on account of falling interest rates. Treasury bills are issued at a discount and redeemed at par. Hence, the implicit yield on a treasury bill is a function of the size of the discount and the period of maturity. Now, these bills are becoming part of debt market. In India, the largest holders of the treasury bills are commercial banks, trust, mutual funds and provident funds. Although the degree of liquidity of treasury bills are greater than trade bills, they are not self liquidating as the genuine trade

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bills are. T-bills are claim against the government and do not require any grading or further endorsement or acceptance.

(c) Inspired by the Dow Theory and by observations found throughout nature, Ralph Elliot formulated Elliot Wave Theory in 1934. This theory was based on analysis of 75 years stock price movements and charts. From his studies, he defined price movements in terms of waves. Accordingly, this theory was named Elliot Wave Theory. Elliot found that the markets exhibited certain repeated patterns or waves. As per this theory wave is a movement of the market price from one change in the direction to the next change in the same direction. These waves are resulted from buying and selling impulses emerging from the demand and supply pressures on the market. Depending on the demand and supply pressures, waves are generated in the prices.

As per this theory, waves can be classified into two parts:-

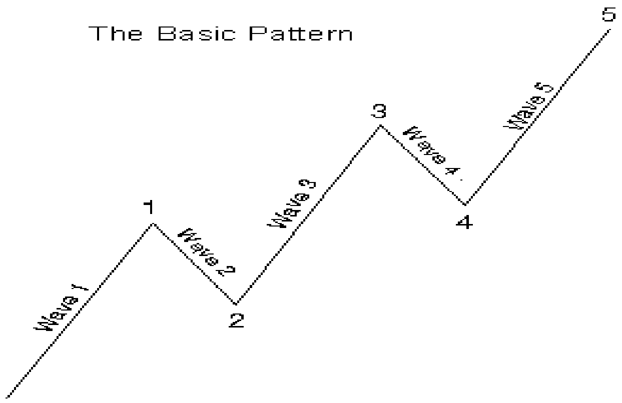
- Impulsive patterns
- Corrective patters

Let us discuss each of these patterns.

(i) **Impulsive Patterns-(Basic Waves) -** In this pattern there will be 3 or 5 waves in a given direction (going upward or downward). These waves shall move in the direction of the basic movement. This movement can indicate bull phase or bear phase.

(ii) **Corrective Patterns-** (**Reaction Waves) -** These 3 w aves are against the basic direction of the basic movement. Correction involves correcting the earlier rise in case of bull market and fall in case of bear market.

As shown in the following diagram waves 1, 3 an d 5 a re directional movements, which are separated or corrected by wave 2 & 4, termed as corrective movements.



Source: http://elliotwave.net/

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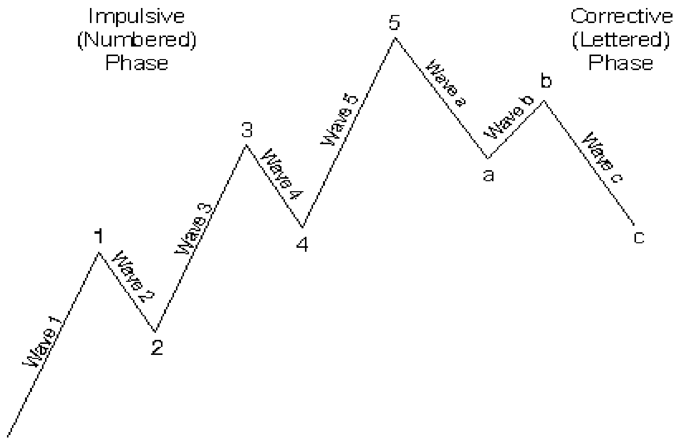
Complete Cycle - As shown in following figure five-wave impulses is following by a three-wave correction (a,b & c) to form a complete cycle of eight waves.



Source: http://elliotwave.net/

One complete cycle consists of waves made up of two distinct phases, bullish and bearish. On completion of fu ll one cycle i.e. termination of 8 w aves movement, the fresh cycle starts with similar impulses arising out of market trading.

(d) The following are, briefly, a summary of investment banking functions:

- **Underwriting:** The underwriting function within corporate finance involves shepherding the process of raising capital for a company. In the investment banking world, capital can be raised by selling either stocks or bonds to the investors.
- **Managing an IPO (Initial Public Offering):** This includes hiring managers to the issue, due diligence and marketing the issue.
- **Issue of debt:** When a company requires capital, it sometimes chooses to issue public debt instead of equity.
- **Follow-on hiring of stock:** A company that is already publicly traded will sometimes sell stock to the public again. This type of offering is called a follow-on offering, or a secondary offering.
- **Mergers and Acquisitions:** Acting as intermediary between Acquirer and target company
- **Sales and Trading:** This includes calling high networth individuals and institutions to suggest trading ideas (on a caveat emptor basis), taking orders and facilitating the buying and selling of stock, bonds or other securities such as currencies.

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- **Research Analysis:** Research analysts study stocks and bonds and make recommendations on whether to buy, sell, or hold those securities.
- **Private Placement:** A private placement differs little from a public offering aside from the fact that a private placement involves a firm selling stock or equity to private investors rather than to public investors.
- **Financial Restructuring:** When a company cannot pay its cash obligations - it goes bankrupt. In this situation, a company can, of course, choose to simply shut down operations and walk away or, it can also restructure and remain in business.

(e) Equity Curve out can be defined as partial spin off in which a company creates its own new subsidiary and subsequently bring out its IPO. It should be however noted that parent company retains its control and only a part of new shares are issued to public.

On the other hand in Spin off parent company does not receive any cash as shares of subsidiary company are issued to existing shareholder in the form of dividend. Thus, shareholders in new company remain the same but not in case of Equity curve out.

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Test Series : September, 2015

MOCK TEST PAPER – 1

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) Radar Ltd. appointed you as its statutory auditor for the current financial year. During the course of auditing, you meticulously analysed that the work performed by company's internal auditor is likely to be adequate for the purpose of statutory audit. Consequently, you decided to use the work of internal auditor in respect of physical verification of tangible assets specifically.

State how you would evaluate the specific work performed by internal auditor to determine its adequacy and who would be responsible for expression of opinion on financial statements.

(b) TCIP Ltd. is planning to extend its business operation for which huge fund is required. The company, therefore, has prepared its projected financial statements for 5 years to be submitted to the bank for loan application.

The company hired you to examine the projected financial statements and give report thereon. What things will you consider before accepting the engagement and what audit evidence will be obtained for reporting on projected financial statements?

(c) Rajasthan Electricity Ltd., a company owned by Rajasthan government, holds 35% equity shares in Colada Ltd. Colada Ltd. is completely dependent on Rajasthan Electricity Ltd. for electric supply. Colada Ltd., in its draft financial statements has not disclosed anything about Rajasthan Electricity Ltd. on the ground that being a government owned entity AS 18 "Related Party Disclosures" does not apply. Comment.

(d) XYZ Ltd. changed its employee remuneration policy from 1st April, 2014 to provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy, the employees can either utilise it or encash it. As at 31st March, 2015, the company obtained an actuarial valuation for leave encashment liability. However, it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilise it. Comment.

(5×4 = 20 Marks)

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

   (a) Mr. Brilliant, a chartered accountant in practice, created his own website in attractive format and highlighted the contents in blue colour. He also circulated the information contained in the website through E-mail to acknowledge public at large about his expertise. However, due to shortage of time, he could not intimate his website address to the Institute.

   (b) CA. Raj is a leading income tax practitioner and consultant for derivative products. He resides in Bangalore near to the XYZ commodity stock exchange and does trading in commodity derivatives. Every day, he invests nearly 50% of his time to settle the commodity transactions, though he has not taken any permission for this. Is CA. Raj liable for professional misconduct?

   (c) CA. Elegant is in practice for two years and runs his proprietorship firm in the name of "M/s Elegant & Co.". He maintains notes in his mobile in which he writes the fees received from various clients. Based on his record, he prepares and files his income tax return.

   (d) The manager of ZedEx (P) Ltd. approached CA. Vineet in the need of a certificate in respect of a consumption statement of raw material. Without having certificate of practice (CoP), CA. Vineet issued the certificate to the manager of the company, acting as a CA in practice and applied for the CoP to the Institute on very next day to avoid any dispute. *(4×4 = 16 Marks)*

3. (a) CA. John is a partner of M/s JK & Associates and leading in-charge of the audit of Pinaco Ltd. The firm is doing audit of Pinaco Ltd. for 10 years. CA. John, knowingly that M/s JK & Associates is no longer eligible to be appointed as auditor of Pinaco Ltd. for another 5 years, resigned from partnership in M/s JK & Associates and joined M/s KL & Associates. Now, Pinaco Ltd. wants to appoint M/s KL & Associates as auditor for 5 years.

   Comment with respect to Companies Act, 2013, whether M/s KL & Associates is allowed to accept the appointment as auditor of Pinaco Ltd. *(4 Marks)*

   (b) Mr. Robert, the director of Alliance Ltd., is holding 25% shares in the company. His daughter-in-law, CA. Stephny, is in practice for 15 years where she provides consultancy services and conduct statutory audits. She has created her niche in statutory audits. The company wanted to appoint her as the statutory auditor of the company for the five consecutive financial years. Consequently, she was appointed by Alliance Ltd. Examine the validity of appointment of CA. Stephny. *(4 Marks)*

   (c) In the books of accounts of ABC Ltd. huge differences has been noticed between the control accounts and subsidiary records. The Chief Accountant informs that this is common due to huge volume of business done by the company during the year. As a Statutory Auditor, how would you deal with the situation? *(4 Marks)*

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(d) Consequences of errors in a computer system are a serious matter as errors tend to be deterministic. Comment with respect to how evaluation of evidences has been changed. *(4 Marks)*

4. (a) Astha Pvt. Ltd. has fully paid capital of Rs. 40 lakh. During the year, the company had borrowed Rs. 15 lakh each from a bank and a financial institution independently. It has the turnover (Net of excise Rs. 50 lakh which is credited to a separate account) of Rs. 475 lakh. Will Companies (Auditor's Report) Order, 2015 be applicable to Astha Pvt. Ltd.? *(4 Marks)*

(b) Under CARO, 2015, as a statutory auditor, how would you report on the following:

(i) A Term Loan was obtained from a bank for Rs. 80 lakh for acquiring R&D equipment, out of which Rs. 15 lakh was used to buy a car for use of the concerned director who was overlooking the R&D activities.

(ii) Physical verification of only 50% of items of inventory has been conducted by the company. The balance 50% will be conducted in next year due to lack of time and resources. *(6 Marks)*

(c) Hansa Ltd. has drawn the financial statement as on 31st March, 2015 and presented to you along with additional information:

Balance Sheet of Hansa Ltd. as on 31st March, 2015

Liabilities	Amt. (Rs.)	Assets	Amt. (Rs.)
Share capital	45,00,000	Fixed Assets	
Reserves & Surplus		Gross block	
Profit and Loss A/c	4,40,000	*Less:* Depreciation	90,00,000
Secured Loans	64,60,000	Investments	Nil
Current Liabilities and		Current Assets	
Provisions		Loans & Advances	
Creditors for trade	5,20,000	Debtors	21,00,000
Advance received	6,80,000	Advance Paid	15,00,000
	1,26,00,000		1,26,00,000

Additional Information:

(i) Entire pre-operative expenses of Rs. 6,60,000/- was charged to Profit and Loss Account whereas for the purpose of Income Tax, only what is allowable is claimed.

(ii) Depreciation as per Books - Rs. 31,00,000/-

Depreciation as per Income tax - Rs. 45,00,000/-

(iii) Losses to be carried forward as per Income Tax Act - Rs. 18,00,000/-

(iv) Donation disallowed while computing tax - Rs. 60,000/-

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Considering the additional information, can you certify as an auditor that the company has complied with the Accounting Standards and issue an unqualified report? *(6 Marks)*

5. (a) In the course of audit of 'Bharat Bank', your firm observed that the bank has classified some of the assets as non-performing assets (NPA), for example, bills receivables for remaining overdue more than 30 days, loans for remaining overdue for more than 60 days etc. Please guide the accountant with regard to criteria to be adopted for classifying an asset as NPA. *(4 Marks)*

   (b) As a cost auditor, what would you check while verifying work-in-progress of an entity? *(4 Marks)*

   (c) State the items contained in the SEBI's check list for auditors in respect of contract notes issued by a Stock Broker. *(4 Marks)*

   (d) While writing the audit program for tax audit in respect of X Ltd., you wish to include possible instances of capital receipt if not credited to Statement of Profit and Loss which needs to be reported under clause 16(e) of form 3CD. Please elucidate possible instances. *(4 Marks)*

6. (a) The 'management audit' concern with the whole field of activities of the concern, from top to bottom, starting, as always where management control is concerned because we are primarily concerned with whether the general management is functioning smoothly and satisfactorily.

   Briefly explain the behavioural aspects encountered in the management audit and state the ways to solve them. *(6 Marks)*

   (b) What are the important aspects to be looked into a due diligence review of Cash flow? *(4 Marks)*

   (c) Being an expert in the field of government audit, you are required to briefly explain the powers of Comptroller and Auditor General of India with respect to supplementary audit and test audit as envisaged under section 143(6) and 143(7) of the Companies Act, 2013. *(6 Marks)*

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

   (a) Frauds committed through supplier's ledger.

   (b) Factors relevant in evaluation of Inherent Risk.

   (c) Constitution of Audit Committee under the Companies Act.

   (d) Approaches to be adopted by peer reviewer in the review process.

   (e) Powers and duties of an auditor of a Multi-state Cooperative Society.

($4 \times 4 = 16$ Marks)

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Test Series : September, 2015

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

SUGGESTED ANSWERS/HINTS

1. (a) **Evaluation of Specific Work Done by Internal Auditor:** The statutory auditor should as a part of his audit, carryout general evaluation of the internal audit function to determine the extent to which he can place reliance upon the work of the internal auditor.

As per SA 610 "Using the Work of Internal Auditors", in order for the external auditor to use specific work of the internal auditors, the external auditor shall evaluate and perform audit procedures on that work to determine its adequacy for the external auditor's purposes. The external auditor shall evaluate whether-

(i) The work was performed by internal auditors having adequate technical training and proficiency;

(ii) The work was properly supervised, reviewed and documented;

(iii) Adequate audit evidence has been obtained to enable the internal auditors to draw reasonable conclusions;

(iv) Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditors are consistent with the results of the work performed; and

(v) Any exceptions or unusual matters disclosed by the internal auditors are properly resolved.

Irrespective of the degree of autonomy and objectivity of the internal audit function, such function is not independent of the entity as is required of the external auditor when expressing an opinion on financial statements. The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal auditors.

(b) Projected Financial Statements: The answer is divided into two parts i.e. (i) the things to be considered before accepting the engagement and (ii) audit evidence to be obtained for reporting on projected financial statements.

(i) **Acceptance of Engagement:** As per SAE 3400, "The Examination of Prospective Financial Information", before accepting an engagement to examine prospective financial information, the auditor would consider, amongst other things-

(1) the intended use of the information;

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(2) whether the information will be for general or limited distribution;

(3) the nature of the assumptions, that is, whether they are best-estimates or hypothetical assumptions;

(4) the elements to be included in the information; and

(5) the period covered by the information.

Further, the auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use.

In accordance with SA 210, "Terms of Audit Engagement", it is necessary that the auditor and the client should agree on the terms of the engagement.

(ii) **Audit evidence to be obtained for Reporting on Projected Financial Statements:** The auditor should document matters, which are important in providing evidence to support his report on examination of prospective financial information, and evidence that such examination was carried out.

The audit evidence in form of working papers will include:

(1) the sources of information,

(2) basis of forecasts,

(3) the assumptions made in arriving the forecasts,

(4) hypothetical assumptions, evidence supporting the assumptions,

(5) management representations regarding the intended use and distribution of the information, completeness of material assumptions,

(6) management's acceptance of its responsibility for the information,

(7) audit plan,

(8) the nature, timing and extent of examination procedures performed, and,

(9) in case the auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision.

(c) AS 18 "Related Party Disclosures" exempts parties being defined on the basis of significant influence in respect of providers of finance; trade unions; public utilities; etc. by virtue of only of those dealings. If an enterprise is completely dependent on an electricity distribution company because of monopoly in that region, but other than for this reason neither enterprises exercise control/significant influence, none of the transactions between them would be related party transactions for AS 18 purposes.

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If a particular enterprise exercises control/significant influence on an electricity distribution company, for example, Colada Ltd. holds 35% equity of Rajasthan Electricity Ltd. (monopoly electricity distribution company) or vice-versa, all transactions (including the supply of electricity) between Colada Ltd. and Rajasthan Electricity Ltd. will be related party transactions and disclosure is necessary for the same as per AS 18.

Similarly, a provider of finance is not a related party by virtue of providing finance, however if the lender in addition to providing finance also holds equity of more than 20% in an enterprise, then it would be deemed to be exercising significant influence on that enterprise unless demonstrated otherwise.

Based on the above cited provisions of AS 18, Colada Ltd. should disclose about Rajasthan Electricity Ltd.

(d) As per Para 11 of **AS-15 on "Employee Benefits"**, issued by the Institute of Chartered Accountants of India, an enterprise should recognise the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences.

Since the company obtained actuarial valuation for leave encashment, it is obvious that the compensated absences are accumulating in nature. An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

Here, XYZ Ltd. shall accumulate the amount of leave encashment benefits as it is the liability of the company to provide 12% PF on amount of leave encashment. Hence, the contention of the auditor is correct that full provision should be provided by the company.

2. (a) Circulating Information Contained in Own Website: As per clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, the guidelines approved by the Council of the Institute of Chartered Accountants of India permit creation of own website by a chartered accountant in his or his firm name and no standard format or restriction on colours is there. The chartered accountant or firm, as per the guidelines, should ensure that none of the information contained in the website be circulated on their own or through E-mail or by any other mode except on a specific "Pull" request.

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Further, members are not required to intimate the Website address to the Institute. Members are only required to comply with the Website Guidelines issued by the Institute in this regard.

In the given case, Mr. Brilliant has circulated the information contained in the website through E-mail to public at large. Therefore, he is guilty of professional misconduct under clause (6) of Part I of the First Schedule to the said Act. However, there is no such misconduct for not intimating website address to the Institute.

(b) **Engaging into a Business:** As per clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

However, the Council has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In this case, CA. Raj is engaged in the occupation of trading in commodity derivatives which is not covered under the general permission.

Hence, specific permission of the Institute has to be obtained otherwise he will be deemed to be guilty of professional misconduct under clause (11) of Part I of First Schedule of Chartered Accountants Act, 1949.

(c) **Maintenance of Books of Account by a CA in Practice:** Chapter V of the Council General Guidelines, 2008 specifies that a member of the Institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his/its professional practice, proper books of accounts including the following-

(i) a Cash Book

(ii) a Ledger

Thus, a Chartered Accountant in practice is required to maintain proper books of accounts.

In the instant case, CA. Elegant does not maintain proper books of accounts and writes the fees received from various clients in notes in his mobile. Notes maintained by him in mobile cannot be treated as books of accounts.

Hence, CA. Elegant, being a practicing Chartered Accountant will be held guilty of misconduct for violation of Council General Guidelines, 2008.

(d) **Issuing Certificate without having Certificate of Practice:** As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional

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misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council.

This clause requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulations made thereunder. Any violation either of the Act or the Regulations by a member would amount to misconduct.

In the given case, CA. Vineet has issued a certificate in respect of a consumption statement of raw material to the manager of ZedEx (P) Ltd., as a Chartered Accountant in practice when he had not even applied for the CoP to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.

Therefore, CA. Vineet will be held guilty of professional misconduct in terms of clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 for contravention of provisions of this Act.

3. **(a)** **Expiration of Appointment Tenure:** Section 139(2) of the Companies Act, 2013 provides that as on the date of appointment, no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

In the given case, CA. John resigned from M/s JK & Associates where he was leading in-charge of the audit of Pinaco Ltd. for 10 years and joined M/s KL & Associates. The tenure of M/s JK & Associates has also been expired in Pinaco Ltd. immediately preceding the financial year i.e. the firm shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term.

Therefore, M/s KL & Associates will be disqualified to be appointed as auditor of Pinaco Ltd. for next five financial years as CA. John was the partner of M/s JK & Associates whose tenure in Pinaco Ltd. has expired.

(b) **Appointment of Relative of Director as an Auditor:** Section 141 of the Companies Act, 2013 deals with the eligibility, qualifications and disqualifications of Auditors. Sub-section (3)(f) of the section 141 of the Act, explicitly disqualifies a person from being appointed as an auditor of a company whose relative is a director or is in employment of the company as a director or key managerial personnel. Further, the definition of the term "relative", as defined under the Companies Act, 2013, includes son's wife i.e. daughter-in-law.

Further, as per Council Guidelines 2008, a member of the Institute shall desist from expressing his opinion on financial statements of any business or enterprise in which one or more persons who are his relatives within the meaning of AS 18 have, either by way of themselves or in conjunction with such members, a substantial interest in the said business or enterprise. Therefore, if the director has substantial

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interest in the company then his relative should not accept the appointment of auditor of that company.

In the instant case, Mr. Robert is the director of Alliance Ltd. and holding 25% shares of the company. Further, CA. Stephny is his son's wife i.e. a relative according to the definition of "relative" given under the Companies Act, 2013. Therefore, she should not accept the appointment as an auditor of that company. If she accepts such appointment, she would be guilty of professional misconduct and would also be liable for punishment for contravention of the provisions of the Companies Act.

(c) **Difference between Control Accounts and Subsidiary Records:** The huge differences found between control accounts and subsidiary records in the books of ABC Ltd. indicates that there may be material misstatements requiring detailed examination by the auditor to ascertain the cause. The contention of Chief Accountant cannot be accepted simply because the company has done huge volume of business. Such a phenomenon indicates that recording of transactions is not being done properly or the accounting system in the company which might have several branches spread over the country fails to capture all transactions in time. It would also be interesting to see whether it is a recurring phenomenon or such reconciliation could not be done at a subsequent date. Having regard to all these circumstances, it appears from the facts of the case that these differences indicate the possibility of some kind of material misstatements.

As per SA 240, "The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements", when the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence. When the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud, the auditor shall evaluate the implications for the audit.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within 60 days of his knowledge and after following the prescribed procedure.

The auditor is also required to comment under clause (xii) of Para 3 of CARO, 2015 whether any fraud on or by the company has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.

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(d) **Changes to Evidence Evaluation:** With increasing complexity of computer systems and control technology, it is becoming more and more difficult for the auditors to evaluate the consequences of strength and weaknesses of control mechanism for placing overall reliability on the system.

Auditors need to understand-

(i) whether a control is functioning reliably or multi functioning,

(ii) traceability of control strength and weakness through the system. In a shared data environment a single input transaction may update multiple data item used by diverse, physically disparate user, which may be difficult to understand.

Consequences of errors in a computer system are a serious matter as errors in computer system tend to be deterministic, i.e., an erroneous program will always execute data incorrectly. Moreover, the errors are generated at high speed and the cost and effort to correct and rerun program may be high. Errors in computer program can involve extensive redesign and reprogramming. Thus, internal controls that ensure high quality computer systems should be designed implemented and operated upon. The auditors must ensure that these control are sufficient to maintain assets safeguarding, data integrity, system effectiveness and system efficiency and that they are in position and functioning.

4. (a) **Applicability of CARO, 2015:** The CARO, 2015 specifically exempts a private limited company with a paid up capital and reserves not more than Rs. 50 lakh and which does not have loan outstanding exceeding Rs. 25 lakh from any bank or financial institution and does not have a turnover exceeding Rs. 5 crore at any point of time during the financial year.

In the case of Astha Pvt. Ltd., it has paid capital of Rs. 40 lakh i.e. less than Rs. 50 lakh, turnover is Rs. 4.75 crore i.e. less than Rs. 5 crore since excise duty is not taken into account if it is credited separately to excise duty account. However, it has outstanding loan of Rs. 30 lakh (Rs. 15 lakh + Rs. 15 lakh) collectively from bank and financial institution.

Therefore, it fails to fulfill the condition relating to outstanding loan. Thus, CARO, 2015 will be applicable to Astha Pvt. Ltd. accordingly.

(b) **Reporting Under CARO, 2015**

(i) **Utilisation of Term Loans:** According to clause (xi) of Para 3 of CARO, 2015, the auditor is required to comment whether term loans were applied for the purpose for which the loans were obtained.

The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been

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utilized for the purpose for which they were obtained, the report should state the fact.

In the instant case, term loan taken for the purpose of R&D equipment has been utilized for the purchase of car which has no relation with R&D equipment.

Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report that out of the term loan taken for R&D equipment, Rs. 15 lakh was not utilised for the purpose of acquiring R&D equipment.

(ii) Physical Verification of Inventory: Clause (ii) of Para 3 of CARO, 2015 requires the auditor to report on whether physical verification of inventory has been conducted at reasonable intervals by the management. Physical verification of inventory is the responsibility of the management which should verify all material items at least once in a year and more often in appropriate cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification.

In the given case, the above requirement of CARO, 2015 has not been fulfilled as such and the auditor should point out the specific areas where he believes the procedure of inventory verification is not reasonable. He may consider the impact on financial statement and report accordingly.

(c) Compliance with the Accounting Standards: As per AS 26 "Intangible Assets", 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 recognised, then such an expenditure is recognised as an expense when it is incurred. Therefore, expenditures for commencing new operations or launching new products or processes (pre-operating costs) should be expensed off in the year of incurrence as no asset is created.

Further, as per AS 22 "Accounting for Taxes on Income", tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the net profit or loss for the period. It may also be noted that Deferred Tax is the tax effect of timing difference. Hence deferred tax should be recognised for all the timing differences, however, permanent differences do not result in deferred tax assets or deferred tax liabilities. Thus, Tax Expense = Current Tax + Deferred Tax.

Point no. (i) of additional information is in compliance with AS 26, hence no qualification is required in view of AS 26. But at the same time it leads to timing difference which will require the creation of DTA/ DTL as per AS 22. (DTA- Deferred Tax Assets, DTL- Deferred Tax Liabilities)

Similarly, point no. (ii) and (iii) of additional information are also the case of timing differences which creates DTA/ DTL as per AS 22.

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Creation of DTA / DTL on account of such timing differences needs to be reported in the Financial Statements.

However, point no. (iv) is a situation of permanent difference as per AS 22. Hence no DTA/DTL is required to be accounted for.

A prima facie look to the given Balance Sheet states that no tax expense has been provided for. Accordingly, qualification in audit report is required in view of non-compliance of AS 22.

Further, presentations of Fixed Assets are also not in compliance with disclosure requirement of AS 6 and AS 10. Therefore, as an auditor, we cannot certify that the company has complied with all the Accounting Standards.

5. (a) Classification of Non-Performing Assets: An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.

Criteria for the classification of a Non Performing Asset (NPA) is a loan or an advance where-

(i) Interest and/or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan.

(ii) The account remains "out of order" in respect of an Overdraft/Cash Credit (OD/CC).

(iii) The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

(iv) The instalments of principal or interest thereon remain overdue for two crop seasons for short duration crops.

(v) The instalment of principal or interest thereon remains overdue for one crop season for long duration crops.

(vi) The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitization dated 1st February, 2006.

(vii) In respect of derivative transactions, the overdue receivables representing positive mark to Market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

(b) Work-in Progress: The Cost Auditor will see the following-

(i) that work-in-progress has been physically verified and that it agrees with the balance in the incomplete cost card;

(ii) that valuation of the work-in-progress is correct with reference to stage of completion of each job or process and the value job cost cards or process cost sheet;

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(iii) that there is no over-valuation or under-valuation of opening work-in-progress or closing work-in-progress, thereby artificially pushing up and down net profits or net assets as the case may be;

(iv) that the volume and value of work-in-progress is not disproportionate compared with the finished out-turn.

(c) 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 numbers 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.

(d) Instances of Capital Receipts to be Stated Under Clause 16(e): The following is an illustrative list of capital receipts which, if not credited to the statement of profit and loss, are to be stated under clause 16(e) of Form 3CD-

(i) Capital subsidy received in the form of government grants, which are in the nature of promoters' contribution i.e., they are given with reference to the total investment of the undertaking or by way of contribution to its total capital outlay. For example, Capital Investment Subsidy Scheme.

(ii) Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.

(iii) Compensation for surrendering certain rights.

(iv) Profit on sale of fixed assets/investments to the extent not credited to the statement of profit and loss.

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6. (a) **Behavioural Aspects Encountered in Management Audit:** Financial auditors deal mainly with figures. Management auditors deal mainly with people. There are many causes for behavioural problems arising in the review function of management audit. Particularly, when management auditors performs comprehensive audit of operations, they cannot be as well informed about such operations as a financial auditor in a financial department. Operating processes may be unfamiliar and complex. The operating people may be speaking a language and using terms that are foreign to the auditor's experience. The nature and causes of behavioural problems that the management auditor is likely to face in the discharge of the review function that is expected of him and possible solutions to overcome these problems are discussed below-

(1) **Staff / Line conflict**: Management auditors are staff people while the members of other departments are line people. Management auditors tend to discount the difficulties the line staff may face, if called on to act on the ideas of management auditors. Management auditors are specialists in their field and they may think their approach and solutions are the only answers.

(2) **Control**: The management auditor is expected to evaluate the effectiveness of controls, there is an instinctive reaction from the auditee that the report of the auditor may affect them. There is a fear that the action taken based on the management audit report will affect the line people. It breeds antagonism. The causes are under:

(i) Fear of criticism stemming from adverse audit findings.

(ii) Fear of change in day to day working habits because of changes resulting from audit recommendations.

(iii) Punitive action by superior prompted by reported deficiencies.

(iv) Insensitive audit practices.

(v) Hostile audit style.

Solution to Behavioural Problems: The following steps may be taken to overcome the aforesaid problems-

(i) To demonstrate that audit is part of an overall programme of review for protective and constructive benefit.

(ii) To demonstrate the objective of review is to provide maximum service in all feasible managerial dimensions.

(iii) To demonstrate the review will be with minimum interference with regular operation.

(iv) The responsible officers will be involved in the process of review of the findings and recommendations before the audit report is formally released.

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It is essential to create an atmosphere of trust and friendliness so that audit reports will be understood in their proper perspective.

Finally, it needs hardly any emphasis that there should be right management culture, enlightened auditees and auditors of the right calibre. May be to expect a combination at all times of all the three is asking for the impossible. But, a concerted effort by the management, auditors and auditees to achieve a more acceptable climate would go a long way to achieve the goal.

(b) Due Diligence Review of Cash Flow

(i) Review the historical pattern of cash flows of the organisation and look for change in trends.

(ii) See whether the company is able to meet its cash requirements from internal generations/accruals or does it seek outside sources from time to time.

(iii) Check whether the company honours its commitments to trade payables, government and other stock holders.

(iv) Verify the ability of the company to turn its inventory into trade receivables i.e. sale ability of its products.

(v) Ensure that the company follows up with trade receivables and that the trade receivables collection period is not very large.

(vi) Check the ability of the company to deploy its funds in profitable investment opportunities.

(vii) Look into the investment pattern of the company, whether they give maximum benefits to the company and are easily realisable.

(c) Powers of Comptroller and Auditor-General of India

(i) **Supplementary audit under section 143(6)(a) of the Companies Act, 2013:** The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct.

Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013: Any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 of the said Act i.e. every member of the company, to every trustee for the debenture-holder of any

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debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

(ii) **Test audit under section 143(7) of the Companies Act, 2013:** Without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of the said Act, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

7. (a) Frauds Committed Through Supplier's Ledger: Fraud through supplier's ledger could be made in any of the following ways, which the auditor has to take care of-

(i) Inflating supplier's account with fictitious or duplicate invoices and subsequent misappropriations as if payments are made to the supplier.

(ii) Suppressing credit notes issued by the suppliers and withdrawing the corresponding amount not claimed by them.

(iii) Withdrawing amounts which remain unclaimed for more than the normal time limit for one reason or other by showing the same have been paid to the parties.

(iv) Inflating values of items purchased and collecting the excess from suppliers i.e. accepting invoices at prices considerably higher than the market price and collecting the excess claim from the suppliers directly.

(b) Factors Relevant in Evaluation of Inherent Risk: While developing an overall audit plan, the auditor is required to assess inherent risk at financial statement level and is then required to relate his assessment to material account balances and the class of transactions. To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors, having regard to his experience of the entity from previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which might have taken place since his last assessment. Normally an auditor evaluates inherent risk by assessing factors such as integrity of the management, experience and knowledge of the management, turnover of key management personnel, circumstances which may motivate the management to misstate the financial statement when its financial performance is not satisfactory, nature of entity's business prone to rapid technological obsolescence, dealing with large number of related parties etc.

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(c) Constitution of Audit Committee under the Companies Act: As per the section 177 of the Companies Act, 2013, every listed company and the following classes of companies shall constitute an Audit Committee -

(i) all public companies with a paid up capital of ten crore rupees or more;

(ii) all public companies having turnover of one hundred crore rupees or more;

(iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation - The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

(d) Approaches to be adopted by Peer Reviewer in the Review Process: The reviewer is required to adopt a combination of compliance approach and substantive approach in the Review process.

(A) Compliance Approach – Assurance Service Engagements

The compliance approach is to assess whether proper control procedures have been established / followed by the Practice Unit to ensure that assurance services are being performed in accordance with Technical, Professional and Ethical Standards.

The following areas shall be considered:

- Assurance services records for Administration
- Review and Evaluation of System of Internal controls
- Substantive Tests
- Financial Statements Presentation and
- Assurance Services Conclusions
- Assurance Services Reporting

(B) Substantive Approach - Assurance Service Engagements

This approach requires a Review of the assurance working papers in order to establish the extent of compliance, whether the assurance work has been carried out as per the Technical, Ethical, and Professional Standards.

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(e) **Powers and Duties of an Auditor of a Multi-state Co-operative Society:** Under section 73 of the Multi-State Cooperative Societies Act, 2002, every auditor of a multi – State Co-operative Society shall have a right of access at all times to the books, accounts and vouchers of the Multi-State Co-operative Society whether kept at the head office of the Multi-State Co-operative Society or elsewhere and shall be entitled to require from the officers or other employees of the Multi-State Co-operative Society such information and explanation as the auditor may think necessary for the performance of the duties as an auditor.

As per section 73(2), the auditor shall make the following inquiries:

(i) Whether loans and advances made by the Multi-State Co-operative Society on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the Multi-State Co-operative or its members;

(ii) Whether transactions of the Multi-State Co-operative Society which are represented merely by book entries are not prejudicial to the interest of the Multi-State Co-operative Society;

(iii) Whether personal expenses have been charged to revenue account; and

(iv) Where it is stated in the books and papers of the Multi-State Co-operative Society that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

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Test Series: September, 2015

MOCK TEST PAPER 1

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) (i) ABC Limited in the Annual General Meeting declared a dividend at the rate of 30 percent payable on paid up share capital of the Company as recommended by Board of Directors on 30th April, 2015. The Company did not paid declared dividend to Mr. S, the shareholder. The Company finds that there was a dispute regarding the right to receive the dividend by S. Mr. S, filed a suit against the ABC Ltd. for the payment of dividend. Examine the given situation in the light of provisions of the Companies Act, 2013, whether Mr. S would be entitled for the declared dividend? *(3 Marks)*

(ii) Mr. R had purchased shares from Mr. B on 30stJune, 2015. He applied to the company for the transfer of shares in his name but the company failed to register the shares in his name. On 1st of August, 2015, the company declared dividend. Referring to the provisions of the Companies Act, 2013, comment whether Mr. R is entitled to receive the dividend? *(3 Marks)*

(b) XYZ Ltd with PQR as its subsidiary incorporated outside India.XYZ with respect to the financial year 2014-2015 proposed to prepared a consolidated financial statement of its own and of its subsidiary in order that it shall be laid before the annual general meeting of the company along with the laying of its own financial statement. PQR failed to prepare its financial statement in time and so XYZ decided not to prepare Consolidated Financial Statement and present financial statement on standalone in the annual general meeting. Considering the provisions of the Companies Act, 2013, discuss the validity of the act of the XYZ Ltd. not to prepare CFS. *(6 Marks)*

(c) Discuss the establishment of special courts and its Jurisdiction under the Securities and Exchange Board of India Act, 1992. *(4 Marks)*

(d) A Stock Exchange has applied to the Central Government for grant of recognition. Referring to the provisions of Securities Contracts (Regulation) Act, 1956 state the conditions the Central Government may impose to grant recognition to stock exchange. *(4 Marks)*

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2. (a) Explaining the regulatory provisions of the Companies Act, 2013 and the rules thereof regarding the appointment of independent directors on the company's Board, state whether BCD Company Ltd, which is a listed company, is required to appoint such directors in the following situations:

(i) The company has a paid up share capital of Rs. 10 Crore.

(ii) What shall be your answer in case the company's paid up share capital is only Rs. 2 crore?

(iii) Whether a person who hold the position of a key Managerial Personnel can be appointed as an Independent Director? *(8 Marks)*

(b) (i) State the conditions under which warrants may be issued along with the public issue or right issue of specified securities as required under the Securities and Exchange Board of India (Issue of capital Disclosure Requirements) (Amendments) Regulation, 2015. *(4 Marks)*

(ii) The Government of India has made it compulsory for the companies incorporated outside India to take the expert's consent before issuing prospectus in India and making allotment of shares. Explain the provisions that have to be followed by the companies incorporated outside India in this regard as per the provisions of the Companies Act, 2013. *(4 Marks)*

3 (a) The Board of Directors of Millionare Ltd did not recommend any dividend for the year 2014-2015 due to loss caused to the company by recession. At the Annual General Meeting of the company, a group of members objected to the Board's decision and wanted the Board to make recommendation for dividend.

On refusal by the Board, the members, who feel oppressed by the Board's decision to skip the dividend, move to the Company Law Board and complain against the Board on the ground of oppression and mis-management.

Examining the provisions of the Companies Act, 1956, decide:

(1) Whether the members contention shall be tenable?

(2) Whether the act of Board of Directors not to recommend any dividend shall amount to oppression and mismanagement? *(8 Marks)*

(b) (i) Mr. Ansh was appointed as a director in the AGM of the company. After three months, a group of shareholders pointed out there are defects in the appointment of Mr. Ansh as the director of the company. As per the provisions of the Companies Act, 2013, suggest the company about the validity of the actions taken by Mr. Ansh during this period. *(4 Marks)*

(ii) Mr. Suresh resided in India during the financial year 2012-2013 for a period of 170 days. He had come to India on 1April, 2013 for business. He intends to leave the business on April 30, 2014 and finally leaves India on June 30, 2014.

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Explaining the provisions of the Foreign Exchange Management Act, 1999, determine the residential status of Mr. Suresh during the financial year 2013-14 and during the year 2014-15 to the date of his departure. *(4 Marks)*

4. (a) The Registrar of Companies, Mumbai filed a petition in the Bombay High Court for compulsory winding up of 'Evergreen Ltd' on the ground that a perusal of the Balance Sheet of the company as at 31-03-2015 revealed that its liabilities far exceeded the assets and consequently the company is unable to pay its debts. Examine with reference to the provisions of the Companies Act, 1956, the various factors the High Court will take into account before the company is ordered to be wound up compulsorily and whether there is any justification in the present case for the Court to order winding up of the company. *(8 Marks)*

   (b) (i) X, a foreign company with its branch office in India have a turn over of rupees 2000 crore in the financial year 2014-2015. Company decided to constitute CSR Committee. Decide in the light of the Companies Act, 2013 whether X is required to constitute CSR Committee? What amount should be contributed towards CSR? *(4 Marks)*

   (ii) State the various situations leading to abuse of dominant position by any enterprise or group as per the Competition Act, 2002. *(4 Marks)*

5. (a) "ABC and Co." is an audit form having partners "A, B & C" Chartered Accountants. A, B & C are holding appointment as an auditor in 4, 6 and 10 companies respectively.

   (i) Provide the maximum no. of audits remaining in the name of ABC & CO.

   (ii) Provide the maximum no. of audits remaining in the name of individual partner i.e. A, B & C. *(8 Marks)*

   (b) (i) A majority of the Board of Directors of M/s Esteem Ltd. have realised that some of the business activities carried out in the name of the company are not in the interest of either the company or its members. They want that the company should make an application to the Central Government to appoint an Inspector to carry out investigation and find out the whole truth. Explain the relevant law that should be taken to achieve the purpose. *(4 Marks)*

   (ii) The Board of Directors of VDV Ltd., a banking company incorporated in India, for the accounting year ended 31-3-2015 transferred 15% of its net profit to its Reserve Fund. Certain shareholders of the company object to the above act of the Board of Directors on the ground that it is violative of the provisions, of the Banking Regulation Act, 1949. Examine the provision of Banking Act and decide:

   (I) Whether contention of the Shareholders is tenable.

   (II) Would your answer be still the same in case the Board of Directors transfer 30% of the company's net profits to Reserve Fund. *(4 Marks)*

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6. (a) (i) 'PQR' a two year old Producer Company registered under the Companies Act, 1956 wants to donate some amount. The Producer Company approached you to advise him as to how and for what purposes the donation can be made. Also state the monetary restrictions, if any, laid down in the Companies Act, 1956 on making donations by a Producer Company. You are informed that as per the Profit & Loss account of the Producer Company for its last accounting year, net profit was Rs. 20.00 lacs. *(4 Marks)*

(ii) State the circumstances in which the Central Government is empowered to provide for the amalgamation of companies in the public interest. *(4 Marks)*

(b) (i) Mr. NBS was employed as a Managing Director of the company for 3 years. Company wanted to dispense his services and so decided to make payment by way compensation for loss of office. Draft a Board resolution to be passed in the meeting for the compensation for loss of office. *(4 Marks)*

(ii) What are the obligations of the Banking Companies under the Prevention of Money Laundering Act, 2002 with respect to the protection of the informations related to the designated business or profession. *(4 Marks)*

7. (a) What is Director Identification Number (DIN)? What procedure has to be followed, if there is any change in particulars of Director? *(4 Marks)*

(b) Who may file complaint for the cognizance of offence alleged to have been committed by any company or any officer thereof under the Companies Act, 2013.

(4 Marks)

(c) State the law as to inspection, production and use of documents as evidence by any person which are kept by the registrar under his custody as per the Companies Act, 2013. *(4 Marks)*

(d) What are the measures for assets reconstruction to be made by the securitization or reconstruction company for the purpose of asset reconstruction? *(4 Marks)*

(e) Explain the "Rule of Exceptional Construction" with regards to interpretation of Statutes. *(4 Marks)*

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Test Series : September, 2015

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 4 : CORPORATE AND ALLIED LAWS

SUGGESTED ANSWERS/HINTS

1. (a) (i) Section 127 of the Companies Act, 2013 deals with the punishment for failure to distribute dividends within the prescribed time period. As per the Provision a dividend declared by a company has to be paid or the warrant in respect thereof has to be posted within thirty days from the date of declaration to any shareholder entitled to the payment of the dividend.

However proviso to section 127 list out the cases where a company is entitled to protection for its failure to pay dividend within the stipulated time period. Clause (c) of the proviso states that where there is a dispute regarding the right to receive the dividend, there no offence shall be deemed to have been committed by the company.

In the given case ABC Ltd. finds the dispute with respect to right of Mr. S, to receive the dividend. Therefore, Mr. S will not succeed in his claim for payment of declared dividend.

(ii) As per Section 126 of the Companies Act, 2013 where any instrument of transfer of shares has been delivered to any company for registration and the transfer of such shares has not been registered by the company, the company shall transfer the dividend in relation to such shares to the Unpaid Dividend Account referred to in section 124 unless the company is authorised by the registered holder of such share in writing to pay such dividend to the transferee specified in such instrument of transfer.

Applying the above provisions to given situation, Mr. R is entitled to receive the dividend. The company shall transfer the dividend to Mr. R 's share to the unpaid dividend account unless the company is authorized by Mr. B, the registered holder of such shares , in writing to pay such dividend to Mr. R, the transferee, specified in the instrument of transfer.

(b) Section 129(3) of the Companies Act, 2013 deals preparation of the Consolidated Financial Statements. According to the section 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. The Consolidated financial statements

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shall also be laid before the annual general meeting of the company along with the laying of its own financial statement.

Further Rule 6 of the Companies (Accounts) Rules, 2014 provides the manner of consolidation of accounts. According to which the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. Vide notification G.S.R. 37(E) dated 16th January 2015 the Central Government further amended the Companies (Accounts) Rules, 2014 by inserting a proviso that "this rule shall not apply in respect of consolidation of financial statement by a company having subsidiary or subsidiaries incorporated outside India only for the financial year commencing on or after 1st April,2014.

In given instance, PQR, a subsidiary of XYZ Ltd, is incorporated outside India, so rule 6 is not applicable here. So the decision taken by the company XYZ that PQR may not prepare Consolidated Financial Statement for the Financial year 2014-2015, is valid.

(c) Establishment of Special Courts (Section 26A):

(1) The Central Government may, for the purpose of providing speedy trial of offences under this Act, by notification, establish or designate as many Special Courts as may be necessary.

(2) A Special Court shall consist of a single judge who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working.

(3) A person shall not be qualified for appointment as a judge of a Special Court unless he is, immediately before such appointment, holding the office of a Sessions Judge or an Additional Sessions Judge, as the case may be.

Offences triable by Special Courts (Section 26B): Notwithstanding anything contained in the Code of Criminal Procedure, 1973, all offences under this Act committed prior to the date of commencement of the Securities Laws (Amendment) Act, 2014 or on or after the date of such commencement, shall be taken cognizance of and tried by the Special Court established for the area in which the offence is committed or where there are more Special Courts than one for such area, by such one of them as may be specified in this behalf by the High Court concerned.

(d) Granting of Recognition (Section 4 of Securities Contracts (Regulation) Act, 1956)

Central Government may grant recognition to stock exchange subject to the following conditions that it may impose-

(i) qualification for membership of stock exchange.

(ii) manner in which contracts shall be entered into and enforced as between members.

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(iii) representation of Central Government on Board of Exchanges.

(iv) maintenance of accounts of members and their audit.

Grant of recognition shall be published in Gazette of India and also in Official Gazette of State in which stock exchange is located.

No application can be refused unless an opportunity of being heard is given to the Stock Exchange. Reason for refusal will be communicated in writing.

2. (a) Independent Director: In accordance with the provisions of the Companies Act, 2013, every listed public company shall have at least one-third of the total number of directors as independent directors. [Section 149(4)]. The Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies. Any fraction contained in such one-third numbers shall be rounded off as one.

Further, according to the Companies (Appointment and Qualification of Directors) Rules, 2014, the following class or classes of companies shall have at least two directors as independent directors:

(1) the Public Companies having paid up share capital of ten crore rupees or more; or

(2) the Public Companies having turnover of one hundred crore rupees or more; or

(3) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees.

However, in case a company covered as under the above rule is required to appoint a higher number of independent directors due to composition of its audit committee, such higher number of independent directors shall be applicable to it.

Accordingly, the sub-questions can be answered as under:

(i) Since the company in question is a listed company, it is required to appoint independent directors as per the above provisions.

(ii) Even in the second case, the answer shall remain the same since the company in question is a listed company. The quantum of paid up share capital shall not affect the answer.

(iii) As per the provisions a person who has been or is a one of the key managerial personnel cannot be appointed as an independent director in the given case.(Section 149(6)]

(b) (i) Regulation 4 of the SEBI (ICDR) Regulation, 2009, lay down the common conditions for public issues or right issues of securities. SEBI Vide Notification dated 24th March, 2015 has issued SEBI (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2015 whereby resulting into further changes in point no. 3 of Regulation 4 of the SEBI (ICDR)

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Regulations, 2009. According to it warrants may be issued along with the public issue or right issue of specified securities subject to the following:

(a) The tenure of such warrants shall not exceed eighteen months from their date of allotment in the public or right issue.

(b) Not more than one warrant shall be attached to on specified securities.

(c) Price of conservation formula of the warrants shall be determined upfront and atleast 25% of the consideration amount shall also be received upfront.

(d) In case warrant holder does not exercise the option to take equity shares against any of the warrants held by him, the consideration paid in respect of such warrant shall be forfeited by the issuer.

(ii) Provisions as to expert's consent and allotment: Section 388 of the Companies Act, 2013 provides for Provisions as to expert's consent and allotment before issuing prospectus. According to this section the companies incorporated outside India have to follow the following provisions as to expert's consent and allotment:

(1) No person shall issue, circulate or distribute in India any prospectus offering for subscription in securities of a company incorporated or to be incorporated outside India, whether the company has or has not been established, or when formed will or will not establish, a place of business in India,—

(a) if, where the prospectus includes a statement purporting to be made by an expert, he has not given, or has before delivery of the prospectus for registration withdrawn, his written consent to the issue of the prospectus with the statement included in the form and context in which it is included, or there does not appear in the prospectus a statement that he has given and has not withdrawn his consent as aforesaid; or

(b) if the prospectus does not have the effect, where an application is made in pursuance thereof, of rendering all persons concerned bound by all the provisions of sections 33 and 40, so far as applicable.

(2) For the purposes of this section, a statement shall be deemed to be included in a prospectus, if it is contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith.

On the basis of the above provisions of the Companies Act, 2013, it is clear that no company incorporated or to be incorporated outside India

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can issue, circulate, or distribute in India any prospectus without taking the expert's consent.

3. (a) **Oppression & Mismanagement:** Under sections 397 and 398 of the Companies Act, 1956, members may apply to the Company Law Board in cases of oppression and mismanagement. However, bona fide decisions consistent with the company's memorandum and articles are not to be equated with mismanagement even if they turn out to be wrong in the circumstances or these cause temporary losses. The Court will not permit the machinery created by the sections to be used by the minority for compelling the majority to come to terms, where the company is honestly managed. Directors' bona fide decision not to declare dividend and to accumulate available profits into reserves is not mismanagement. *(Thomas Vettom (V.J.) vs. Kuttanad Rubber Co. Ltd. (1984) 56 Com. Cases 284 (Ker).*

Thus in the given case, the group of members who complain to CLB against the decision of the Board not to declare any dividend and to accumulate available profits into reserves, would not succeed, as the act of directors does not amount to mismanagement. Furthermore, the shareholders cannot compel the Board to recommend a dividend. The Board's recommendations are placed in the general meeting. The general meeting can reduce the dividend, but cannot even increase the dividend as recommended by the Board. Therefore, the members cannot compel the company to declare dividend and cannot charge the directors with oppression or mismanagement.

Applying the above, answers to the question shall be as under:

(1) The contention of members shall not be tenable.

(2) The act of the Board of directors who acted bona fide, not to recommend any dividend shall not amount to oppression or mismanagement.

(b) (i) **Defects in appointment of directors not to invalidate actions taken** (Section 176) - Referring to the provisions of the Companies Act, 2013, if it comes to the notice of the company that there have been some irregulaties in the appointment of the director, the actions done by the person as a director shall not be deemed to be invalid. According to this section:

1. No act done by a person as a director shall be deemed to be invalid, notwithstanding that it was subsequently noticed that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles of the company.

2. Nothing in this section shall be deemed to give validity to any act done by the director after his appointment has been noticed by the company to be invalid or to have terminated.

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Hence, it could be concluded from the above explanation that before getting pointed out by a group of shareholders about the invalidity of his (Mr. Ansh's) appointment, the acts done by him are valid. But, the acts done by Mr. Ansh after getting pointed out regarding the invalidity of his appointment will be invalid.

(ii) As per the definition of the term "Person resident in India' means the person should have resided in India in the preceding financial year for more than 182 days. The residence of a person is calculated not with reference to his stay in India during that year but with reference to his stay in an earlier financial year. Therefore, a person may come into India in a financial year and stay for that year only but still, for that year he would not be resident in India. He would have to wait for the end of the year and on the commencement of the next year he would become resident in India.

Also, there may be situations where person may stay in India for more than 182 days, and leave India thereafter. In the next year, he may be out of India for that whole year still he would be treated as resident in India since in the preceding financial year he was in India for more than 182 days. Therefore, a person may have to wait for upto one and a half-year to become a resident.

If that person has gone out of India or who stays outside India in either case for taking up employment, or for carrying on business or vocation or for any other purpose which would indicate his intention to stay outside India for an uncertain period, he would be treated as resident outside India.

Therefore, applying the above provisions in the given case, Mr. Suresh cannot be considered 'person resident in India' during the financial year 2013-2014 not withstanding the purpose or duration of his stay. As regards financial year 2014-2015, Mr. X would have been in India in the preceding financial year (2013-2014) for a period exceeding 182 days. Accordingly, he would be 'resident' in India during financial year 2014-2015. However, if he leaves India for the purpose of taking up employment or for business/vocation outside India, or for any other purpose as would indicate his intention to stay outside India for an uncertain period, he would cease to be person resident in India from the date of his departure. It may be noted that even if Mr. Suresh is a foreign citizen, if he has not left India for any these purposes, he would be considered, 'person resident in India' during the financial year 2014-2015.

4. (a) Compulsory Winding Up: In the case law *Registrar of Companies Punjab vs. Ajanta Lucky Scheme and Investment Co. Private ltd.,* the Registrar of Companies filed a petition for the winding up of the respondent company under Section 433 (e) read with Section 439(5) of the Companies Act, 1956 on the ground that the Company was unable to pay its debts and that its liabilities exceeded its assets. In the said case, it was held by the Court that for determining the Company's ability or

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otherwise to pay its debts, it was to be considered whether the company was able to meet its liability as and when they accrued due. Section 434 of the Act, prescribes the circumstances in which a company was to be treated as unable to pay its debts. Admittedly none of these circumstances was present in the said case and no complaint had even been received by the company from its creditors as regards non-fulfilments of any of their claims against the company. In a case where no debt had been due, a demand, therefore, could not be made. The mere fact that certain liabilities might accrue due in further, which could exceed the existing assets of the company, would not necessarily lead to the conclusion that the company would be unable to meet its liabilities when they accrued due. The mere fact that the Company's liabilities being in excess of its assets could not *ipso facto* be a ground for putting the company into liquidation. The test would be that the company should be commercially solvent i.e., the company ought to be in a position to meet its liabilities as and when they arose.

Thus in the present case, the Bombay High Court may not order the winding up of the Company viz. Evergreen Ltd. merely because its liabilities far exceeded the assets of the Company. The Court will take into account whether the company has failed to meet any of the demands made by the creditors etc.

(b) (i) Requirement for constitution of CSR Committee: As per the provision given under section 135 of the Companies Act, 2013,every company including its holding or subsidiary, and a foreign company defined under section 2(42) of the Companies Act, 2013 having its branch office or project office in India, having

(1) net worth of rupees 500 crore or more, or

(2) turnover of rupees 1000 crore or more or

(3) a net profit of rupees 5 crore or more

during any financial year shall constitute a Corporate Social Responsibility Committee of the Board.

However, the net worth, turnover or net profit of a foreign company shall be computed in accordance with balance sheet and profit and loss account of such company as prepared in accordance with the provisions of section 381(1)(a) and section 198 of the Act.

Since, X, a foreign company with branch office in India with turnover of Rupees 2000 crore in financial year 2014-2015 is required to constitute CSR committee of the Board.

Amount of contribution: The Board of every company shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR Policy.

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(ii) As per Section 4 of the Competition Act, 2002, in the following situations, there shall be abuse of dominant position by an enterprise or group, if such an enterprise or a group, -

(a) directly or indirectly, imposes unfair or discriminatory—

(i) condition in purchase or sale of goods or services; or

(ii) price in purchase or sale (including predatory price) of goods or service, or

The unfair or discriminatory condition in purchase or sale of goods or service referred to in sub-clause (i) and unfair or discriminatory price in purchase or sale of goods (including predatory price) or service referred to in sub-clause (ii) shall not include such discriminatory condition or price which may be adopted to meet the competition; or

(b) limits or restricts—

(i) production of goods or provision of services or market therefor; or

(ii) technical or scientific development relating to goods or services to the prejudice of consumers; or

(c) indulges in practice or practices resulting in denial of market access in any manner; or

(d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or

(e) uses its dominant position in one relevant market to enter into, or protect, other relevant market. Dominant position means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to—

(i) operate independently of competitive forces prevailing in the relevant market; or

(ii) affect its competitors or consumers or the relevant market in its favour;

5. (a) **Fact of the Case**: In the instant case, Mr. A is holding appointment in 4 companies, whereas Mr. B is having appointment in 6 Companies and Mr. C is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.

Provisions and Explanations: As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its

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auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

As per section 141 (3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be 3 × 20 = 60 company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

Conclusion:

(i) Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies:

Total Number of Audits available to the Firm = 20*3	=	60
Number of Audits already taken by all the partners		
In their individual capacity = 4+6+10	=	20
Remaining number of Audits available to the Firm	=	40

(ii) With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g)- already holding appointments as an auditor. Hence (1) Mr. A can hold: 20 - 4 = 16 more audits. (2) Mr. B can hold 20-6 = 14 more audits and (3) Mr. C can hold 20-10 = 10 more audits

(b) (i) Investigation into affairs of Company: (1) According to section 210 (1) of the Companies Act, 2013 the Central Government may order an investigation into the affairs of the company, if it is of the opinion that it is necessary to do so:

(a) on the receipt of a report of the Registrar or inspector under section 208;

(b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated;

(c) in public interest.

(2) According to section 210(3) of the Companies Act, 2013, the Central Government may appoint one or more persons as inspectors to investigate into the affairs of the company and to report thereon in such manner as the Central Government may direct.

In the given case, the majority of directors are already of the view that the affairs of the company are not conducted in a manner beneficial either to the company or to the members and want to make an application to the Central Government to appoint an inspector. Therefore, the steps to be carried out for the purpose will be as under:

(a) Convene an Extraordinary General Meeting of members for passing the required special resolution. The provisions for convening the meeting

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should be complied with and the explanatory statement with the notice of the meeting must provide full details of the proposed special resolution.

(b) Once the special resolution is passed, a copy of it along with the copy of the notice should be filed with the Registrar;

(c) An application should be made under section 210 (1) to the Central Government requesting it to appoint an inspector to investigate the affairs of the company.

(d) The Central Government on receipt of such notice will ask for information, documents and other supporting evidence and may order an investigation only if it is of the opinion that an investigation is warranted. It may appoint one or more inspectors to investigate into the affairs of the company and to report thereon in such manner as it may direct.

(ii) In accordance with the provisions of the Banking Regulation Act, 1949 as contained in section 17, every banking company incorporated in India must create a reserve fund and transfer a sum equivalent to not less than 20% of its net profits. However, Central Government is empowered to exempt from this requirement on the recommendation of the RBI. Such exemption will be allowed only:

1 when the amount in the reserve fund and the share premium account are equal to the paid-up share capital of the banking company.

2. when the Central Govt. feels that its paid-up share capital and reserves are adequate to safeguard the interest of the depositors.

If the banking company appropriates any sum from the Reserve Fund or the Share Premium account, it must be reported to RBI within 21 days explaining the circumstances leading to such appropriation.

Therefore, applying the above provisions:

(I) Contention of share holders shall be tenable since the 15%of transfer of profits to Reserve Fund is lower than statutory limits, as provided in the Act.

(II) In the second case the contention of shareholders shall not be tenable, since 30% is more than the minimum statutory limit of 20% of the net profits.

6. (a) (i) As per provisions of section 581 ZH of the Companies Act, 1956, a Producer Company may, by special resolution, make donation or subscription to any institution or individual for the following purposes:-

(a) For promoting the social and economic welfare of Producer Members or Producers or general public; or

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(b) For promoting the mutual assistance principles.

Thus as per the above stated provisions of the Companies Act, 1956, a Producer Company may make a donation by passing a special resolution and for the above mentioned purposes.

The 1st Proviso to the said section 581ZH lays down the monetary limit for making the donation by a Producer Company. According to the said proviso the aggregate amount of all such donation and subscription in any financial year shall not exceed three per cent of the net profit of the Producer Company in the financial year immediately preceding the financial year in which the donation or subscription was made.

Since the net profit of the PQR Company as per its last profit & loss account was Rs. 20.00 lacs, it can make a total donation of Rs. 60,000/- in this year being three percent thereof.

(ii) Power of the Central Government to provide for amalgamation of companies in the public interest: Section 396(1) provides that where in the "Public" interest it appears to the Central Government that amalgamation of two companies is essential, it may, through notification in the Official Gazette, provide for the amalgamation of the two companies into a single company with such constitution, property, powers, rights, interests, authorities and privileges and with such liabilities, duties and obligations as may be specified in the notification.

Every member or creditor (including a debentureholder) of each of the companies before the amalgamation shall have, as nearly as may be, the same interests in or rights against the amalgamated company as he has in the company of which he was originally a member or creditor. If his interests in or rights against the amalgamated company are less than his original interests etc., in the original company, he shall be entitled to receive compensation from the amalgamated company to the extent these have been reduced. [section 396(3)]

The prescribed authority would assess the amount of compensation receivable.

Any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may, within thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Company Law Board and thereupon the assessment of the compensation shall be made by the Company Law Board

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(b) (i) Section 202 of the Companies Act, 2013: Compensation for loss of office – Board Resolution

"*WHEREAS* Mr. NBS was employed for a period of three years as the Managing Director of the company from July 2013 to July 2016. and Whereas the company wanted to dispense with the services of the said Managing Director, and WHEREAS the company has duly served notice to the said Managing Director in terms of clause……… of the agreement between the company and the said Mr. NBS governing his terms and condition as the Managing Director of the company, it is hereby resolved that an amount of Rs…………., be paid to Mr. NBS as compensation for the loss of his office as the Managing Director of the company."

(ii) 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 (1) 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.

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

7. **(a)** It is an unique Identification Number allotted to an individual who is an existing director of a company or intends to be appointed as director of a company pursuant to section 153 and 154 of the Companies Act, 2013.

Director is required to download and fill up eForm DIR-6 for such changes and follow the same process for uploading the same as mentioned for eForm DIR-3. The requested change is taken into the system on verification of the proof enclosed with the application for change request. In the case of change in applicant's name, gazette notification is must with form DIR-6. Married ladies, who are having Id proof with their maiden name, can submit marriage certificate along with application. Verification as per Form DIR-7 of Companies Act, 2013 also needs to be attached to Form DIR-6 as it is a mandatory attachment now.

(b) **Cognizance of offence:** A court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof only on the written complaint of -

(a) The Registrar,

(b) A shareholder of the company, or

(c) Of a person authorised by the Central Government in that behalf.

Provided that the court may take cognizance of offences relating to issue and transfer of securities and non-payment of dividend, on a complaint in writing, by a person authorised by the Securities and Exchange Board of India.

Provided that nothing in this sub-section shall apply to a prosecution by a company of any of its officers.

(c) Section 399 of the Companies Act, 2013 provides for Inspection, production and evidence of documents kept by Registrar. According to this section:

(i) any person may—

(a) inspect by electronic means any documents kept by the Registrar in accordance with the rules made, being documents filed or registered by him in pursuance of this Act, or making a record of any fact required or authorised to be recorded or registered in pursuance of this Act, on payment for each inspection of such fees as may be prescribed;

(b) require a certificate of the incorporation of any company, or a copy or extract of any other document or any part of any other document to be certified by the Registrar, on payment in advance of such fees as may be prescribed:

(ii) The rights conferred as mentioned above shall be exercisable—

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(a) in relation to documents delivered to the Registrar with a prospectus in pursuance of section 26, only during the 14 days beginning with the date of publication of the prospectus; and at other times, only with the permission of the Central Government; and

(b) in relation to documents so delivered in pursuance of clause (b) of subsection(1) of section 388, only during the 14 days beginning with the date of the prospectus; and at other times, only with the permission of the Central Government.

(iii) According to section 399(2) of the Companies Act, 2013, no process for compelling the production of any document kept by the Registrar shall issue from any court except with the leave of that court and any such process, if issued, shall bear thereon a statement that it is issued with the leave of the court.

(d) Measures for assets reconstruction (Section 9)

A securitisation company or reconstruction company may, provide for any one or more of the following measures, for the purposes of asset reconstruction, in accordance with the guidelines framed by the Reserve Bank:-

(i) the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower;

(ii) the sale or lease of a part or whole of the business of the borrower;

(iii) rescheduling of payment of debts payable by the borrower;

(iv) enforcement of security interest in accordance with the provisions of this Act;

(v) settlement of dues payable by the borrower;

(vi) taking possession of secured assets in accordance with the provisions of this Act;

(vii) to convert any portion of debt into shares of a borrower company:

Provided that conversion of any part of debt into shares of a borrower company shall be deemed always to have been valid, as if the provisions of this clause were in force at all material times.

(e) Rule of Exceptional Construction: This rule has several aspects, viz.

(i) *The Common Sense Rule:* Despite the general rule that full effect must be given to every word, if no sensible meaning can be fixed to a word or phrase, or if it would defeat the real object of the enactment, it should be eliminated. The words of a statute must be so construed as to give a sensible meaning to them, if at all possible. They ought to be construed **'utres magis valeat quampereat'** meaning thereby that it is better for a thing to have effect than to be made void.

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(ii) *Conjunctive and Disjunctive Words 'or' 'and':* The word **'or'** is normally disjunctive and **'and'** is normally conjunctive. However, at times they are read as *vice versa* to give effect to the manifest intention of the legislature as disclosed from the context. This would be so where the literal reading of the words produces an unintelligible or absurd result: in such a case 'and' may by read for 'or' and 'or' for 'and' even though the result of so modifying the words is less favourable to the subject, provided that the intention of the legislature is otherwise quite clear.

(iii) *'May', 'must' and 'shall':* Before discussing this aspect, it would be worth while to note the terms **'mandatory'** and **'directory'**. Practically speaking, the distinction between a provision which is **'mandatory'** and one which is **'directory'** is that when it is mandatory, it must be strictly observed; when it is 'directory' it would be sufficient that it is substantially complied with. However, we have to look to the substance and not merely the form: an enactment in mandatory form might substantially be directory and, conversely, a statute in directory form may in substance be mandatory. Hence, it is the substance that counts and must take precedence over mere form. If a provision gives a power coupled with a duty, it is mandatory: whether it is or is not so would depend on such consideration as:

— the nature of the thing empowered to be done,

— the object for which it is done, and

— the person for whose benefit the power is to be exercised.

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