PAPER – 1: FINANCIAL REPORTING

PART – I : RELEVANT AMENDMENTS, NOTIFICATIONS AND ANNOUNCEMENTS

A. Applicable for May, 2015 examination

1. Amendment to Schedule VII to the Companies Act, 2013

The Central Government vide Notification No. G.S.R. 568(E) dated 6th August, 2014, made amendments in Schedule VII to the Companies Act, 2013, wherein it has added "slum area development" as one of the avenue for contribution for CSR.

The term 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.

Further, MCA vide notification no. G.S.R. 741(E) dated 24th October, 2014 has made further amendments to Schedule VII to the Companies Act, 2013 by notifying two more avenues for incurring eligible expenditure under CSR requirements for companies. According to the said notification, the contributions to the "Swach Bharat Kosh set up for the promotion of sanitation" and "contributions to the Clean Ganga Fund set up for rejuvenation of river Ganga" will also be considered as eligible expenditure qualifying for CSR.

2. Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014

SEBI vide Circular No. LAD-NRO/GN/2014-15/16/1729 dated 28th October, 2014 has formulated the SEBI (Share Based Employee Benefits) Regulations, 2014 which replaces the SEBI (Employees Stock Option Plan) Guidelines, 1999. The said Regulations deal with various provisions relating to employee stock option schemes, employee stock purchase schemes, stock appreciation rights schemes, general employee benefits schemes and retirement benefit schemes formulated by listed companies. The regulations deal with definition of eligible employees, formation of compensation committee, shareholders approvals variation of terms of issue, listing, compliances etc. For the complete text of this notification please refer to the link: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1414568485252.pdf

3. Amendment to the Rule 6 of the Companies (Accounts) Rules, 2014

The Central Government vide Notification No. GSR… (E) dated 14th October, 2014, has amended the Companies (Accounts) Rules, 2014 by inserting two provisos in its Rule 6. Rule 6 talks about the manner of consolidation for the companies mandated to prepare the consolidated financial statements under section 129(3) of the Companies Act, 2013.

1. According to the first proviso added therein, an intermediate wholly-owned subsidiary company whose immediate parent is a company incorporated in India

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would not be required to comply with the requirements of the Rule 6 of the Companies (Accounts) Rules, 2014.

However, the intermediate wholly-owned subsidiary company whose immediate parent is a company incorporated outside India is required to comply with the requirements of the Rule 6.

2. According to the second proviso added therein, those companies which do not have any subsidiary but have one or more associates or joint ventures or both, have been exempted from preparing Consolidated Financial Statements for the financial year 2014-15.

4. Schedule III related disclosures made in the stand-alone financial statements not to be repeated in CFS – Clarification

Under the Act, the requirements of Schedule III would apply to preparation of stand-alone financial statements as well as to the preparation of Consolidated Financial Statements.

While AS 21, 'Consolidated Financial Statements', inter alia, provides that certain information required under Schedule III to the Companies Act, 2013 given in the notes to the stand-alone financial statements of the parent and/or the subsidiary, need not be included in the Consolidated Financial Statements.

MCA has resolved the conflict between the accounting standards and the Act by providing a clarification in this regard vide Circular No. 39/2014, dated 14th October, 2014, after consulting with the ICAI.

The clarification mentions that Schedule III of the Act read with the applicable accounting standards does not envisage a company while preparing its Consolidated Financial Statements to repeat the disclosures made by it under the stand-alone financial statements used for consolidation. In the Consolidated Financial Statements, the company would need to give all disclosures relevant to Consolidated Financial Statements only.

5. Amendment to the Companies (Corporate Social Responsibility Policy) Rules, 2014

The Central Government vide Notification No. G.S.R. 644(E) dated 12th September, 2014, has amended sub-rule (6) of Rule 4 of the Companies (Corporate Social Responsibility Policy) Rules, 2014.

Earlier sub-rule (6) of Rule 4 states that Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure shall not exceed five percent of total CSR expenditure of the company in one financial year. This sub rule has now been amended and states that such expenditure will include expenditure on administrative overheads also.

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6. Amendment to Schedule II to the Companies Act, 2013

The Central Government vide Notification No. G.S.R. 627(E) dated 29th August, 2014 has amended Schedule II to the Companies Act, 2013 dealing with the useful lives of assets for calculation of depreciation. The said amendments will be voluntary for companies in respect of financial year commencing on or after 1st April, 2014 and mandatory for financial statements in respect of financial years commencing on or after 1st April, 2015.

7. Clarification on Accounting Standard 10 - Capitalization of Cost

MCA, vide general circular no. 35/2014 dated 27th August, 2014, has received a number of representations seeking clarifications on capitalization of borrowing costs incurred during extended delay in commercial production for reasons beyond the developer's control and whether capitalization of power plant should be unit wise or project wise.

On consultation with the Accounting Standard Board of the ICAI, MCA has clarified that AS 10 'Accounting for Fixed Assets' and AS 16 'Borrowing Costs' prescribe the principles of capitalization of various costs.

According to AS 10, only such expenditure should be capitalized and form part of the cost of the fixed asset which increase the worth of the asset. Cost incurred during extended delay in commencement of commercial production after the plant is otherwise ready does not increase the worth of the fixed assets. Therefore, such cost cannot be capitalized.

AS 16, inter alia provides guidance with regard to capitalization where some units of a project are complete and ready for commercial production while construction continues for the other units. In such a case, cost should be capitalized in relation to that part once the part is ready for commercial production.

MCA further clarified that AS 10 and AS 16 are applicable irrespective of whether the power projects are 'Cost Plus Projects' or 'Competitive Bid Projects'.

8. Insertion of Paragraph 46 for Entities Other than Companies

In line with para 46 inserted by the MCA for corporate entities, the Council of the ICAI has also inserted Paragraph 46 in AS 11 for Entities other than Companies in the month of February, 2014, which is as follows:

46(1) In respect of accounting periods commencing on or after 7th December, 2006 (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference

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Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset or liability, by recognition as income or expense in each of such periods, with the exception of exchange differences dealt with in accordance with the provisions of paragraph 15.

(2) To exercise the option referred to in sub-paragraph (1), an asset or liability shall be designated as a long-term foreign currency monetary item, if the asset or liability is expressed in a foreign currency and has a term of twelve months or more at the date of origination of the asset or the liability:

Provided that the option exercised by the enterprise should disclose the fact of such option and of the amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized."

9. Modification of Guidelines on Mortgage Guarantee Companies (MGCs)

In the wake of representations received from the industry and keeping in view the long – term beneficial impact of development of the Mortgage Guarantee industry, RBI vide Notification No. RBI/2014-15/170 DNBS (PD) CC. No.20/MGC/03.011.001/2014-15, dated August 08, 2014, has decided to make certain modifications to the existing Guidelines on Mortgage Guarantee Companies (MGCs) as under:

(a) *Capital Adequacy:* While calculating the capital adequacy of the MGC, the mortgage guarantees provided by the MGCs may be treated as Contingent Liabilities and the credit conversion factor applicable to these Contingent Liabilities will be fifty percent as against the present applicable credit conversion factor of hundred percent.

(b) *Contingency Reserve*

i. If provision made towards losses exceed 35% of the premium or fee earned during a financial year, the Contingency Reserves could go to a minimum of 24% of the premium or fee earned, such that the aggregate of Provisions made towards Losses and Contingency Reserves is at least 60% of the premium or fee earned during a financial year.

ii. A MGC can utilize the Contingency Reserves without the prior approval of RBI for the purpose of meeting and making good the losses suffered by the mortgage guarantee holders. Such a measure can be initiated only after exhausting all other avenues and options to recoup the losses.

(c) *Classification on Investments*: It has now been decided that investments made by MGCs towards Government securities, quoted or otherwise, government guaranteed securities and bonds not exceeding the MGC's capital may be treated as "Held To Maturity (HTM)" for the purpose of valuation and accounted for accordingly. Investment classified under HTM need not be marked to market and will be carried at acquisition cost, unless it is more than the face value, in which case the premium should be amortised over the period remaining to maturity. The

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book value of the security should continue to be reduced to the extent of the amount amortised during the relevant accounting period. However, if any security out of this HTM category is traded before maturity, the entire lot will be treated as securities held for trade and will have to be marked to market.

(d) *Provision for Loss on invoked Guarantees*: In case the provisions already held for loss on invoked guarantees are in excess of the contract wise aggregate of 'amount of invocation' (after adjusting the realizable value of the assets held by the company in respect of each housing loan), the excess may be reversed. However, the reversal can be done only after full recovery /closure of the invoked guarantee amount or after the account becomes standard.

10. Relevant Section of the Companies Act, 2013

The relevant Sections of the Companies Act, 2013 notified up to 30th September 2014 are applicable for May, 2015 Examination.

11. Schedule III to the Companies Act, 2013

Students may note that Schedule III to the Companies Act, 2013 gives general instructions for preparation of balance sheet and statement of profit and loss of a company. Schedule III to the Companies Act, 2013, also contains general instructions for preparation of consolidated financial statements, at its end in addition to Part I - Balance Sheet and Part II - Statement of Profit and Loss. Students are advised to go through complete Schedule III to the Companies Act, 2013 carefully for preparation of financial statements of companies including consolidated financial statements.

Students may refer Schedule III to the Companies Act, 2013 on the Institute's website www.icai.org>>Students>>Bos knowledge portal>>Final Course>>Paper 1 Financial Reporting>>Additional Reading Material>>Schedule III to the Companies Act, 2013.

12. Buy Back of Securities (Amendment) Regulations, 2013

In exercise of the powers conferred under section 30 of the Securities and Exchange Board of India Act, 1992, SEBI made Securities and Exchange Board of India (Buy-back of Securities) (Amendment) Regulations, 2013 to amend the Securities and Exchange Board of India (Buy back of Securities) Regulations, 1998.

The important provisions of the new regulations (applicable for listed companies) are:

(i) No offer of buy-back for fifteen per cent or more of the paid up capital and free reserves of the company shall be made from the open market.

(ii) A company shall not make any offer of buyback within a period of one year reckoned from the date of closure of the preceding offer of buy-back, if any.

(iii) The company shall ensure that at least fifty per cent of the amount earmarked for buy-back is utilized for buying back shares or other specified securities.

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These new regulations can be downloaded from the link http://203.199.247.102/cms/sebi_data/ attachdocs/1375961931576.pdf

B. Not applicable for May, 2015 examination

Ind ASs issued by the Ministry of Corporate Affairs

To bring Indian standards at par with the IAS/IFRS, some of the earlier Accounting Standards and Guidance Notes have been revised or are under the process of revision. However, at present, the Accounting Standard Board in consultation with the Ministry of Corporate Affairs (MCA) for convergence of Indian Accounting Standards with International Financial Reporting Standards (IFRS), has placed on its website 35 Ind ASs which are in actual issued in correspondence to IFRS with certain carve outs. This was done in the year 2011. Earlier the government of India planned to implement the Ind ASs to various corporate in the phase manner. However, due to certain implementation issues like the requirements of various laws and Act prevailing in India which were not in consonance with the Ind AS, the implementation of Ind AS get was deferred.

At that time it was also decided that there will be two separate sets of Accounting Standards viz. (i) Indian Accounting Standards converged with the IFRS – standards which are being converged by eliminating the differences of the Indian Accounting Standards vis-à-vis IFRS (known as Ind AS) and (ii) Existing Notified Accounting Standards.

The Ind ASs have been prepared by National Advisory Committee on Accounting Standards (NACAS) and with its recommendation submitted to Ministry of Corporate Affairs (MCA). The final recommended Ind ASs (as on 2011) have certain carve outs. The carve outs have been made to fill up the gap/differences in application of Accounting Principles Practices and economic conditions prevailing in India**.**

A. Carve-outs which are due to differences in application of accounting principles and practices and economic conditions prevailing in India.

1. Ind AS 21: The Effects of Changes in Foreign Exchange Rates

It requires recognition of exchange differences arising on translation of monetary items from foreign currency to functional currency directly in profit or loss.

Carve out

Ind AS 21 permits an option to recognise exchange differences arising on translation of certain long-term monetary items from foreign currency to functional currency directly in equity. In this situation, Ind AS 21 requires the accumulated exchange differences to be amortised to profit or loss in an appropriate manner.

Note: ICAI has proposed the removal of this carve out on the ground that as per IFRS 9, only those exposures can qualify for hedge accounting which have impact on the statement of profit and loss. Where an entity follows the option by not recognising the gains and losses on foreign exchange fluctuations in profit or loss

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but directly in equity, such an entity would not be able to use hedge accounting as per IFRS 9. It was felt that, in any case, the option is conceptually inappropriate as the entity is able to defer the gains/losses arising from foreign exchange risks. At present, the said proposal is under consideration of the MCA.

2. Ind AS 28: Investment in Associates

1. Paragraph 25 require that difference between the reporting period of an associate and that of the investor should not be more than three months, in any case.

Carve out

The phrase 'unless it is impracticable' has been added in the relevant requirement i.e., paragraph 25 of Ind AS 28.

2. IAS 28 requires that for the purpose of applying equity method of accounting in the preparation of investor's financial statements, uniform accounting policies should be used. In other words, if the associate's accounting policies are different from those of the investor, the investor should change the financial statements of the associate by using same accounting policies.

Carve out

The phrase, 'unless impracticable to do so' has been added in the relevant requirements i.e., paragraph 26 of Ind AS 28.

Note: The ICAI proposed the removal of this carve-out on the ground that impracticability to obtain financial statements prepared in accordance with the uniform accounting policies of the investor and as on the date on which the financial statements of the investor are drawn (except the time gap permitted by the standard) may be considered as the investor may not have significant influence over the investee. In other words, in such a case, it may be difficult to establish that the investor is having significant influence over the investee and, therefore, investee may not be regarded as an associate of the investor. Accordingly, the ICAI is of the view that term 'unless impracticable' should be deleted. At present, the said proposal is under consideration of the MCA.

3. Ind AS 32- Financial Instruments in Presentation Part

A Carve out is an exception has been included to the definition of 'financial liability' in paragraph 11 (b) (ii), Ind AS 32 to consider the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of entity's own equity instruments as an equity instrument if the exercise price is fixed in any currency. This exception is not provided in IAS 32.

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4. Ind AS 39- Financial Instruments: Recognition and Measurement

IAS 39 requires all changes in fair values in case of financial liabilities designated at fair value through Profit and Loss at initial recognition shall be recognised in profit or loss. IFRS 9 which will replace IAS 39 requires these to be recognised in 'other comprehensive income'

Carve out

A proviso has been added to paragraph 48 of Ind AS 39 that in determining the fair value of the financial liabilities which upon initial recognition are designated at fair value through profit or loss, any change in fair value consequent to changes in the entity's own credit risk shall be ignored.

5. Ind AS 103, Business Combinations

IFRS 3 requires bargain purchase gain arising on business combination to be recognised in profit or loss.

Carve out

Ind AS 103 requires the same to be recognised in other comprehensive income and accumulated in equity as capital reserve, unless there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, in which case, it shall be recognised directly in equity as capital reserve.

6. Ind AS 101, First-time Adoption of Indian Accounting Standards

(i) Presentation of comparatives in the First-time Adoption of Indian Accounting Standards (Ind AS) 101 (corresponding to IFRS 1)

IFRS 1 defines transitional date as beginning of the earliest period for which an entity presents full comparative information under IFRS. It is this date which is the starting point for IFRS and it is on this date the cumulative impact of transition is recorded based on assessment of conditions at that date by applying the standards retrospectively except to the extent specifically provided in this standard as optional exemptions and mandatory exceptions. Accordingly, the comparatives, i.e., the previous year figures are also presented in the first financial statements prepared under IFRS on the basis of IFRS.

Carve out

Ind AS 101, requires an entity to provide comparatives as per the existing notified Accounting Standards. It is provided that, in addition to aforesaid comparatives, an entity may also provide comparatives as per Ind AS on a memorandum basis.

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(ii) Presentation of reconciliation

IFRS 1 requires reconciliations for opening equity, total comprehensive income, cash flow statement and closing equity for the comparative period to explain the transition to IFRS from previous GAAP.

Carve out

Ind AS 101 provides an option to provide a comparative period financial statements on memorandum basis. Where the entities do not exercise this option and, therefore, do not provide comparatives, they need not provide reconciliation for total comprehensive income, cash flow statement and closing equity in the first year of transition but are expected to disclose significant differences pertaining to total comprehensive income. Entities that provide comparatives would have to provide reconciliations which are similar to IFRS.

(iii) Cost of Non-current Assets Held for Sale and Discontinued Operations on the date of transition on First-time Adoption of Indian Accounting Standards (Ind AS)

Carve out

Ind AS 101 provides transitional relief that while applying Ind AS 105 - Non-current Assets Held for Sale and Discontinued Operations, an entity may use the transitional date circumstances to measure such assets or operations at the lower of carrying value and fair value less cost to sell.

(iv) Foreign currency gains/losses on translation of long term monetary items

Carve out

Ind AS 101 provides that on the date of transition, if there are long-term monetary assets or long-term monetary liabilities mentioned in paragraph 29A of Ind AS 21, an entity may exercise the option mentioned in that paragraph regarding spreading over the unrealised Gains/Losses over the life of Assets/Liabilities either retrospectively or prospectively. If this option is exercised prospectively, the accumulated exchange differences in respect of those items are deemed to be zero on the date of transition.

(v) Financial instruments existing on transition date

Carve out

Ind AS 101 provides that the financial instruments carried at amortised cost should be measured in accordance with Ind AS 39 from the date of recognition of financial instruments unless it is impracticable (as defined in Ind AS 8) for an entity to apply retrospectively the effective interest method or the impairment requirements of Ind AS 39. If it is impracticable to do so then the fair value of the financial asset at the date of transition to Ind-ASs shall be the new amortised cost of that financial asset at the date of transition to Ind ASs. Ind

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AS 101 provides another exemption that financial instruments measured at fair value shall be measured at fair value as on the date of transition to Ind AS.

(vi) Definition of previous GAAP under Ind AS 101 First time Adoption of Indian Accounting Standards

IFRS 1 defines previous GAAP as the basis of accounting that a first-time adopter used immediately before adopting IFRS.

Carve out

Ind AS 101 defines previous GAAP as the basis of accounting that a **first-time adopter** used immediately before adopting Ind ASs for its reporting requirements in India. For instance, for companies preparing their financial statements in accordance with the existing Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006 shall consider those financial statements as previous GAAP financial statements.

(vii) Cost of Property, Plant and Equipment (PPE), Intangible Assets, Investment Property, on the date of transition of First-time Adoption of Indian Accounting Standards.

Ind AS 101 provides an entity an option to use carrying values of all assets as on the date of transition in accordance with previous GAAP as an acceptable starting point under Ind AS.

B. Carve-outs for specific industries

7. Ind AS 18-Revenue

On the basis of principles of the IAS 18, IFRIC 15 on Agreement for Construction of Real Estate, prescribes that construction of real estate should be treated as sale of goods and revenue should be recognised when the entity has transferred significant risks and rewards of ownership and has retained neither continuing managerial involvement nor effective control.

Carve out

IFRIC 15 has not been included in Ind AS 18, Revenue. Such agreements have been scoped out from Ind AS 18 and have been included in Ind AS 11, Construction Contracts.

8. Ind AS 18- Revenue

Carve out

A footnote has been added in paragraph 1 to Ind AS 18, Revenue, that for rate regulated entities, this standard shall stand modified, where and to the extent the recognition and measurement of revenue of such entities is affected by recognition and measurement of regulatory assets/liabilities as per the Guidance Note on the subject being issued by the Institute of Chartered Accountants of India.

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9. **Ind AS 19 Employee Benefits vis-à-vis IFRSs/IASs restricting options**

According to Ind AS 19 the rate to be used to discount post-employment benefit obligation shall be determined by reference to the market yields on government bonds, whereas under IAS 19, the government bonds can be used only where there is no deep market of high quality corporate bonds. To illustrate treatment of gratuity subject to ceiling under Indian Gratuity Rules, an example has been added in Ind AS 19. IAS 19 permits various options for treatment of actuarial gains and losses for post employment defined benefit plans whereas Ind AS 19 requires recognition of the same in other comprehensive income, both for post-employment defined benefit plans and other long-term employment benefit plans. The actuarial gains recognised in other comprehensive income should be recognised immediately in retained earnings and should not be reclassified to profit or loss in a subsequent period.

In a significant step towards convergence of Indian accounting standards with the IFRS, the Ministry of Corporate Affairs (MCA) on January 2, 2015 announced a roadmap for adoption of Indian Accounting Standards (Ind AS) which is closely aligned with the International Financial Reporting Standards (IFRS), as issued by International Accounting Standards Board (IASB).

In pursuance of the Budget statement, the Ministry of Corporate Affairs, Government of India after wide consultations with various stakeholders and regulators, on January 2, 2015 has announced a revised Road Map for companies other than Banking Companies, Insurance Companies and Non-Banking Finance Companies (NBFCs) for implementation of Indian Accounting Standards (Ind AS) converged with the International Financial Reporting Standards (IFRS).

According to it, the Indian Accounting Standards (Ind ASs) shall be applicable to the companies as follows:

(i) On voluntary basis for financial statements for accounting periods beginning on or after April 1, 2015, with the comparatives for the periods ending 31st March, 2015 or thereafter;

(ii) On mandatory basis for the accounting periods beginning on or after April 1, 2016, with comparatives for the periods ending 31st March, 2016, or thereafter, for the companies specified below:

   (a) Companies whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having net worth of ₹ 500 Crore or more.

   (b) Companies other than those covered in (ii) (a) above, having net worth of ₹ 500 Crore or more.

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(c) Holding, subsidiary, joint venture or associate companies of companies covered under (ii) (a) and (ii) (b) above.

(iii) On mandatory basis for the accounting periods beginning on or after April 1, 2017, with comparatives for the periods ending 31st March, 2017, or thereafter, for the companies specified below:

(a) Companies whose equity and/or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than rupees 500 Crore.

(b) Companies other than those covered in paragraph (ii) and paragraph (iii)(a) above that is unlisted companies having net worth of rupees 250 crore or more but less than rupees 500 Crore.

(c) Holding, subsidiary, joint venture or associate companies of companies covered under paragraph (iii) (a) and (iii) (b) above.

However, Companies whose securities are listed or in the process of listing on SME exchanges shall not be required to apply Ind AS. Such companies shall continue to comply with the existing Accounting Standards unless they choose otherwise.

(iv) Once a company opts to follow the Indian Accounting Standards (Ind AS), it shall be required to follow the Ind AS for all the subsequent financial statements.

(v) Companies not covered by the above roadmap shall continue to apply existing Accounting Standards prescribed in Annexure to the Companies (Accounting Standards) Rules, 2006.

The issuance of Ind AS is a significant step towards the implementation of converged standards in India. **However, Ind ASs are not made applicable for May, 2015 examination.**

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

AS 2

1. (a) Hema Ltd. is in the business of manufacturing computers. During the year ended 31st March, 2015 the company manufactured 550 computers, it has the policy of valuing finished stock of goods at a standard cost of ₹ 1.8 lakhs per computer. The details of the cost are as under:

	(₹ in lakhs)
Raw material consumed	400
Direct Labour	250
Variable production overheads	150
Fixed production overheads (including interest of ₹ 100 lakhs)	290

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Compute the value of cost per computer for the purpose of closing stock and also comment on the policy of valuation of inventory adopted by Hema Ltd.

AS 3

(b) A Finance House Ltd. purchased commercial paper (CP) of ₹ 100 crores on 28th February, 2015 for 89 days maturity. There is a ready market for sale/purchase of commercial paper. While preparing cash flow statement for the financial year ended on 31.3.2015, Finance House Ltd. showed CP of ₹ 100 crores under Investing Activities.

AS 5

2. (a) At March 31, 2015, High Ltd. was holding long-lived assets, which it intended to sell. The company appropriately recognized a loss in 2014-15 related to these assets. State whether on High Ltd.'s Income Statement for the year ended March 31, 2015, this loss should be reported as

   (a) An extraordinary item.

   (b) A component of income from continuing operations before income-taxes to be disclosed separately.

   (c) A separate component of selling or general and administrative expenses, disclosed net of tax benefit.

   (d) A component of gain (loss) from sale of discontinued operations, disclosed net of income-taxes.

AS 6

(b) In the books of Optic Fiber Ltd., plant and machinery stood at ₹ 6,32,000 on 1.4.2014. However, on scrutiny it was found that machinery worth ₹ 1,20,000 was included in the purchases on 1.6.2014. On 30.6.2014 the company disposed a machine having book value of ₹ 1,89,000 on 1.4.2014 at ₹ 1,75,000 in part exchange of a new machine costing ₹ 2,56,000. The company charges depreciation @ 20% WDV on plant and machinery.

   You are required to calculate:

   (i) Depreciation to be charged to the Profit and Loss Account.

   (ii) Book value of Plant and Machinery A/c as on 31.3.2015.

   (iii) Loss on exchange of machinery.

AS 7

3. (a) Vatika Ltd. has undertaken bridge construction contract wherein, bridge will be constructed in 3 years. The details of the contracts are as follows:

   (i) Initial contract revenue ₹ 900 crores

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(ii) Initial contract cost ₹ 800 crores

	Years		
	I	II	III
	₹ in crores	₹ in crores	₹ in crores
Estimated contract cost	805		
Increase in contract revenue	-	20	
Estimated additional increase cost	-	15	
Contract cost incurred upto	161	584	820

At the end of year II cost incurred includes ₹ 10 crores, for material stored at the sites to be used in year III to complete the project.

State the amount of revenue, expenses and profit to be recognized in the Statement of Profit and Loss in these three years.

AS 9

(b) When will the revenue be recognized in the case of inter divisional transfers?

(c) Sarita Publications publishes a monthly magazine on the 15th of every month. It sells advertising space in the magazine to advertisers on the terms of 80% sale value payable in advance and the balance within 30 days of the release of the publication. The sale of space for the March 2015 issue was made in February 2015. The magazine was published on its scheduled date. It received ₹ 2,40,000 on 10.3.2015 and ₹ 60,000 on 10.4.2015 for the March 2015 issue.

Discuss in the context of AS 9 the amount of revenue to be recognized and the treatment of the amount received from advertisers for the year ending 31.3.2015. What will be the treatment if the publication is delayed till 2.4.2015?

AS 10

4. (a) On 1.4.2015, Orbit Ltd. had sold some of its fixed assets for ₹ 100 lakhs whose written down value was ₹ 250 lakhs. These assets were revalued earlier. As on 1.4.2015, the revaluation reserve corresponding to these assets stood at ₹ 200 lakhs. The profit on sale of property ₹ 200 lakhs shown in the profit and loss statement presented the transfer of this amount. Loss on sale of asset was included in cost of goods sold. Comment on the above accounting treatment done by Orbit Ltd. in light of the relevant accounting standards.

AS 11

(b) Path Ltd. purchased a fixed asset for US $ 50 lakhs on 01.04.2014 and the same was fully financed by the foreign currency loan [i.e. US $] repayment in five equal instalments annually. (Exchange rate at the time of purchase was 1 US $=₹ 60].

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As on 31.03.2015 the first instalment was paid when 1 US $ fetched ₹ 62.00. The entire loss on exchange was included in cost of goods sold. Path Ltd. normally provides depreciation on fixed assets at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss and its treatment and depreciation.

AS 12

5. (a) Power Ltd. has acquired a generator on 1.4.2013 for ₹ 100 lakhs. On 2.4.2013, it applied to Indian Renewal Energy Development Authority (IREDA) for a subsidy. The subsidy was granted in June, 2014 after the accounts for 2013-14 were finalized. The company has not accounted for the subsidy for the year ended 31.3.2014.

State

(i) Is this a prior period item?

(ii) How should the subsidy be accounted in the accounting year 2014-15?

(iii) Would your opinion differ, if the sanction letter for subsidy was received in June 2014 before the accounts for 2013-14 were approved by the Board of Directors?

(iv) Would your opinion differ had the company made many similar applications in the past and on all occasions, it has received the subsidy applied for?

AS 13

(b) A company is engaged in the business of refining, transportation and marketing of petroleum products. During the financial year ended March 31st, 2015, the company acquired controlling interest from Government of India in another public sector undertaking @ ₹ 1,551 per share as against the book value of ₹ 192.58 per share and market value of ₹ 876 per share as on February 18, 2015.

Thus the strategic premium of ₹ 675 per share has been paid considering various tangible and intangible factors.

The above investment in the shares of the acquired company has been considered as long term strategic investment and, therefore, has been accounted for at cost, i.e. at ₹ 1,551 per share in the financial statements. No provision for diminution in value has been made in the books of account.

As per the requirement of Schedule III to the Companies Act, 2013, the aggregate market value of the quoted shares has been properly reflected in the financial statements.

On March 28, 2015, the acquired shares were quoted at ₹ 880 per share on BSE and the current market price as on July 18 was around ₹ 300.

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Considering the tangible and intangible benefits the Management is of the view that there is no permanent diminution in the value of the strategic investment in the acquired company, as the same has been considered as a long-term investment. Therefore, there is no need for provision for diminution in the value of the shares of the acquired company.

Required:

(i) Whether the accounting treatment 'at cost' under the head 'Long Term Investments' without providing for any diminution in value is correct and in accordance with the provisions of AS 13.

(ii) If not, what should have been the accounting treatment in such a situation particularly considering the fact that there is no material change in circumstances and strength of the acquired company which further supported the expected benefits from such synergy? Whether the reduction in market value should be considered in isolation for ascertaining the value of such investment or not? What methodology should be adopted for ascertaining the provision for diminution in the value of investment, if any?

(iii) If any provision for diminution in the value is to be made, whether such provision should be charged to the profit and loss account or whether same can be considered as deferred expenditure and amortised over a period of 5 years. Whether it is open for the company to charge off such diminution in the value in the books of account instead of creating provision.

(iv) Whether the premium paid for strategic benefits for investment described in facts of the case, can be accounted for separately in the books of account keeping in view that AS 13 specifies that long term investments should be recorded at cost and there is no specific provision in the standard in respect of accounting for premium paid for strategic benefits.

AS 16

6. (a) A company capitalizes interest cost of holding investments and adds to cost of investment every year, thereby understating interest cost in profit and loss account. State whether the accounting done by the company is usual or not?

AS 17

(b) Whether interest expense relating to overdrafts and other operating liabilities identified to a particular segment should be included in the segment expense or not?

In case interest is included as a part of the cost of inventories where it is so required as per AS 16, read with AS 2 and those inventories are part of segment assets of a particular segment, state whether such interest would be considered as a segment expense.

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AS 18

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

How would you assess the situation from the view point of AS 18 on 'Related Party Disclosures'?

AS 19

(b) A machine having expected useful life of 6 years, is leased for 4 years. Both the cost and the fair value of the machinery are ₹ 7,00,000. The amount will be paid in 4 equal instalments and at the termination of lease, lessor will get back the machinery. The unguaranteed residual value at the end of the 4th year is ₹ 70,000. The IRR of the investment is 10%. The present value of annuity factor of ₹ 1 due at the end of 4th year at 10% IRR is 3.169. The present value of ₹ 1 due at the end of 4th year at 10% rate of interest is 0.683.

State with reasons whether the lease constitutes finance lease and also compute the unearned finance income.

AS 20

8. (a) In the following list of shares issued, for the purpose of calculation of weighted average number of shares, from which date weight is to be considered:

(i) Equity Shares issued in exchange of cash,

(ii) Equity Shares issued as a result of conversion of a debt instrument,

(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise,

(iv) Equity Shares issued for rendering of services to the enterprise,

(v) Equity Shares issued in lieu of interest and/or principal of an other financial instrument,

(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash.

Also define Potential Equity Share.

AS 24

(b) Qu Ltd. is in the business of manufacture of Passenger cars and commercial vehicles. The company is working on a strategic plan to shift from the Passenger car segment over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its plan it will reduce the production of passenger cars by 20% annually. It also plans to commence another

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new factory for the manufacture of commercial vehicles plus transfer of employees in a phased manner.

(i) You are required to comment if mere gradual phasing out in itself can be considered as a 'Discontinuing Operation' within the meaning of AS 24.

(ii) If the company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS 24 ?

(iii) Would your answer to the above be different if the company resolves to sell the assets of the Passenger Car Division in a phased but time bound manner?

AS 25

9. (a) On 30.6.2014, X Limited incurred ₹ 3,00,000 net loss from disposal of a business segment. Also on 31.7.2014, the company paid ₹ 80,000 for property taxes assessed for the calendar year 2014. How should the above transactions be included in determination of net income of X Limited for the six months interim period ended on 30.9.2014?

AS 28

(b) A significant raw material used for plant Y's final production is an intermediate product bought from plant X of the same enterprise. X's products are sold to Y at a transfer price that passes all margins to X. 80% of Y's final production is sold to customers outside the reporting enterprise. 60% of X's final production is sold to Y and the remaining 40% is sold to customers outside the reporting enterprise.

For each of the following cases, what are the cash-generating units for X and Y?

Case 1: X could sell the products it sells to Y in an active market. Internal transfer prices are higher than market prices.

Case 2: There is no active market for the products X sells to Y.

AS 29

10. (a) WZW Ltd. is in dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 1000 Lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the Annual Accounts of the company?

Guidance Note

(b) Futura Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 2015:

	Amount ₹ in lakhs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

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The company had an accumulated loss of ₹ 250 lakhs on the same date, which it has disclosed under the head "Statement of Profit and Loss" as an asset in its Balance Sheet. Comment on accuracy of this treatment in line with Schedule III to the Companies Act, 2013.

IFRS vis a vis AS applicable in India

11. (a) Explain the treatment of the following items with reference to Existing Accounting Standards (as applicable in India) vis-a-vis IFRS:

    (1) Consolidated Financial Statements

    (2) Joint Arrangements

    (b) Who are the beneficiaries of convergence with IFRS in India?

Corporate Financial Reporting

(c) Explain the role of SEBI with respect to Corporate Financial Reporting.

Accounting for Corporate Restructuring – Business Acquisition

12. AB Ltd. and CD Ltd. two private companies, decide to amalgamate their business into a new holding company EF Ltd., which was incorporated on 1st August, 2014 with an authorised capital of ₹ 40,00,000 in equity shares of ₹ 10 each. The new company plans to commence operations on 1st October, 2014.

    From the information given below, and assuming that all transactions are completed by 31st March, 2015, you are required to:

    (a) Prepare Projected Statement of Profit & Loss of EF Ltd. for the six months ending 31st March, 2015.

    (b) Prepare Projected Balance Sheet of EF Ltd. as on 31st March, 2015.

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

    Information

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

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

    The following information is relevant:

	AB Ltd. (₹)	*CD Ltd. (₹)*
Equity Shares of ₹ 10 each fully paid	10,00,000	4,00,000
8% Cumulative Preference shares		1,00,000

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10% Debentures	2,00,000	
Future annual maintainable pre tax profits (before interest/dividend)	2,30,000	1,12,000
Price Earnings Ratio	10 times	8 times

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

(4) It is expected that the Group profits of the new company in 2014-15 will be at least ₹ 4,50,000 but that will be required as additional working capital to facilitate expansion. Accordingly it is planned to make a further issue of 37,500 Equity shares to the public for cash at a premium of 30% on 1st February, 2015. The new shares will not rank for interest/dividend to be paid on 31st March, 2015.

(5) Out of the proceeds of the right issue EF Ltd. will advance ₹ 2,50,000 to AB Ltd. and ₹ 2,00,000 to CD Ltd. on 1st February, 2015 for working capital. These advances will carry interest @ 15% p.a. to be paid monthly.

(6) Preliminary Expenses are estimated at ₹ 8,000 and Administrative Expenses for the half-year ended 31st March, 2015 at ₹ 16,000 but this expenditure will be covered by temporary overdraft facility. It is estimated that Interest on Bank Overdraft cost will be ₹ 1,600 in the first six months.

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

(8) On 31st March, 2015, Interim Dividends on Equity Shares, will be paid by AB Ltd. @ 5%, by CD Ltd. @ 4.4% and by EF Ltd. @ 4%.

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

Consolidated Financial Statements

13. A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.2008 at cost of ₹ 10,00,000 when B Ltd. had an equity share capital of ₹ 10,00,000 and reserves and surplus of ₹ 80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of ₹ 2,50,000, ₹ 4,00,000, ₹ 5,00,000 and ₹ 1,20,000 respectively. Thereafter in 2012-13, B Ltd. experienced turnaround and registered an annual profit of ₹ 50,000. In the next two years i.e. 2013-14 and 2014-15, B Ltd. recorded annual profits of ₹ 1,00,000 and ₹ 1,50,000 respectively. Show the minority interests and cost of control at the end of each year for the purpose of consolidation.

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Consolidated Financial Statements of Subsidiary, Associate and Joint Venture Companies

14. The following information relates to the results of the parent and subsidiary (jointly) and the investment in associate and joint venture:

Summarised Balance Sheet as at 31.3.2015

	Holding and subsidiary	*Associate*	*Joint Venture*
Called up equity shares of ₹ 1 each	1,00,000	40,000	10,000
General reserve	40,000		-
Profit and loss account	37,000	27,000	83,000
Minority Interest	20,000	-	-
Creditors	20,000	32,000	6,000
Provision for tax	9,000	11,000	7,000
Proposed dividend	10,000	-	4,000
	2,36,000	1,10,000	1,10,000
Fixed assets	1,95,000	74,000	41,000
Investments:			
8,000 shares in Associate	15,000	-	-
5,000 shares in Joint Venture	5,000	-	-
Current assets	21,000	36,000	69,000
	2,36,000	1,10,000	1,10,000

Profit and Loss account for the year ended 31.3.2015

	Holding and subsidiary	*Associate*	*Joint venture*
Turnover	3,00,000	4,00,000	2,00,000
Less: Cost of sales	(2,14,000)	(2,80,000)	(1,40,000)
Gross profit	86,000	1,20,000	60,000
Less: Administration expenses	(53,200)	(90,000)	(20,000)
Operating profit	32,800	30,000	40,000
Less: Exceptional charge	(5,400)	(3,000)	(1,000)
Add: Dividends from Associate	1,600		
Dividends from Joint venture	5,000		

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Profit before taxation	34,000	27,000	39,000
Less: Tax	(7,000)	(8,000)	(6,000)
Profit after taxation	27,000	19,000	33,000
Less: Minority interest	(2,000)	-	-
Dividend paid	-	(8,000)	(6,000)
Dividend proposed	(10,000)	-	(4,000)
Retained profit for the year	15,000	11,000	23,000
Add: Retained profit brought forward	22,000	16,000	60,000
Retained profit carried forward	37,000	27,000	83,000

You are given the following additional information:

(a) The parent company purchased its investment in the associate two years ago when the balance on the profit and loss account was ₹ 17,000. The useful life of the goodwill is estimated at ten years and there are no signs of impairment of the goodwill.

(b) The parent company entered into a joint venture to access a lucrative market in the former East Germany. It set up a company two years ago and has 50 per cent of the voting rights of the company set up for this joint venture.

Prepare the consolidated balance sheet and profit and loss account for the Group for the year ended 31.3.2015.

Financial Instruments

15. Friendly Ltd. granted ₹ 100 lakhs as loan to its employees on 1st January, 2014 at a concessional rate of interest of 4 per cent per annum on the condition that the loan is to be repaid in five equal annual instalments along with interest thereon. You are informed that the prevailing lending rate for such risk profiles is 10% p.a. You are required to find out at what value the loan should be recognized initially and the amount of annual amortization till closure thereof. Show Journal Entries with appropriate narrations that will be recorded in the company's books in the year 2014.

    [Present value of an Indian Rupee at a discount rate of 10 per cent per annum for 5 years will be .9090, .8263, .7512, .6829 and .6208 which is to be adopted for the purpose of calculation].

Share Based Payments

16. Kush Ltd. announced a Share Based Payment Plan for its employees who have completed 3 years of continuous service, on 1st April, 2010. The plan is subject to a 3 years vesting period. The following information is supplied to you in this regard:

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

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

(iii) The current fair value of the shares at (ii) above is ₹ 60 and that in respect of freely tradeable shares is higher by 20%.

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

	Year 2010-11	Year 2011-12	Year 2012-13
% of Increase	6	10	15

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

(I) Employee Compensation Account,

(II) Provision for Liability Component Account,

(III) ESOP Outstanding Account.

Mutual Fund

17. (a) On 1.4.2014, a mutual fund scheme had an outstanding of 18 lakhs units of face value of ₹ 10 each. The scheme earned ₹ 162 lakhs in 2014-15, out of which ₹ 90 lakhs was earned in the first half of the year. On 30.9.2014, 2 lakh units were sold at a "NAV" of ₹ 70.

Pass Journal entries for sale of units and distribution of dividend at the end of 2014-15.

NBFC

(b) While closing its books of account on 31st March, 2015 a non-banking finance company has its advances classified as follows:

Particulars	*₹ in lakhs*
Standard Assets	16,800
Sub-Standard Assets	1,340
Secured portion of doubtful debts:	
- Upto one year	320
- One year to three years	90
- More than three years	30

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Unsecured portion of doubtful debts	97
Loss Assets	48

Calculate the amount of provision, which must be made against the advances.

Valuation of Shares

18. Yogesh Ltd. showed the following performance over 5 years ended 31st March, 2015:

Year Ended on 31st March	**Net profit before tax*		*Prior period adjustment*	*Remarks*
	₹		₹	
2011	4,00,000	(–)	1,00,000	Relating to 2009-10
2012	3,50,000	(–)	2,50,000	Relating equally to 2009-10 and 2010-11
2013	6,50,000	(+)	1,50,000	Relating to 2011-12
2014	5,50,000	(–)	1,75,000	Relating to 2011-12
2015	6,00,000	(–)	1,00,000	Relating to 2011-12
		(+)	25,000	Relating to 2013-14

*Net profit before tax is after debiting or crediting the figures of loss (–) or gains (+) mentioned under the columns for prior period adjustments.

The net worth of the business as per the balance sheet of 31st March, 2010 is ₹ 6,00,000 backed by 10,000 fully paid equity shares of ₹ 10 each. Reserves and surplus constitute the balance net worth. Yogesh Ltd. has not declared any dividend till date.

You are asked to value equity shares on:

(a) Yield basis as on 31.3.2015, assuming:

(i) 40% rate of tax

(ii) anticipated after tax yield of 20%.

(iii) differential weightage of 1 to 5 being given for the five years starting on 1.4.2010 for the actual profits of the respective years.

(b) Net asset basis as per corrected balance sheets for each of the six years ended 31.3.2015.

Looking to the performance of the company over the 5 years period, would you invest in the company?

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Valuation of Business

19. Shobhit Garments Ltd. produces and sells to retailers a certain range of fashion clothings.

(a) They have made the following estimates of potential cash flows for the next 10 years.

Year	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*
Cash Flows (₹ in lakhs)	30,00	34,00	40,00	50,00	60,00	68,00	76,00	90,00	100,00	120,00

(b) Style Ltd. is a company which owns a series of boutiques in a certain locality. The boutiques buy clothes from various suppliers and retail them. Each boutique has a manager and an assistant but all purchasing and policy decisions are taken centrally. Independent cash flow estimates of Style Ltd. were as follows:

Year	1	2	3	4	5	6	7	8	9	10
Cash flows (₹ in lakhs)	240	320	400	560	680	920	1040	1200	1320	1600

(c) Shobhit Garments Ltd. is interested in acquiring Style Ltd. in order to get some additional retail outlets. They make the following cost-benefit calculations:

(i) Net value of assets of Style Ltd.

	₹ in lakhs
Tangible Fixed Assets	1600
Investments	400
Stock & Receivables	800
	2,800
Less: Current Liabilities	(800)
Net Assets represented by Equity Shares of ₹ 100 each	2,000

(ii) Tangible Fixed Assets amounting to ₹ 100 lakhs cannot be used and their net realisable value is ₹ 90 lakhs.

(iii) Stock & Receivables can be realised immediately at ₹ 940 lakhs.

(iv) Investment can be disposed off for ₹ 424 lakhs.

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(v) Some workers of Style Ltd. are to be retrenched for which estimated compensation is ₹ 260 lakhs.

(vi) Current Liabilities are to be discharged immediately.

(vii) ₹ 14.10 lakhs are payable on account of a compensation claim awarded against Style Ltd., which has been treated as a Contingent Liability in the accounts on which 20% was provided for.

(viii) Shobhit Garments Ltd. will invest ₹ 50 lakhs for renovating the building of Style Ltd. immediately on takeover and will invest further ₹ 50 lakhs at the end of second year.

(ix) Expected cash flows of the combined business will be as follows:

Year	1	2	3	4	5	6	7	8	9	10
Cash flow (₹ in lacs)	36,00	38,00	46,00	59,00	70,00	80,00	90,00	106,00	116,00	138,00

(x) Shobhit Garments Ltd. estimates that its Goodwill in the industry will increase by a minimum of ₹ 300 lakhs consequent the acquisition.

Calculate the maximum price per share of Style Ltd. which Shobhit Garments Ltd. can quote. Use 20% as discount factor.

Value Added Statement

20. (a) From the following Profit & Loss Account of Brightex Co. Ltd., prepare a gross value added statement for the year ended 31.12.2014:

Show also the reconciliation between gross value added and profit before taxation.

Profit and Loss Account for the year ended 31.12.2014

	Notes	*(₹ '000)*	*(₹ '000)*
Income:			
Sales			6,240
Other Income			55
			6,295
Expenditure:			
Production and operational expenses	1	4,320	
Administration expenses (Factory)	2	180	
Interest & Other charges	3	624	

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Depreciation		16	(5,140)
Profit before tax			1,155
Provision for tax			(55)
			1,100
Balance as per last Balance Sheet			60
			1,160
Transferred to fixed assets replacement reserve		400	
Dividend paid		160	(560)
Surplus carried to Balance Sheet			600

Notes:

1. Production & Operation expenses:

Consumption of raw materials	3,210
Consumption of stores	40
Local tax	8
Salaries to administrative staff	620
Other manufacturing expenses	442
	4,320

2. Administration expenses include salaries and commission to directors.
3. Interest on other charges include:
   (a) Interest on bank overdraft (Overdraft is of temporary nature) 109
   (b) Fixed loan from I.C.I.C.I. 51
   (c) Working capital loan from I.F.C.I. 20
   (d) Excise duties amount to one-tenth of total value added by manufacturing and trading activities.

Economic Value Added

(b) Prosperous Ltd. provides you the following data to calculate Economic Value Added (EVA):

30 crores Equity Shares of ₹ 10 each	
1 crores, 15% Preference Shares of ₹ 100 each	
8 crores, 15% Debentures of ₹ 100 each	
Tax Rate	30%

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Beta Factor	1.5
Market Rate of Return	15.5%
Equity Market Risk Premium	9%
Financial Leverage	1.5 times
Immovable Property (held as Investment)	₹ 100 crores

SUGGESTED ANSWERS / HINTS

1. **(a)** As per para 9 of AS 2 'Valuation of Inventories', for inclusion in the cost of inventory, allocation of fixed production overheads is based on the normal capacity of the production facilities.

In this, case finished stock has been valued at a standard cost of ₹ 1.8 lakhs per computer which incidentally synchronizes with the value computed on the basis of absorption costing as under:

		(₹ in lakhs)
Materials		400
Direct Labour		250
Variable production overheads		150
Fixed production overheads	290	
Less: Interest	(100)	190
Total cost		990

Number of computers produced = 550 computers (Assumed to be normal production)

Cost per computer ₹ 990 lakhs/550 computers = ₹ 1.80 lakhs

Policy of the company to value closing stock on the basis of standard costing is not as per AS 2. As per para 18 of AS 2, the techniques of standard cost method may be used for convenience if the result approximates to the actual cost. However, standard cost should be regularly reviewed, if necessary, and be revised in the light of the current conditions. In the instant case, the cost of inventory can be conveniently calculated as per absorption costing. Therefore, there is no reason to adopt standard costing method.

(b) As per para 15 of AS 3 "Cash Flow Statements", cash payment for acquisition of shares, warrant or debt instruments shall be shown under investing activities if they are not qualified as cash equivalent.

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As per para 6 of AS 3, an investment shall be qualified as cash equivalent if it is readily convertible to a known amount of cash i.e. it has short maturity of say three months or less from the date of acquisition.

It is given in the question that the Commercial Papers purchased by Finance House Ltd. has a ready market for its sale/purchase. Therefore, it should be considered as cash equivalent & not to be shown under Investing Activity.

2. (a) Losses on long-lived assets to be disposed of are neither unusual nor infrequent occurrences. Hence, it cannot be considered as an extraordinary item. Therefore, Answer (a) is incorrect. Answer (c) is incorrect because these losses are not part of selling or general and administrative expenses and they are not disclosed net of tax. Answer (d) is incorrect, because discontinued operations result from disposal of a business and not from the disposal of long-lived assets held for resale. As per AS 5 "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" losses associated with long-lived assets, which are to be disposed of, are to be reported as a component of income from continuing operations before income-taxes for entities preparing income statements and are disclosed separately. Therefore, answer (b) is correct.

(b) (i) Depreciation to be charged in the Profit and Loss Account

	₹
Depreciation on old Machinery [20% on ₹ 6,32,000 for 3 months (01.4.14 to 30.6.14)]	31,600
Add: Depreciation machinery acquired on 01.06.2014 (₹ 1,20,000 x 20% x 10/12)	20,000
Depreciation on Machinery after adjustment of Exchange [20% of ₹ (6,32,000 - 1,89,000 + 2,56,000) for 9 months]	1,04,850
Total Depreciation to be charged in Profit and Loss A/c	1,56,450

(ii) Book Value of Plant and Machinery as on 31.03.2015

	₹	₹
Balance as per books on 01.04.2014		6,32,000
Add: Included in purchases on 01.06.2014	1,20,000	
Add: Purchase on 30.06.2014	2,56,000	3,76,000
		10,08,000
Less: Book value of Machine sold on 30.06.2014		(1,89,000)
		8,19,000

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Less: Depreciation on machinery in use (1,56,450-9,450)		(1,47,000)
Book value as on 31.03.2015		6,72,000

(iii) Loss on exchange of Machinery

	₹
Book value of machinery as on 01.04.2014	1,89,000
Less: Depreciation for 3 months	(9,450)
WDV as on 30.06.2014	1,79,550
Less: Exchange value	(1,75,000)
Loss on exchange of machinery	4,550

3. (a) Statement showing analysis of the contract details

				(₹ in crores)
		Year I	*Year II*	*Year III*
(a)	Initial revenue agreed	900	900	900
(b)	Increase in contract revenue	-	20	20
(c)	Total Contract Value	900	920	920
(d)	Contract cost incurred upto the date of reporting	161	574 (excluding ₹ 10 crores of material stored)	820
(e)	Estimated cost to complete	644	246	-
(f)	Total estimated contract	805	820	820
(g)	Stage of Completion (d/f 100)	20% (161/805x100)	70% (574/820x100)	100% (820/820x100)

Statement showing amount of revenue, expenses and profit to be recognized in the Statement of Profit and Loss in three years (₹ in crores)

	Upto reporting date	*Recognised in the prior year*	*Recognized in the current year*
Year I			
Revenue (900 x 20/100)	180	-	180

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Expenses	161	-	161
Profit	19	-	19
Year II			
Revenue (920 x 70/100)	644	180	464
Expenses (820 x 70/100)	574	161	413
Profit	70	19	51
Year III			
Revenue	920	644	276
Expenses	820	574	246
Profit	100	70	30

(b) The Accounting Standard Board of ICAI has come up with an announcement in the earlier years wherein it clarified that the inter-divisional transfers / sales are not revenue as per AS 9 "Revenue Recognition". According to it, in case of inter-divisional transfers, risks and rewards remain within the enterprise and also there is no consideration from the point of view of the enterprise as a whole. Therefore, the recognition criteria for revenue recognition are also not fulfilled in respect of inter-divisional transfers. Hence, no revenue is recognized in the case of inter-divisional transfers.

(c) As per AS 9 'Revenue Recognition', in a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method as the service is performed, whichever relates the revenue to the work accomplished.

In the given case, income accrues when the related advertisement appears before public. The advertisement service would be considered as performed on the day the advertisement is published and hence revenue is recognized on that date. In this case, 15.03.2015 is the date of publication of the magazine.

Hence, ₹ 3,00,000 (₹ 2,40,000 + ₹ 60,000) is recognized as income in March, 2015. The terms of payment are not relevant for considering the date on which revenue is to be recognized. Since, the revenue of ₹ 3,00,000 will be recognised in the March, 2015, ₹ 60,000 will be treated as amount due from advertisers as on 31.03.2015 and ₹ 2,40,000 will be treated as payment received against the sale.

However, if the publication is delayed till 02.04.2015 revenue recognition will also be delayed till the advertisements get published in the magazine. In that case revenue of ₹ 3,00,000 will be recognized in the year ended 31.03.2016 after the magazine is published on 02.04.2015**.** The amount received from sale of advertising space on 10.03.2015 of ₹ 2,40,000 will be considered as an advance from advertisers as on 31.03.2015.

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4. **(a)** As per para 32 of AS 10 'Accounting for Fixed Assets', on disposal of a previously revalued item of fixed assets, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that to the extent such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilized, it is charged directly to that account.

Accordingly, the amount standing in revaluation reserve account following the retirement or disposal of an asset, which relates to that asset, may be transferred to general reserve. Hence, the following journal entries are to be passed to reverse the effect already given in the books of Orbit Ltd.:

		(₹ in lakhs)
Profit on sale of property A/c Dr.	200	
To Cost of goods sold A/c		150
To General reserve A/c		50

(b) Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring fixed assets should be adjusted in the carrying amount of the respective fixed assets as Path Ltd. has exercised the option and it is long term foreign currency monetary item.

Thus, the entire exchange loss due to variation of ₹ 20 lakhs on 31.03.2015 on payment of US $ 10 lakhs, should be added to the carrying amount of fixed assets and not to the cost of goods sold. Further, depreciation on the unamortized depreciable amount should also be provided, in accordance with AS 6 "Depreciation Accounting".

Calculation of Exchange loss:

Foreign currency loan (in ₹) = (50 lakhs $ x ₹ 60) = ₹ 3,000 lakhs

Exchange loss on outstanding loan on 31.03.2015 = ₹ 40 lakhs US $ x (62.00-60.00) = ₹ 80 lakhs.

So, ₹ 80 lakhs should also be added to cost of fixed asset with corresponding credit to outstanding loan in addition to ₹ 20 lakhs on account of exchange loss on payment of instalment. The total cost of fixed asset to be increased by ₹ 100 lakhs.

Total depreciation to be provided for the year 2014-15 = 20% of (₹ 3,000 lakhs + 100 lakhs) = ₹ 620 lakhs.

5. **(a)** (i) Whether a subsidy applied is to be classified as prior period item as per AS 5, depends upon whether the company has committed an error in 2013-14 by not recognising the subsidy? The answer is in para 13 of AS 12 "Accounting for Government Grants" which permits recognition of grant only when there is reasonable assurance that (i) the enterprise will comply with the conditions

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attached to them and (ii) the subsidy will be received. Mere making of an application does not provide the reasonable assurance that the subsidy will be received. Letter of sanction from IREDA is required to provide this assurance. Since, the subsidy was granted in June, 2014 after approval of accounts, non-recognition of grant in 2013-14 will not be considered as an error. Hence, this is not a prior period item. Therefore, the company was right in not recognizing the grant.

Further, AS 4 requires adjustment of events occurring after the balance sheet date only upto the date of approval of accounts by the Board of Directors. In view of this, the company is correct in not adjusting the same in the accounts in the year 2013-14.

(ii) The subsidy should be deducted from the cost of the generator. The revised unamortised amount of generator should be written off over the remaining useful life.

Alternatively, the same may be treated as Deferred Income and allocated over the remaining useful life in the proportion in which depreciation is charged.

(iii) Here in this case, the opinion given in (i) and (ii) above would change. AS 4 requires the value of assets and liabilities to be adjusted for events occurring after the balance sheet date which occur upto the date of approval of accounts by the Board of Directors if they confirm the conditions existing at the balance sheet date. Since, in this case books of account have not been approved, grant of subsidy will be considered as an adjusting event. Hence, the accounts should be adjusted for the subsidy in 2013-14. The subsidy should be credited to the cost of the generator.

Alternatively, the subsidy may be treated as deferred income to be written off over the useful life in proportion in which depreciation is written off.

(iv) As per the past experience of the company wherein similar applications were made and subsidy was granted on all occasion, one can conclude that the reasonable assurance that subsidy will be received, as envisaged in Para 13, is there in the form of past record. If there are no changes in the subsidy scheme and the application is submitted in the same manner as in the past, then subsidy should have been accounted in 2013-14 itself. The opinion in (i) and (ii) would change. The opinion in (iii) above will hold good in this case also.

(b) (i) The accounting treatment 'at cost' under the head 'Long Term Investment' in the separate financial statements of the company without providing for any diminution in value is correct and is in accordance with the provisions of AS 13 provided that there is no decline, other than temporary, in the value of investment.

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(ii) If the decline in the value of investment is not other than temporary compared to the time when the shares were purchased, no provision is required to be made. The reduction in market value should not be considered in isolation to determine the decline, other than temporary. The amount of the provision for diminution in the value of investment may be ascertained considering the factors indicated in paragraph 17 of AS 13.

(ii) The provision for diminution in the value of investment should be a charge to the profit and loss statement. As per the requirements of AS 13, the diminution in the value of investment can neither be accounted for as deferred revenue expenditure nor it can be written off in the statement of profit and loss.

(iii) The long-term investments should be carried at cost as per the requirements of AS 13. The amount paid over and above the market price should be treated as cost and cannot be accounted for separately.

6. (a) ICAI has opinioned that investments other than investment properties are not qualifying assets as per AS 16 "Borrowing Costs". Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying asset, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale. Even where the investment properties meet the definition of 'qualifying asset', for the capitalisation of borrowing costs the other requirements of the standard such as that borrowing cost should be directly attributable to the acquisition or construction of the investment property and suspension of capitalization as per paragraphs 17 and 18 of AS 16 have to be complied with.

(b) The interest expense relating to overdrafts and other operating liabilities identified to a particular segment should not be included as a part of the segment expense unless the operations of the segment are primarily of a financial nature or unless the interest is included as a part of the cost of inventories.

In case interest is included as part of the cost of inventories where it is so required as per AS 16 "Borrowing Costs", read with AS 2 "Valuation of Inventories", and those inventories are part of segment assets of a particular segment, such interest should be considered as a segment expense.

In this case, the amount of such interest and the fact that the segment result has been arrived at after considering such interest should be disclosed by way of a note to the segment result.

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

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

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

(b) (i) Determination of nature of lease

Fair value of asset = ₹ 7,00,000

Unguaranteed residual value = ₹ 70,000

Present value of residual value at the end of 4th year = ₹ 70,000 x 0.683
= ₹ 47,810

Present value of lease payment recoverable = ₹ 7,00,000 - ₹ 47,810
= ₹ 6,52,190

The percentage of present value of lease payment to fair value of the asset is
= (₹ 6,52,190/₹ 7,00,000)x100
= 93.17%

Since, it substantially covers the major portion of lease payment and life of the asset, the lease constitutes a finance lease.

(ii) Calculation of Unearned Finance Income

Annual lease payment = ₹ 6,52,190 / 3.169
= ₹ 2,05,803 (approx.)

Gross investment in the lease = Total minimum lease payment + unguaranteed residual value
= (₹ 2,05,803 x 4) + ₹ 70,000
= ₹ 8,23,212 + ₹ 70,000
= ₹ 8,93,212

Unearned finance income = Gross investment – Present value of minimum lease payment and unguaranteed residual value.
= ₹ 8,93,212 – ₹ 7,00,000 (₹ 6,52,190 + ₹ 47,810)
= ₹ 1,93,212.

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8. **(a)** The following dates should be considered for consideration of weights for calculation of weighted average number of shares in the given situations:

(i) Equity Shares issued in exchange of cash - Date of Cash receivable

(ii) Equity Shares issued as a result of conversion of a debt instrument - Date of conversion

(iii) Equity Shares issued in exchange for the settlement of a liability of the enterprise - Date on which settlement becomes effective

(iv) Equity Shares issued for rendering of services to the enterprise - When the services are rendered

(v) Equity Shares issued in lieu of interest and/or principal of another financial instrument - Date when interest ceases to accrue

(vi) Equity Shares issued as consideration for the acquisition of an asset other than in cash - Date on which the acquisition is recognised.

A Potential Equity Share is a financial instrument or other contract that entitles, or may entitle its holder to equity shares.

(b) Mere gradual phasing out is not considered as discontinuing operation as defined under para 3 of AS 24, 'Discontinuing Operations'.

Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:

(1) Gradual or evolutionary phasing out of a product line or class of service;

(2) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;

(3) Shifting of some production or marketing activities for a particular line of business from one location to another; and

(4) Closing of a facility to achieve productivity improvements or other cost savings.

A Reportable business segment or geographical segment as defined in AS 17, would normally satisfy criteria (b) of the definition.

In view of the above the answers are:

(i) No, the companies' strategic plan has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Above all, the new segment i.e. commercial vehicle production line in a new factory has not started.

(ii) No, the resolution is salient about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, closure road map and new segment starting roadmap are missing. Hence, AS 24 will not be applicable.

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(iii) Yes, phased and time bound programme resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap. Hence, this action will attract compliance of AS 24.

9. (a) Para 28 of AS 25 "Interim Financial Reporting" states that revenues and gains should be recognised in interim reports on the same basis as used in annual reports. As at September 30, 2014, X Ltd. would report the entire ₹ 3,00,000 loss on the disposal of its business segment since the loss was incurred during the interim period.

A cost charged as an expense in an annual period should be allocated among the interim periods, which are clearly benefited from the expense, through the use of accruals and/or deferrals. Since ₹ 80,000 property tax payment relates to the entire 2014 calendar year, only ₹ 40,000 of the payment would be reported as an expense at September 30, 2014, while out of the remaining ₹ 40,000, ₹ 20,000 for January, 2014 to March, 2014 would be shown as payment of the outstanding amount of previous year and another ₹ 20,000 related to quarter October, 2014 to December, 2014, would be reported as a prepaid expense.

(b) Case 1: As per para 68 of AS 28 "Impairment of Assets" if an active market exists for the output produced by an asset or a group of assets, this asset or group of assets should be identified as a separate cash-generating unit, even if some or all of the output is used internally.

X could sell its products in an active market and, so, generate cash inflows from continuing use that would be largely independent of the cash inflows from Y. Therefore, it is likely that X is a separate cash-generating unit, although part of its production is used by Y.

It is likely that Y is also a separate cash-generating unit. Y sells 80% of its products to customers outside the reporting enterprise. Therefore, its cash inflows from continuing use can be considered to be largely independent.

Internal transfer prices do not reflect market prices for X's output. Therefore, in determining value in use of both X and Y, the enterprise adjusts financial budgets/forecasts to reflect management's best estimate of future market prices for those of X's products that are used internally.

Case 2: It is likely that the recoverable amount of each plant cannot be assessed independently from the recoverable amount of the other plant because:

(a) the majority of X's production is used internally and could not be sold in an active market. So, cash inflows of X depend on demand for Y's products. Therefore, X cannot be considered to generate cash inflows that are largely independent from those of Y; and

(b) the two plants are managed together.

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As a consequence, it is likely that X and Y together is the smallest group of assets that generates cash inflows from continuing use that are largely independent.

10. (a) As per AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when:

(i) An enterprise has a present obligation as a result of past event;

(ii) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(iii) A reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognised.

A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote. The possibility of an outflow of resources embodying economic benefits is remote in the given situation, since the directors of WZW Ltd. are of the opinion that the claim can be successfully resisted by the company. Therefore, the company shall not disclose the same as contingent liability. However, following note in this regard may be given in annual accounts:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 1,000 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company".

(b) Note 6 (B) given under Part I of Schedule III to the Companies Act, 2013 provides that debit balance of Statement of Profit and Loss (after all allocations and appropriations) shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

In this case, the debit balance of profit and loss i.e. ₹ 250 lakhs exceeds the total of all the reserves i.e. ₹ 230 lakhs. Therefore, balance of 'Reserves and Surplus' after adjusting debit balance of profit and loss is negative by ₹ 20 lakhs, which should be disclosed on the face of the balance sheet as the sub-heading 'Reserves & Surplus' under the heading 'Shareholders' fund'. Thus, the treatment done by the company is incorrect.

11. (a)

	Existing Accounting Standards	*IFRS*
Consolidated Financial Statements	The accounting standard does not mandate an enterprise to present consolidated financial statements; but, if the enterprise	Under IFRS 10, if an entity is a parent, then it is mandatory to prepare consolidated financial statements (CFS).

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	presents consolidated financial statements for complying with the requirements of any statute or otherwise, it should prepare and present consolidated financial statements in accordance with AS 21.	
	As per AS 21, subsidiary is excluded from consolidation (a) when control is intended to be temporary or (b) when subsidiary operates under severe long term restrictions.	As per IFRS 10, an entity that is a parent shall be excluded to present consolidated financial statements when (i) it is a wholly or partially owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements; (ii) its debt or equity instruments are not traded in a public market; (iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and (iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with IFRSs.
	A mere ownership of more than 50% of equity shares is sufficient to constitute control under AS 21	Control specifies that an investor has control over an investee if and only if it has

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	or control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.	power over the investee, exposure, or rights, to variable returns from its involvement with the investee and the ability to use its power over the investee to affect the amount of the investor's returns.
	In case an entity is controlled by two entities (one controls by virtue of ownership of majority of the voting power of that enterprise and other controls, by virtue of an agreement or otherwise, the composition of the board of directors so as to obtain economic benefit from its activities), an enterprise is controlled by two enterprises as per the definition of 'control', the enterprise will be considered as subsidiary of both the controlling enterprises and, therefore, both the enterprises need to consolidate the financial statements of that enterprise.	When two or more investors collectively control an investee, in such a case no investor can direct the activities without the co-operation of the others or no investor individually controls the investee. Each investor would account for its interest in the investee in accordance with IFRS 11 "Joint Arrangements", IAS 28 "Investments in Associates and Joint Ventures" or IFRS 9 "Financial Instruments".
	For considering share ownership, potential voting rights of the investee held by investor are not taken into account as per AS 21.	As per IFRS 10, effects of potential voting rights are considered when assessing whether an entity has control over the subsidiary.
	AS 21 permits the use of financial statements of the subsidiaries drawn upto a date different from the date of financial statements of the parent after making adjustments regarding effects of significant transactions. The difference between the reporting dates should not be more than six months.	As per IFRS 10, the length of difference in the reporting dates of the parent and the subsidiary should not be more than three months.
	As per AS 21, no deferred tax is recognised on elimination of	IFRS 10 states that IAS 12 applies to temporary

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	intra-group transactions.	differences that arise from the elimination of profits and losses resulting from intra-group transactions.
Joint Arrangements	AS 27 recognises three forms of joint venture namely: a) jointly controlled operations; b) jointly controlled assets; and c) jointly controlled entities.	As per IFRS 11 a joint arrangement is either a joint operation or a joint venture. Such classification of joint arrangement depends upon the rights and obligations of the parties to the arrangement and disregards the legal structure.
	AS 27 prescribes the use of proportionate consolidation method only.	IFRS 11 provides that a venturer should recognise its interest in joint venture using only equity method.
	AS 27 requires application of the proportionate consolidation method only when the entity has subsidiaries and prepares Consolidated Financial Statements.	IFRS 11 requires application of equity method in financial statements other than separate financial statements in case of a joint venture, even if the venturer does not have any subsidiary in the financial statements.

(b) There are many beneficiaries of convergence with IFRSs such as-

The Economy: When the markets expand globally the need for convergence increases since the convergence benefits the economy by increasing growth of its international business. It facilitates maintenance of orderly and efficient capital markets and also helps to increase the capital formation and thereby economic growth. It encourages international investing and thereby leads to more foreign capital flows to the country.

Investors: A strong case for convergence can be made from the viewpoint of the investors who wish to invest outside their own country. Investors want the information that is more relevant, reliable, timely and comparable across the jurisdictions. Financial statements prepared using a common set of accounting standards help investors better understand investment opportunities as opposed to financial statements prepared using a different set of national accounting standards. Investors' confidence is strong when accounting standards used are globally

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accepted. Convergence with IFRSs contributes to investors' understanding and confidence in high quality financial statements.

The industry: A major force in the movement towards convergence has been the interest of the industry. The industry is able to raise capital from foreign markets at lower cost if it can create confidence in the minds of foreign investors that their financial statements comply with globally accepted accounting standards. With the diversity in accounting standards from country to country, enterprises which operate in different countries face a multitude of accounting requirements prevailing in the countries. The burden of financial reporting is lessened with convergence of accounting standards because it simplifies the process of preparing the individual and group financial statements and thereby reduces the costs of preparing the financial statements using different sets of accounting standards.

(c) The listed companies in India are governed by one single regulator that is SEBI. SEBI is the regulator for the securities market in India. SEBI gets statutory powers through the SEBI Act, 1992 for protecting the interests of investors, developing, promoting and regulating the securities market in India.

SEBI majorly covers the following under its jurisdiction:

- Corporates in the issuance of capital and transfer of securities; and Intermediaries;
- Persons associated with securities market.

The Listing Agreement is a charter, issued by SEBI for all the listed companies and other entities which are covered through SEBI Act, 1992. This charter dictates the terms and conditions for the listed entities, which are to be mandatorily followed by them. In case, the said terms are not followed, these entities will be subject to the penal provisions, as laid down under the SEBI Act, 1992. The Listing Agreement gets amended from time to time, depending upon market and other economic conditions and to keep pace with other regulations in India.

Apart from the requirements with respect to registration and other compliance, SEBI emphasises much on the disclosures to be made by the listed entities to make the results of these entities transparent to the investors. SEBI has imposed a number of mandatory disclosures and other requirements on the listed entities in India. Some of these are:

1. Clause 32

    (i) Sending Annual Report

    - Soft copies of full annual report are required to be sent to all those shareholder(s) who have registered their email address for this purpose.
    - Hard copy of statement containing the salient features of all the

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prescribed documents is sent to those shareholder(s) who have not registered.

- Hard copy of full annual report is sent to those shareholders, who request for the same.

(ii) Disclosures in compliance with AS 18 on "Related Party Transactions" in its Annual Report.

2. Clause 40B

   Compliance with Takeover Code

3. Clause 41

   - Interim unaudited financial results are required to be disclosed and published.
   - If the name of the company is changed due to any new line of business, separate disclosure of net sales or income, expenditure and net profit or loss after tax figures pertaining to the said new line of business is required in the financial statements. This separate disclosure shall continue for the three years succeeding the date of change in the name.

4. Clause 49

   Compliance of Corporate governance explanation

5. Clause 53

   (i) Companies are required to notify to stock exchange(s) and put on their website on immediately entering into agreement(s) with media companies, with respect to the following information:

   - Disclosure regarding the shareholding (if any) of such media companies/associates in the company, nominee of such media company/companies/associates on the board of the company, etc
   - Disclosures regarding any other back to back treaties/ contracts/ agreements/MoUs or similar instruments entered into by the company with media companies and/ or their associates for the purpose of advertising, publicity, etc

12. (a) Projected Profit and Loss Account of EF Ltd. for the period ending 31st March, 2015

Particulars	₹
Total Revenue	
Dividend Income [50,000 + 17,600]	67,600
Interest Income	11,250

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	78,850
Less: Expenses	
Finance Costs (Interest on Bank Overdraft)	(1,600)
Other Expenses [Directors Fee (7,500) + Administrative Expenses (16,000) + Preliminary expenses (8,000)]	(31,500)
Profit before tax	45,750

(b) Projected Balance Sheet of EF Ltd. as on 31st March, 2015

	Particulars	Note No.	(₹)
I.	Equity and Liabilities		
	(1) Shareholders' Funds		
	(a) Share Capital	1	15,70,000
	(b) Reserves and Surplus	2	3,49,450
	(2) Non-Current Liabilities		
	(3) Current Liabilities		
	(a) Other Current Liabilities	3	23,500
	Total		19,42,950
II.	Assets		
	(1) Non-Current Assets		
	Non-Current Investments	4	14,34,000
	(2) Current Assets		
	(a) Cash and Cash Equivalents (W.N.1)		58,950
	(b) Other Current Assets		4,50,000
	Total		19,42,950

Notes to Accounts:

	Particulars	*(₹)*
1.	Share Capital	
	Authorised share capital	
	4,00,000 Equity shares of ₹ 10 each	40,00,000
	Issued share capital	
	1,57,000 Equity Shares of ₹ 10 each	15,70,000
	(Of the above 1,19,500 shares were issued for consideration other than cash)	

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2.	Reserves and Surplus		
	Securities Premium [2,39,000 + 1,12,500]		3,51,500
	Profit & Loss Account	45,750	
	Less: Interim dividend (₹ 95,000 x 4%)	(47,800)	(2,050)
			3,49,450
3.	Other Current Liabilities		
	Bank Overdraft	16,000	
	Directors Fee	7,500	23,500
4.	Non-current investment		
	Investment in shares of AB Ltd. @ ₹ 12	10,50,000	
	Investment in shares of CD Ltd. @ ₹ 12	3,84,000	14,34,000

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

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

Working Note:

Bank Account

Particulars	₹	*Particulars*	₹
To Equity Share Capital A/c	3,75,000	By Preliminary Expenses	8,000
To Securities Premium A/c	1,12,500	By Interest on Bank Overdraft	1,600
To Dividends from AB Ltd.	50,000	By Advance to AB Ltd.	2,50,000

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To Dividends from CD Ltd.	17,600	By Advance to CD Ltd.	2,00,000
To Interest Income	11,250	By Interim Dividend	47,800
		By Balance c/d (Bal. fig.)	58,950
	5,66,350		5,66,350

13. As per para 26 of AS 21 "Consolidated Financial Statements", the losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered. Accordingly,

Year	*Profit/(Loss)*	*Minority Interest (30%)*	*Additional Consolidated P & L (Dr.) Cr.*	*Minority's Share of losses borne by A Ltd.*		*Cost of Control*
				₹	*Balance*	
At the time of acquisition in 2008		3,24,000 (W.N.)	-			
2008-09	(2,50,000)	(75,000)	(1,75,000)			2,44,000 (W.N.)
		2,49,000				
2009-10	(4,00,000)	(1,20,000)	(2,80,000)			2,44,000
	-	1,29,000				
2010-11	(5,00,000)	(1,50,000)				2,44,000
		(21,000)	(3,50,000)			
	Loss of minority borne by Holding Co.	21,000	(21,000)	21,000	21,000	
		Nil	(3,71,000)			
2011-12	(1,20,000)	- (on application of para 26 of AS 21)	(1,20,000)	36,000	57,000	2,44,000
		Nil				
2012-13	50,000	- (on	50,000	(15,000)	42,000	2,44,000

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		application of para 26 of AS 21)				
		Nil				
2013-14	1,00,000	- (on application of para 26 of AS 21)	1,00,000	(30,000)	12,000	2,44,000
		Nil				
2014-15	1,50,000	45,000	1,05,000	(12,000)	Nil	2,44,000
		(12,000) (application of para 26)	12,000			
		33,000	1,17,000			

Working Note:

Calculation of Minority interest and Cost of control on 1.1.2008

		Share of Holding Co.	*Minority Interest*
	100%	*70%*	*30%*
	(₹)	*(₹)*	*(₹)*
Share Capital	10,00,000	7,00,000	3,00,000
Reserve	80,000	56,000	24,000
		7,56,000	3,24,000
Less: Cost of investment		(10,00,000)	
Goodwill		2,44,000	

14. Consolidated Balance Sheet as on 31.3.2015

Particulars	*Note No.*	*₹*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,00,000
(b) Reserves and Surplus	2	1,20,700
(2) Minority Interest (W.N.)		20,000
(3) Current Liabilities		
(a) Trade Receivables	3	23,000

(b) Short Term Provisions	4	12,500
(c) Other Current Liabilities	5	10,000
Total		2,86,200
II. Assets		
(1) Non-current assets		
(a) Fixed assets	6	2,15,500
(b) Non-current investment	7	17,200
(2) Current assets	8	53,500
Total		2,86,200

Notes to Accounts

			₹
1.	Share Capital		
	Called up equity shares of ₹ 1 each		1,00,000
2.	Reserves and Surplus		
	General Reserve	40,000	
	Profit and Loss A/c (W.N.3)	80,700	1,20,700
3.	Trade Receivables		
	Holding & Subsidiary	20,000	
	Joint Venture (50%)	3,000	23,000
4.	Short term provisions		
	Provisions for Tax		
	Holding & Subsidiary	9,000	
	Joint Venture (50%)	3,500	12,500
5.	Other Current Liabilities		
	Proposed Dividend		
	Holding & Subsidiary	10,000	
	Joint Venture (50%)	2,000	
		12,000	
	Less: Mutual owings	(2,000)	10,000
6.	Fixed Assets		
	Holding & Subsidiary	1,95,000	
	Joint Venture (50%)	20,500	2,15,500

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7.	Non-current investment		
	Investment in Associate (W.N.4)		17,200
8.	Current Asset		
	Holding & Subsidiary	21,000	
	Joint Venture	34,500	
		55,500	
	Less: Mutual Owings (Dividend Receivable from Joint Venture included in Current Asset)	(2,000)	53,500

Working Notes:

1. Analysis of Profit & Loss of Associate / Joint Venture

	Pre-acquisition	*Post-acquisition*
	₹	₹
Profit as on 31.3.2015 27,000	16,000	11,000
Share of Associate company (20%)	3,200	2,200
Analysis of Profit and Loss of Joint Venture	Nil	83,000
Share of Joint Venture (50%)		41,500

2. Calculation of Goodwill/Capital Reserve

	Associate		*Joint Venture*	
		₹		₹
Investment		15,000		5,000
Less: Nominal Value	8,000		5,000	
Capital Profit	3,200	(11,200)	-	(5,000)
Goodwill		3,800		Nil

3. Calculation of Consolidated Profit and Loss Account

	₹
Profit and Loss Account of Holding & Subsidiary	37,000
Add: Share of Associate	2,200
Joint Venture	41,500
	80,700

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4. Calculation of Investment in Associate

	₹
Goodwill (W.N.2)	3,800
Net worth	11,200
Cost	15,000
Add: Share of Revenue Profit	2,200
	17,200

Notes:

1. Dividend income is booked without the receipt. This meant that income was on receivable stage appearing on the asset side.
2. JCE was formed, by the Venturers two years ago. All the reserves as on the date of consolidation are to be treated as revenue.
3. Out of ₹ 17,000 existed at the time of acquisition, only ₹ 16,000 (Opening Balance) is continuing in the books of the associate. Therefore, ₹ 16,000 is taken as capital profit assuming that it is a part of that ₹ 17,000 existed at the time of acquisition.

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

Year end	*Cash Inflow*		*Total*	*P.V. factor @10%*	*Present value*
	Principal ₹	*Interest @ 4%* ₹	₹		₹
2014	20,00,000	4,00,000	24,00,000	0.9090	21,81,600
2015	20,00,000	3,20,000	23,20,000	0.8263	19,17,016
2016	20,00,000	2,40,000	22,40,000	0.7512	16,82,688
2017	20,00,000	1,60,000	21,60,000	0.6829	14,75,064
2018	20,00,000	80,000	20,80,000	0.6208	12,91,264
Present value or Fair value					85,47,632

(ii) Calculation of amortised cost of loan to employees

Year	*Amortised cost (Opening balance) [1]* ₹	*Interest to be recognised@10% [2]* ₹	*Repayment (including interest) [3]* ₹	*Amortised Cost (Closing balance) [4]=[1]+ [2] – [3]* ₹
2014	85,47,632	8,54,763	24,00,000	70,02,395
2015	70,02,395	7,00,240	23,20,000	53,82,635

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2016	53,82,635	5,38,264	22,40,000	36,80,899
2017	36,80,899	3,68,090	21,60,000	18,88,989
2018	18,88,989	1,91,011•	20,80,000	Nil

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

for the year ended 31st December, 2014 (regarding loan to employees)

		Dr. Amount (₹)	*Cr. Amount (₹)*
Staff loan A/c	Dr.	1,00,00,000	
To Bank A/c			1,00,00,000
(Being the disbursement of loans to staff)			
Staff cost A/c ₹ (1,00,00,000–85,47,632) [Refer part (ii)]	Dr.	14,52,368	
To Staff loan A/c*			14,52,368
(Being the write off of excess of loan balance over present value thereof in order to reflect the loan at its present value of ₹ 85,47,632)			
Staff loan A/c	Dr.	8,54,763	
To Interest on staff loan A/c			8,54,763
(Being the charge of interest @ market rate of 10% on the loan)			
Bank A/c	Dr.	24,00,000	
To Staff loan A/c			24,00,000
(Being the repayment of first instalment with interest for the year)			
Interest on staff loan A/c	Dr.	8,54,763	
To Profit and loss A/c			8,54,763
(Being transfer of balance of staff loan Interest account to profit and loss account)			
Profit and loss A/c	Dr.	14,52,368	
To Staff cost A/c			14,52,368
(Being transfer of balance of staff cost account to profit and loss account)			

• The difference of ₹ 2,112 (₹ 1,91,011 – ₹ 1,88,899) is due to approximation in computations.

* Loans and receivables should be measured at amortized cost using the effective rate of interest method as per AS 30 'Financial Instruments: Recognition and Measurement'.

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16. (a) **Employees Compensation Account**

Year		₹	Year		₹
2010-11	To Provision for Liability (W.N. 3)	1,27,200	2010-11	By Profit & Loss A/c	1,27,200
2011-12	To Provision for Liability (W.N. 3)	1,52,633	2011-12	By Profit & Loss A/c	1,52,633
2012-13	To Provision for Liability (W.N. 3)	2,02,867	2012-13	By Profit & Loss A/c	2,02,867

Provision for Liability Component Account

Year		₹	Year		₹
2010-11	To Balance c/d	1,27,200	2010-11	By Employees Compensation A/c	1,27,200
2011-12	To Balance c/d	2,79,833	2011-12	By Balance b/d	1,27,200
				By Employees Compensation A/c	1,52,633
		2,79,833			2,79,833
2012-13	To Balance c/d	4,82,700	2012-13	By Balance b/d	2,79,833
				By Employees Compensation A/c	2,02,867
		4,82,700			4,82,700

If Employee opts for Cash settlement

Provision for Liability Component Account

Year	Particulars	₹	Year	Particulars	₹
2013-14	To Bank (5000 x ₹ 96.54)	4,82,700	2013-14	By Balance c/d	4,82,700

If employee opts for Equity Settlement

Provision for Liability Component Account

Year	Particulars	₹	Year	Particulars	₹
2013-14	To ESOP outstanding A/c	4,82,700	2013-14	By Balance c/d	4,82,700

ESOP Outstanding Account

Year		₹	Year		₹
2013-14	To Equity Share Capital	60,000	2013-14	By Provision for Liability	4,82,700

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	A/c (6000 x ₹ 10)			Component A/c	
	To Securities Premium A/c	12,86,700		By Bank (6,000 x ₹ 144)	8,64,000
		13,46,700			13,46,700

Working Notes:

1. Computation of Fair Values

Fair value of shares subject to lock in as on 1st April, 2010	₹ 60
% of increase in fair value of shares not subjected to lock in	20%
Fair value as on 1st April, 2010 of shares not subject to lock in (60+20%)	₹ 72
% increase over previous value in respect of fair value on 31.03.2011	6%
Fair value of shares not subject to lock in restriction on 31.03.2011 (72 + 6%)	₹ 76.32
% increase over previous value in respect of fair value on 31.03.2012	10%
Fair value of shares not subject to lock in restriction on 31.03.2012 (76.32 + 10%)	₹ 83.95
% increase over previous value in respect of fair value on 31.03.2013	15%
Fair value of shares not subject to lock in restriction on 31.03.2013 (83.95 + 15%)	₹ 96.54

2. Expense to be recognized in respect of Equity Component

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

3. Expenses to be recognized for Liability Component

	2010-11	*2011-12*	*2012-13*
Number of shares (A)	5000	5000	5000
Fair value at the end of each year (B)	76.32	83.95	96.54

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Fair value of liability component (A x B)	3,81,600	4,19,750	4,82,700
Expenses to be recognized*	1,27,200	1,52,633	2,02,867

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

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

17. (a)

Allocation of Earnings	*Old Unit Holders* [18 lakhs units] ₹ in lakhs	*New Unit Holders* [2 lakhs units] ₹ in lakhs	*Total* ₹ in lakhs
First half year (₹ 5 per unit)	90.00	Nil	90.00
Second half year (₹ 3.60 per unit)	64.80	7.20	72.00
	154.80	7.20	162.00
Add: Equalization payment recovered	-	-	10.00
Total amount available for distribution			172.00
Equalization Payment: (₹ 90 lakhs ÷ 18 lakhs) = ₹ 5 per unit			
		Old Unit Holders ₹	*New Unit Holders* ₹
Dividend distributed		8.60	8.60
Less: Equalization payment		-	(5.00)
		8.60	3.60

Journal Entries

			(₹ in lakhs)
30.9.2014	Bank A/c Dr.	150.00	
	To Unit Capital A/c		20.00
	To Reserve A/c		120.00
	To Dividend Equalization A/c		10.00
	(Being the amount received on sale of 2 lakhs units at a NAV of ₹ 70 per unit)		
31.3.2015	Dividend Equalization A/c Dr.	10.00	
	To Revenue A/c		10.00

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	(Being the amount transferred to Revenue Account)		
30.9.2015	Revenue A/c Dr.	172.00	
	To Bank A/c		172.00
	(Being the amount distributed among 20 lakhs unit holders @ ₹ 8.60 per unit)		

(b) Calculation of Provision required on Advances as on 31st March, 2015

	Amount ₹ in lakhs	*Percentage of provision*	*Provision ₹ in lakhs*
Standard assets	16,800	0.25	42
Sub-standard assets	1,340	10	134
Secured portion of doubtful debts			
–upto one year	320	20	64
– one year to three years	90	30	27
–more than three years	30	50	15
Unsecured portion of doubtful debts	97	100	97
Loss assets	48	100	48
			427

Note: Prudential norms of NBFCs have been revised in November, 2014. According to it, provisioning rates of various Performing and Non-performing Assets have been changed. However, the changed rates are not applicable for the financial year 2014-15 and is also not applicable for May, 2015 examination.

18. (a) Valuation of Shares on Yield basis as on 31st March, 2015

Year ended 31st March	*Profits as given*	*Adjustments*		*Revised Profits*	*Tax Provision*	*After tax Profits*	*Weight*	*Weighted profits*
		Increase	*Decrease*					
	₹	₹	₹	₹	₹	₹		₹
2011	4,00,000	1,00,000	1,25,000	3,75,000	1,50,000	2,25,000	1	2,25,000
2012	3,50,000	2,50,000	1,00,000	4,75,000	1,90,000	2,85,000	2	5,70,000
		1,50,000	1,75,000					
2013	6,50,000	Nil	1,50,000	5,00,000	2,00,000	3,00,000	3	9,00,000
2014	5,50,000	1,75,000	Nil	7,50,000	3,00,000	4,50,000	4	18,00,000

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		25,000						
2015	6,00,000	1,00,000	25,000	6,75,000	2,70,000	4,05,000	5	20,25,000
							15	55,20,000

Weighted average profit (after tax) = $\frac{₹\ 55,20,000}{15}$ = ₹ 3,68,000

Value of business = $\frac{₹\ 3,68,000}{20\%}$ = ₹ 18,40,000

Value of equity share = $\frac{₹\ 18,40,000}{10,000}$ = ₹ 184

(b) Valuation of Shares on Net Asset Basis

(i)	**Revised net worth as on 31st March, 2010**		₹	₹
	Net worth			6,00,000
	Less: Adjustments relating to			
		2010-11	1,00,000	
		2011-12	1,25,000	
			2,25,000	
	Less: Relief from tax @ 40%		(90,000)	(1,35,000)
				4,65,000
(ii)	**Net asset value** (No. of shares = 10,000)			
	As on 31st March		₹	₹
	2010:	Revised net worth	4,65,000	
		Value per share		46.50
	2011:	Revised net worth as on 31.3.2010	4,65,000	
		Add: After tax revised profits of 2010-11	2,25,000	
		Net worth as on 31.3.2011	6,90,000	
		Value per share		69.00
	2012:	Revised net worth as on 31.3.2011	6,90,000	
		Add: After tax revised profits of 2011-12	2,85,000	
		Net worth as on 31.3.2012	9,75,000	
		Value per share		97.50
	2013:	Revised net worth as on 31.3.2012	9,75,000	
		Add: After tax revised profits of 2012-13	3,00,000	

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		Net worth as on 31.3.2013	12,75,000	
		Value per share		127.50
	2014:	Revised net worth as on 31.3.2013	12,75,000	
		Add: After tax revised profits of 2013-14	4,50,000	
		Net worth as on 31.3.2014	17,25,000	
		Value per share		172.50
	2015:	Revised net worth as on 31.3.2014	17,25,000	
		Add: After tax revised profits of 2014-15	4,05,000	
		Net worth as on 31.3.2015	21,30,000	
		Value per share		213.00

Performance Appraisal

Revised net worth as on 31st March		*Profit during the year ended 31st March*		*Return on net worth*
	₹		₹	%
2010	4,65,000	2011	2,25,000	48.39
2011	6,90,000	2012	2,85,000	41.30
2012	9,75,000	2013	3,00,000	30.77
2013	12,75,000	2014	4,50,000	35.29
2014	17,25,000	2015	4,05,000	23.48

The company's return has fallen from 48.39% to 23.48%. This may be perhaps due to the fact that the company has been ploughing back its profits without having adequate reinvestment opportunities. Unless the company has profitable investment opportunities, it may not be advisable to invest in the company.

Note: Return on net worth may also be calculated on the basis of average net worth during the relevant year.

19. Maximum Value that can be quoted by Shobhit Garments Ltd.

	₹ in lakhs	*₹ in lakhs*
Present Value of Incremental Cash Flows (W.N.)		3726.49
Add: Cash to be collected immediately by disposal of assets:		
Tangible Fixed Assets	90	
Investments	424	
Stock & Receivables	940	1454.00

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		5180.49
Less: Current Liabilities [including 20% of 14.10]	800	
Contingent Liability [14.10 x 80%]	11.28	
Retrenchment Compensation	260	
Renovation of Plant [50 + (50 x 0.6944)]	84.72	(1156.00)
Goodwill		300.00
Maximum Value that can be quoted		4324.49
Maximum Price per Share [4324.49/20 lakh shares]		216.22

Working Note:

Calculation of Present Value of Incremental Cash Flows

Year	*Cash Flows before takeover*	*Cash Flows after takeover*	*Incremental Cash Flows D=C-B*	*Discount Factor @ 20%*	*Discounted Cash Flow F = D x E*
A	*B*	*C*		*E*	
1	3000	3600	600	0.8333	499.98
2	3400	3800	400	0.6944	277.76
3	4000	4600	600	0.5787	347.22
4	5000	5900	900	0.4823	434.07
5	6000	7000	1000	0.4019	401.90
6	6800	8000	1200	0.3349	401.88
7	7600	9000	1400	0.2791	390.74
8	9000	10600	1600	0.2326	372.16
9	10000	11600	1600	0.1938	310.08
10	12000	13800	1800	0.1615	290.70
					3726.49

20. (a) Brightex Co. Ltd

Value Added Statement

for the year ended 31st December, 2014

	(₹ in thousands)	*(₹ in thousands)*	*% thousands*
Sales		6,240	
Less: Cost of bought in material and services:			
Production and operational			

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expenses			
₹ (4,320 – 8 - 620)	3,692		
Administration expenses ₹ (180 - 5)	175		
Interest on bank overdraft	109		
Interest on working capital loan	20		
Excise duties (Refer to working note)	180		
Other/miscellaneous charges ₹ (444 - 180)	264	(4,440)	
Value added by manufacturing and trading activities		1,800	
Add: Other income		55	
Total Value Added		1,855	
Application of Value Added:			
To Pay Employees :			
Salaries to Administrative staff		620	33.42
To Pay Directors:			
Salaries and Commission		5	0.27
To Pay Government:			
Local Tax	8		
Income Tax	55	63	3.40
To Pay Providers of Capital :			
Interest on Fixed Loan	51		
Dividend	160	211	11.37
To Provide For Maintenance and Expansion of the Company:			
Depreciation	16		
Fixed Assets Replacement Reserve	400		
Retained Profit ₹ (600 - 60)	540	956	51.54
		1,855	100.00

Reconciliation between Total Value Added and Profit Before Taxation:

	(₹ in thousands)	*(₹ in thousands)*
Profit before Tax		1,155
Add back:		

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Depreciation	16	
Salaries to Administrative Staff	620	
Director's Remuneration	5	
Interest on Fixed Loan	51	
Local Tax	8	700
Total Value Added		1,855

Working Note:

Calculation of Excise Duty

		(₹ in thousands)
Interest and other charges		624
Less : Interest on bank overdraft	109	
Interest on loan from ICICI	51	
Interest on loan from IFCI	20	(180)
Excise duties and other/miscellaneous charges		444

Assuming that these miscellaneous charges have to be taken for arriving at Value Added

(In the first part of Value Added Statement), the excise duty will be computed as follows.

Let excise duty be x; thus miscellaneous/ other charges =₹ 444 -x

Thus x = 1/10 x [₹ 6,240 – {₹ 3692+ ₹ 175+ ₹ 109+ ₹ 20+ x + (₹ 444-x)}]

= 1/10 x [₹ 6240 – ₹ 4440] = ₹ 180

Other/ miscellaneous charges = ₹ 444 – ₹ 180 = ₹ 264

The above solution is given accordingly.

However, if other/miscellaneous charges are taken as any type of application of Value Added (i.e, to be taken in the application part), then excise duty (x) will be computed as follows:

x = 1/10 x [₹ 6240 – ₹ (3692+175+109+20+x)]

x = 1/10 x [₹ 2244 – x]

11x = ₹ 2244

x = ₹ 204

And thus total value added will be ₹ 2040 + ₹ 55 (other income) = ₹ 2095

And accordingly, application part will be prepared, taking miscellaneous charges.

₹ ('000) 240 [i.e, ₹ 444 – ₹ 204] as the application of value added.

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(b) Computation of EVA

Particulars	*₹ in crores*
Net Operating Profit after Tax (NOPAT)	252.00
Less: Cost of Operating Capital Employed (COCE) [13.25% of ₹ 1,100]	(145.75)
Economic Value Added (EVA)	106.25

Working Notes:

1. Cost of Debt = Interest Rate (1 – Tax Rate) = 15% (1 - 30) = 10.50%
2. Cost of Preference Share = 15%
3. Cost of Equity = Risk Free Rate + (Beta x Equity Market Risk Premium)

   = (15.5% - 9%) + (1.5 x 9) = 20%
4. Total Capital Employed = 800 + 100 + 300 = 1,200 crores
5. WACC $= \left(\frac{800}{1,200}\times 10.50\%\right)+\left(\frac{100}{1,200}\times 15\%\right)+\left(\frac{300}{1,200}\times 20\%\right)$

   = 7% + 1.25% + 5% = 13.25%
6. Financial Leverage = $\frac{\text{EBIT}}{\text{EBIT -Interest}}=\frac{\text{EBIT}}{\text{EBIT}-120}$ = 1.5

   EBIT = (120 x 1.5)/0.5 = 360
7. Net Operating Profit after Tax = 360 - 30% of 360 = 252
8. Operating Capital Employed = Total Capital Employed - Non-Operating Capital Employed

   = 1,200 -100 = 1,100 crores

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PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

QUESTIONS

Index Futures

1. Mr. Careless was employed with ABC Portfolio Consultants. The work profile of Mr. Careless involves advising the clients about taking position in Future Market to obtain hedge in the position they are holding. Mr. ZZZ, their regular client purchased 100,000 shares of X Inc. at a price of $22 and sold 50,000 shares of A plc for $40 each having beta 2. Mr. Careless advised Mr. ZZZ to take short position in Index Future trading at $1,000 each contract.

   Though Mr. Careless noted the name of A plc along with its beta value during discussion with Mr. ZZZ but forgot to record the beta value of X Inc.

   On next day Mr. ZZZ closed out his position when:

   - Share price of X Inc. dropped by 2%
   - Share price of A plc appreciated by 3%
   - Index Future dropped by 1.5%

   Mr. ZZZ, informed Mr. Careless that he has made a loss of $114,500 due to the position taken. Since record of Mr. Careless was incomplete he approached you to help him to find the number of contract of Future contract he advised Mr. ZZZ to be short to obtain a complete hedge and beta value of X Inc.

   You are required to find these values.

2. Mr. X, is a Senior Portfolio Manager at ABC Asset Management Company. He expects to purchase a portfolio of shares in 90 days. However he is worried about the expected price increase in shares in coming day and to hedge against this potential price increase he decides to take a position on a 90-day forward contract on the Index. The index is currently trading at 2290. Assuming that the continuously compounded dividend yield is 1.75% and risk free rate of interest is 4.16%, you are required to determine:

   (a) Calculate the justified forward price on this contract.

   (b) Suppose after 28 days of the purchase of the contract the index value stands at 2450 then determine gain/ loss on the above long position.

   (c) If at expiration of 90 days the Index Value is 2470 then what will be gain on long position.

   Note: Take 365 days in a year and value of $e^{0.005942}$ = 1.005960, $e^{0.001849}$ = 1.001851.

3. Sensex futures are traded at a multiple of 50. Consider the following quotations of Sensex futures in the 10 trading days during February, 2014:

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Day	High	Low	Closing
4-2-14	3306.4	3290.00	3296.50
5-2-14	3298.00	3262.50	3294.40
6-2-14	3256.20	3227.00	3230.40
7-2-14	3233.00	3201.50	3212.30
10-2-14	3281.50	3256.00	3267.50
11-2-14	3283.50	3260.00	3263.80
12-2-14	3315.00	3286.30	3292.00
14-2-14	3315.00	3257.10	3309.30
17-2-14	3278.00	3249.50	3257.80
18-2-14	3118.00	3091.40	3102.60

Abshishek bought one sensex futures contract on February, 04. The average daily absolute change in the value of contract is ₹ 10,000 and standard deviation of these changes is ₹ 2,000. The maintenance margin is 75% of initial margin.

You are required to determine the daily balances in the margin account and payment on margin calls, if any.

Foreign Exchange Risk Management

4. Sun Ltd. is planning to import equipment from Japan at a cost of 3,400 lakh yen. The company may avail loans at 18 percent per annum with which it can import the equipment. The company has also an offer from Osaka branch of an India based bank extending credit of 180 days at 2 percent per annum against opening of an irrecoverable letter of credit.

   Additional information:

Present exchange rate	₹100 = 340 yen
180 day's forward rate	₹100 = 345 yen

   Commission charges for letter of credit at 2 per cent per 12 months.

   Advice the company whether the offer from the foreign branch should be accepted.

5. An exporter requests his bank to extend the forward contract for US$ 20,000 which is due for maturity on 31st October, 2014, for a further period of 3 months. He agrees to pay the required margin money for such extension of the contract.

   Contracted Rate – US$ 1= ₹ 62.32

   The US Dollar quoted on 31-10-2014:-

   Spot – 61.5000/61.5200

   3 months' Discount -0.93% /0.87%

   Margin money from bank's point of view for buying and selling rate is 0.45% and 0.20% respectively.

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Compute:

(i) The cost to the importer in respect of the extension of the forward contract, and

(ii) The rate of new forward contract.

6. Columbus Surgicals Inc. is based in US, has recently imported surgical raw materials from the UK and has been invoiced for £ 480,000, payable in 3 months. It has also exported surgical goods to India and France.

   The Indian customer has been invoiced for £ 138,000, payable in 3 months, and the French customer has been invoiced for € 590,000, payable in 4 months.

   Current spot and forward rates are as follows:

   £ / US$

   Spot: 0.9830 – 0.9850

   Three months forward: 0.9520 – 0.9545

   US$ / €

   Spot: 1.8890 – 1.8920

   Four months forward: 1.9510 – 1.9540

   Current money market rates are as follows:

   UK: 10.0% – 12.0% p.a.

   France: 14.0% – 16.0% p.a.

   USA: 11.5% – 13.0% p.a.

   You as Treasury Manager are required to show how the company can hedge its foreign exchange exposure using Forward markets and Money markets hedge and suggest which the best hedging technique is.

Security Valuation

7. Suppose Mr. A is offered a 10% Convertible Bond (par value ₹ 1,000) which either can be redeemed after 4 years at a premium of 5% or get converted into 25 equity shares currently trading at ₹ 33.50 and expected to grow by 5% each year. You are required to determine the minimum price Mr. A shall be ready to pay for bond if his expected rate of return is 11%.

8. The following data is related to 8.5% Fully Convertible (into Equity shares) Debentures issued by JAC Ltd. at ₹ 1000.

Market Price of Debenture	₹ 900
Conversion Ratio	30
Straight Value of Debenture	₹ 700
Market Price of Equity share on the date of Conversion	₹ 25
Expected Dividend Per Share	₹ 1

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You are required to calculate:

(a) Conversion Value of Debenture

(b) Market Conversion Price

(c) Conversion Premium per share

(d) Ratio of Conversion Premium

(e) Premium over Straight Value of Debenture

(f) Favourable income differential per share

(g) Premium pay back period

Financial Services

9. A Ltd. has an export sale of ₹ 50 crore of which 20% is paid by importers in advance of dispatch and for balance the average collection period is 60 days. However, it has been observed that these payments have been running late by 18 days. The past experience indicates that bad debt losses are 0.6% on Sales. The expenditure incurred for efforts in receivable collection are ₹ 60,00,000 p.a.

   So far A Ltd. had no specific arrangements to deal with export receivables, following two proposals are under consideration:

   (i) A non-recourse export factoring agency is ready to buy A Ltd.'s receivables by charging 2% commission. The factor will pay an advance on receivables to the firm at an interest rate of MIBOR + 1.75% after withholding 20% as reserve.

   (ii) Insu Ltd. an insurance company has offered a comprehensive insurance policy at a premium of 0.45% of the sum insured covering 85% of risk of non-payment. A Ltd. can assign its right to a bank in return of an advance of 75% of the value insured at MIBOR+1.50%.

   Assuming that MIBOR is 6% and A Ltd. can borrow from its bank at MIBOR+2% by using existing overdraft facility determine the which of the two proposal should be accepted by A Ltd. (1 Year = 360 days).

Capital Rationing

10. JHK Private Ltd. is considering 3 projects (not mutually exclusive) has no cash reserves, but could borrow upto ₹ 60 crore @ of 10% p.a. Though borrowing above this amount is also possible, but it shall be at a much higher rate of interest.

    The initial capital outlay required, the NPV and the duration of each of these project is as follows:

	Initial Capital Outlay (₹ Crore)	NPV (₹ Crore)	Duration (Years)
Project X	30.80	5.50	6
Project Y	38.00	7.20	7
Project Z	25.60	6.50	Indefinite

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Other information:

1. Cost of capital of JHK is 12%.
2. Applicable tax rate is 30%.
3. All projects are indivisible in nature and cannot be postponed.

You are required to:

(a) Comment whether given scenario is a case of hard capital rationing or soft capital rationing.

(b) Which project (or combination thereof) should be accepted if these investment opportunities are likely to be repeated in future also?

(c) Assuming that these opportunities are not likely to be available in future then and Government is ready to support Project Y on following terms then which projects should be accepted.

(i) A cash subsidy of ₹ 7 crore shall be available.

(ii) 50% of initial cash outlay shall be available at subsidized rate of 8% and repaid in 8 equal installments payable at the end of each year.

Mergers and Acquisitions

11. M plc and C plc operating in same industry are not experiencing any rapid growth but providing a steady stream of earnings. M plc's management is interested in acquisition of C plc due to its excess plant capacity. Share of C plc is trading in market at £4 each. Other date relating to C plc is as follows:

Particulars	M plc	C plc	Combined Entity
Profit after tax	£4,800,000	£3,000,000	£9,200,000
Residual Net Cash Flow per year	£6,000,000	£4,000,000	£12,000,000
Required return on Equity	12.5%	11.25%	12.00%

Balance Sheet of C plc

Assets	Amount (£)	Liabilities	Amount (£)
Current Assets	27,300,000	Current Liabilities	13,450,000
Other Assets	5,500,000	Long Term Liabilities	11,100,000
Property Plants & Equipments	21,500,000	Reserve & Surplus	24,750,000
		Share Capital	5,000,000
		(5 million common shares @ £1 each)	
	54,300,000		54,300,000

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You are required to compute:

(i) Minimum price per share C plc should accept from M plc.

(ii) Maximum price per share M plc shall be willing to offer to C plc.

(iii) Floor Value of per share of C plc. Whether it shall play any role in decision for its acquisition by M plc.

12. Hanky Ltd. and Shanky Ltd. operate in the same field, manufacturing newly born babies's clothes. Although Shanky Ltd. also has interests in communication equipments, Hanky Ltd. is planning to take over Shanky Ltd. and the shareholders of Shanky Ltd. do not regard it as a hostile bid.

The following information is available about the two companies.

	Hanky Ltd.	Shanky Ltd.
Current earnings	₹ 6,50,00,000	₹ 2,40,00,000
Number of shares	50,00,000	15,00,000
Percentage of retained earnings	20%	80%
Return on new investment	15%	15%
Return required by equity shareholders	21%	24%

Dividends have just been paid and the retained earnings have already been reinvested in new projects. Hanky Ltd. plans to adopt a policy of retaining 35% of earnings after the takeover and expects to achieve a 17% return on new investment.

Saving due to economies of scale are expected to be ₹ 85,00,000 per annum.

Required return to equity shareholders will fall to 20% due to portfolio effects.

Requirements

(a) Calculate the existing share prices of Hanky Ltd. and Shanky Ltd.

(b) Find the value of Hanky Ltd. after the takeover

(c) Advise Hanky Ltd. on the maximum amount it should pay for Shanky Ltd.

13. A Ltd. (Acquirer company's) equity capital is ₹ 2,00,00,000. Both A Ltd. and T Ltd. (Target Company) have arrived at an understanding to maintain debt equity ratio at 0.30 : 1 of the merged company. Pre-merger debt outstanding of A Ltd. stood at ₹ 20,00,000 and T Ltd at ₹ 10,00,000 and marketable securities of both companies stood at ₹ 40,00,000.

You are required to determine whether liquidity of merged company shall remain comfortable if A Ltd. acquires T Ltd. against cash payment at mutually agreed price of ₹ 65,00,000.

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International Capital Budgeting

14. XY Limited is engaged in large retail business in India. It is contemplating for expansion into a country of Africa by acquiring a group of stores having the same line of operation as that of India.

    The exchange rate for the currency of the proposed African country is extremely volatile. Rate of inflation is presently 40% a year. Inflation in India is currently 10% a year. Management of XY Limited expects these rates likely to continue for the foreseeable future.

    Estimated projected cash flows, in real terms, in India as well as African country for the first three years of the project are as follows:

	Year – 0	Year – 1	Year – 2	Year - 3
Cashflows in Indian ₹ (000)	-50,000	-1,500	-2,000	-2,500
Cash flows in African Rands (000)	-2,00,000	+60,000	+80,000	+1,00,000

    It evaluates all investments using nominal cash flows and a nominal discounting rate. The present exchange rate is African Rand 6 to ₹ 1.

    You are required to calculate the net present value of the proposed investment considering the following:

    (i) African Rand cash flows are converted into rupees and discounted at a risk adjusted rate.

    (ii) All cash flows for these projects will be discounted at a rate of 20% to reflect it's high risk.

    (iii) Ignore taxation.

	Year - 1	Year - 2	Year - 3
PVIF @ 20%	.833	.694	.579

Portfolio Management

15. Following data is related to Company X, Market Index and Treasury Bonds for the current year and last 4 years:

Year	Company X		Market Index		Return on Treasury Bonds
	Average Share Price (P)	Dividend Per Share (D)	Average Market Index	Market Dividend Yield	
2010	₹ 139	₹ 7.00	1300	3%	7%
2011	₹ 147	₹ 8.50	1495	5%	9%
2012	₹ 163	₹ 9.00	1520	5.5%	8%

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2013	₹ 179	₹ 9.50	1640	4.75%	8%
2014 (Current Year)	₹ 203.51	₹ 10.00	1768	5.5%	8%

With the above data estimate the beta of Company X's share.

16. The rates of return on the security of Company X and market portfolio for 10 periods are given below:

Period	Return of Security X (%)	Return on Market Portfolio (%)
1	20	22
2	22	20
3	25	18
4	21	16
5	18	20
6	–5	8
7	17	–6
8	19	5
9	–7	6
10	20	11

(i) What is the beta of Security X?

(ii) What is the characteristic line for Security X?

Economic Value Added

17. ABC Ltd. has divisions A,B & C. The division C has recently reported on annual operating profit of ₹ 20,20,00,000. This figure arrived at after charging ₹ 3 crores full cost of advertisement expenditure for launching a new product. The benefits of this expenditure is expected to be lasted for 3 years.

The cost of capital of division C is ₹11% and cost of debt is 8%.

The Net Assets (Invested Capital) of Division C as per latest Balance Sheet is ₹ 60 crore, but replacement cost of these assets is estimated at ₹84 crore.

You are required to compute EVA of the Division C.

Equity Beta

18. The total market value of the equity share of O.R.E. Company is ₹ 60,00,000 and the total value of the debt is ₹ 40,00,000. The treasurer estimate that the beta of the stock is currently 1.5 and that the expected risk premium on the market is 10 per cent. The Treasury bill rate is 8 per cent.

Required:

(1) What is the beta of the Company's existing portfolio of assets?

(2) Estimate the Company's Cost of capital and the discount rate for an expansion of the company's present business.

Venture Capital Financing

19. TMC is a venture capital financier. It received a proposal for financing requiring an investment of ₹45 crore which returns ₹600 crore after 6 years if succeeds. However, it may be possible that the project may fail at any time during the six years.

The following table provide the estimates of probabilities of the failure of the projects.

Year	1	2	3	4	5	6
Probability of Failure	0.28	0.25	0.22	0.18	0.18	0.10

In the above table the probability that the project fails in the second year is given that it has survived throughout year 1. Similarly for year 2 and so forth.

TMC is considering an equity investment in the project. The beta of this type of project is 7. The market return and risk free rate of return are 8% and 6% respectively. You are required to compute the expected NPV of the venture capital project and advice the TMC.

20. Write a short note on

(a) Arbitrage Pricing Theory

(b) Conglomerate Merger

(c) Takeover Strategies

(d) Factors affecting investment decision in portfolio management

(e) Role of Investment Banks in Private Placement

SUGGESTED ANSWERS/HINTS

1. Let the number of contract in Index future be y and Beta of X Inc. be x. Then,

$$\frac{100{,}000 \times 22 \times x - 50{,}000 \times 40 \times 2}{1{,}000} = -y^{*}$$

* Negative (-) sign indicates the sale (short) position

2,200,000x – 4,000,000 = -1,000y

Cash Outlay (Outflow)

Purchase of 100,000 shares of X Inc. at a price of $22 (100,000 × 22)	2,200,000
Sale of 50,000 shares of A plc for $40 (50,000 × 40)	– 2,000,000

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Short Position in Index Futures (1,000 × y)	-1,000y*
Net	200,000 – 1,000y

* Negative (-) sign indicates the indicates inflow due to sale (short) position

Cash Inflow

Sale of 100,000 shares of X Inc. (100,000 × 22 × 0.98)	2,156,000
Purchase of 50,000 shares of A plc (50,000 × 40 × 1.03)	– 2,060,000
Long Position in Index Futures (1,000 × y x 0.985)	-985y
Net	96,000 – 985y

* Negative (-) sign indicates the indicates outflow due to purchase (long) position

Position on Close Out

(200,000 -1,000 y) – (96,000 - 985y) = 114,500

y=-700

Thus number of future contract short is 700

Beta of X Inc. can be calculated as follows:

2,200,000x – 4,000,000 = -1000 × 700

2,200,000x = 3,300,000

x = 1.5

Thus Beta of X Inc. shall be 1.5

2. **(a)** The Forward Price shall be = $S_0e^{n(r-y)}$

Where

S_0 = Spot price

n = period

r = risk free rate of interest

y = dividend yield

Accordingly,

Forward Price = $2290\ e^{90/365(0.0416 - 0.0175)}$

= $2290\ e^{0.005942}$

= 2290(1.005960)

= 2303.65

(b) Gain/loss on Long Position after 28 days

= $2450 - 2290\ e^{28/365(0.0416 - 0.0175)}$

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$= 2450 – 2290\ e^{0.001849}$

$= 2450 – 2290(1.001851)$

$= 2450 – 2294.24$

$= 155.76$

(c) Gain/loss on Long Position at maturity

$= S_n – S_0 e^{n(r – y)}$

$= 2470.00 – 2303.65 = 166.35$

3. Initial Margin $= \mu + 3\sigma$

Where μ = Daily Absolute Change

σ = Standard Deviation

Accordingly

Initial Margin = ₹ 10,000 + ₹ 6,000 = ₹ 16,000

Maintenance margin = ₹ 16,000 x 0.75 = ₹ 12,000

Day	Changes in future Values (₹)	Margin A/c (₹)	Call Money (₹)
4/2/14	-	16000	-
5/2/14	50 x (3294.40 - 3296.50)= -105	15895	-
6/2/14	50 x (3230.40 - 3294.40)= -3200	12695	-
7/2/14	50 x (3212.30 - 3230.40)= -905	16000	4210
10/2/14	50x(3267.50 - 3212.30)= 2760	18760	-
11/2/14	50x(3263.80 - 3267.50)= -185	18575	-
12/2/14	50x(3292 - 3263.80) =1410	19985	-
14/2/14	50x(3309.30 - 3292)=865	20850	-
17/2/14	50x(3257.80 - 3309.30)=-2575	18275	-
18/2/14	50x(3102.60 - 3257.80)=-7760	16000	5485

4. (1) Workings-

Option I (To finance the purchases by availing loan at 18% per annum):

Cost of equipment	*₹ in lakhs*
3400 lakh yen at ₹100 = 340 yen	1,000.00
Add: Interest at 18% (on ₹1000 lakhs) for 6 months	90.00
Total outflow in Rupees	1,090.00

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Option II (To accept the offer from foreign branch):

Cost of letter of credit	*₹ in lakhs*
At 1 % on 3400 lakhs yen at ₹100 = 340 yen	10.00
Add: Interest	0.90
(A)	10.90

Payment at the end of 180 days:

Cost	3400.00 lakhs yen
Interest at 2% p.a. [3400 × 2/100 × 180/365]	33.53 lakhs yen
	3433.53 lakhs yen
Conversion at ₹100 = 345 yen [3433.53 / 345 × 100] (B)	= ₹995.23 lakhs
Total Cost: (A) + (B)	= 1006.13 lakhs

Advise: Option 2 is cheaper by (1090.00 – 1006.13) lakh or 83.87 lakh. Hence, the offer may be accepted.

5. (i) The contract is to be cancelled on 31-10-2014 at the spot selling rate of US$ 1 = ₹ 61.5200

Add: Margin Money 0.20%	= ₹ 0.1230
	= ₹ 61.6430 or ₹ 61.64
US$ 20,000 @ ₹ 61.64	= ₹ 12,32,800
US$ 20,000 @ ₹ 62.32	= ₹ 12,46,400
The difference in favour of the Customer	= ₹ 13,600

(ii) The Rate of New Forward Contract

Spot Selling Rate US$ 1	= ₹ 61.5000
Less: Discount @ 0.93%	= ₹ 0.5720
	= ₹ 60.9280
Less: Margin Money 0.45%	= ₹ 0.2742
	= ₹ 60.6538 or ₹ 60.65

6. £ Exposure

Since Columbus has a £ receipt (£ 138,000) and payment of (£ 480,000) maturing at the same time i.e. 3 months, it can match them against each other leaving a net liability of £ 342,000 to be hedged.

(i) Forward market hedge

Buy 3 months' forward contract accordingly, amount payable after 3 months will be

£ 342,000 / 0.9520 = US$ 359,244

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(ii) Money market hedge

To pay £ after 3 months' Columbus shall requires to borrow in US$ and translate to £ and then deposit in £.

For payment of £ 342,000 in 3 months (@2.5% interest) amount required to be deposited now

(£ 342,000 ÷ 1.025) = £ 333,658

With spot rate of 0.9830 the US$ loan needed will be = US$ 339,429.

Loan repayable after 3 months @3.25% interest

[$339,429 (1+0.0325)] will be = US$ 350,460.

In this case the money market hedge is a cheaper option.

€ Receipt

Amount to be hedged = € 590,000

Now we Convert exchange rates to home currency

4 months forward 1.9510 – 1.9540

(i) Forward market hedge

Sell 4 months' forward contract accordingly, amount receivable after 4 months will be

(€ 590,000 X 1.9510) = US$ 1,151,090

(ii) Money market hedge

For money market hedge Columbus shall borrow in € and then translate to US$ and deposit in US$

For receipt of € 590,000 in 4 months (@ 5.33% interest) amount required to be borrowed now

(€590,000 ÷ 1.0533) = € 560,144

With spot rate of 0.5294 the US$ deposit will be = US$ 1,058,073

deposit amount will increase over 3 months (@3.83% interest) will be [$1058073 X 1.0383] = US$ 1,098,597

In this case, more will be received in US$ under the forward hedge.

7. First we shall find the Conversion Value of Bond

$CV = C\ (1+g)^n x\ R$

Where:

C = Current Market Price

g = Growth Rate of Price

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R = Conversion Ratio

n = No. of years

Accordingly, CV shall be

= ₹ 33.50 x 1.05^4 x 25 = ₹ 33.50 x 1.2155 x 25 = ₹ 1017.98

Value of Bond if Conversion is opted = ₹ 100 x PVAF (11%, 4) + ₹ 1017.98 PVF (11%,4)

= ₹ 100 x 3.102 + ₹ 1017.98 x 0.659

= ₹ 310.20 + ₹ 670.85 = ₹ 981.05

Since above value of Bond is based on the expectation of growth in market price which may or may not as per expectations. In such circumstances the redemption at premium still shall be guaranteed and bond may be purchased at its floor value computed as follows:

Value of Bond if Redemption is opted = ₹ 100 x PVAF (11%, 4) + ₹ 1050 PVF (11%,4)

= ₹ 100 x 3.102 + ₹ 1050 x 0.659

= ₹ 310.20 + ₹ 691.95 = ₹ 1002.15

8. (a) Conversion Value of Debenture

= Market Price of one Equity Share X Conversion Ratio

= ₹ 25 X 30 = ₹ 750

(b) Market Conversion Price

$$= \frac{\text{Market Price of Convertible Debenture}}{\text{Conversion Ratio}} = \frac{₹900}{30} = ₹\ 30$$

(c) Conversion Premium per share

Market Conversion Price – Market Price of Equity Share

= ₹ 30* – ₹ 25 = ₹ 5

$$*\left(\frac{₹\ 900}{30} = ₹\ 30\right)$$

(d) Ratio of Conversion Premium

$$= \frac{\text{Conversion premium per share}}{\text{Market Price of Equity Share}} = \frac{₹5}{₹25} = 20\%$$

(e) Premium over Straight Value of Debenture

$$= \frac{\text{Market Price of Convertible Bond}}{\text{Straight Value of Bond}} - 1 = \frac{₹900}{₹700} - 1 = 28.6\%$$

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(g) Favourable income differential per share

$$\frac{\text{Coupon Interest from Debenture - Conversion Ratio} \times \text{Dividend Per Share}}{\text{Conversion Ratio}}$$

$$\frac{₹85 - 30 \times ₹1}{30} = ₹\ 1.833$$

(h) Premium pay back period

$$= \frac{\text{Conversion premium per share}}{\text{Favourable Income Differntial Per Share}} = \frac{₹5}{₹1.833} = 2.73 \text{ years}$$

9. Working Notes:

Total Annual Export Sales	₹ 50 crore
Cash Received in Advance (20%)	₹ 10 crore
Balance on 60 days credit (80%)	₹ 40 crore
Bad Debts 0.6% x ₹ 40 crore	₹ 0.24 crore
Average Export Debtors ₹ 40 crore x $\frac{78}{360}$	₹ 8.67 crore

Proposal I – Factoring Services

Due to non-recourse factoring agreement there will be saving of bad debt. A Ltd. can choose one option out of these options:

(a) Using Factoring Services (Debt Collection) only.

(b) Using Factoring and Finance Services i.e. above services in combination of cash advance.

Since, cash advance rate is lower by 0.25% (2.00% - 1.75%), A Ltd. should take advantage of the same.

Particulars	Amount (₹)
Annual Factoring Commission (2% x ₹ 40 crore)	(0.80 crore)
Saving of Administrative Cost	0.60 crore
Saving of Bad Debts	0.24 crore
Interest Saving on 80% of Debtors (₹ 8.67 crore x 80% x 0.25%)	0.01734 crore
Net Saving to A Ltd.	0.05734 crore

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Proposal II – Insurance of Receivables

Particulars	Amount (₹)
Insurance Premium (0.45% x ₹ 40 crore)	(0.180 crore)
Saving of Bad Debts (85% x ₹ 0.24 crore)	0.204 crore
Interest Saving on 75% of Debtors (0.5% x 75% x ₹ 8.67 crore)	0.03251 crore
Net Saving to A Ltd.	0.05651 crore

Since saving in Factoring is marginally higher it should be accepted.

10. (a) Hard Capital Rationing is a situation is due to factors external to the orgnaisation. In other words It implies a situation where in an entity could not raise funds beyond a certain point due to external circumstances. On the contrary, when an entity is unable to raise funds beyond a certain limits due to reasons internal to the organization is the case of Soft Capital Rationing. These limitations may be due to any reason such as budgetary ceiling, difficulty in planning and control etc. Since in the given case the limitation of loan upto ₹ 30 crore is due to unwillingness to take loan at expensive rate, it will be a case of Soft Capital Rationing.

(b) **Computation of Equivalent Annuities**

	Project X	Project Y	Project Z
NPV (₹ Crore) (1)	5.50	7.20	6.50
Duration (2)	6 years	7 years	Indefinite
PVAF@12% (3)	4.111	4.564	8.33
Equivalent Cash Inflow (₹ Crore) [(1)/(3)]	1.34	1.58	0.780
Ranking	II	I	III

Since equivalent cash inflow is maximum in case of Project Y, same should be accepted.

(c) If the projects are not repeated in the future it shall be decided on the basis of NPV as follows:

Combinations	Initial Investments (₹ Crore)	NPV (₹ Crore)	Possible/Not Possible	Ranking
X	30.80	5.50	Possible	IV
Y	38.00	7.20	Possible	II
Z	25.60	6.50	Possible	III
XY	30.80+38.00 = 68.80	12.70	Not Possible	-
YZ	38.00+25.60 = 63.60	13.70	Not Possible	-
XZ	30.80+25.60= 56.40	12.00	Possible	I

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Thus combination XZ should be accepted as it results in maximum NPV.

Now let us consider the aspect of Government support to evaluate the project Y using Adjusted Present Value (APV) approach as follows:

- Base NPV = ₹ 7.20 Crore + ₹ 7 crore = ₹ 14.20 crore
- Present value of side effect of financing

1. Grant of Cash Subsidy ₹ 7.00 crore
2. Subsidized Loan 50% (₹ 38 crore - ₹ 7 crore) = ₹ 15.50 crore

Present Value of Side Effect of Financing

	₹ Crore
Tax benefit on Interest (₹ 15.50 crore x 8% x 30%)	0.372
Saving on Interest (₹ 15.50 crore x 2%)	0.310
Tax benefit foregone on Interest (₹ 15.50 crore x 2% x 30%)	(0.093)
	0.589
PVAF @ 10% for 8 years	5.335
Present Value of Side Effect of Financing (0.589 x 5.335)	3.1423

APV = Base NPV + Present Value of Side Effect of Financing

= ₹ 14.20 crore + ₹ 3.1423 crore = ₹ 17.3423 crore

Since APV of Project Y is more than combination XZ same should be accepted.

11. Working Notes:

Value of C plc = $\frac{\text{Residual Cash Flow}}{k_e - g} = \frac{4,000,000}{0.1125-0}$ = £35,555,556

Value of per share of C plc = $\frac{35,555,556}{5,000,000}$ = £7.11

Book Value of per share of C plc = $\frac{29,750,000}{5,000,000}$ = £5.95

Value of M plc = $\frac{\text{Residual Cash Flow}}{k_e - g} = \frac{6,000,000}{0.125-0}$ = £48,000,000

Value of Combined Entity = $\frac{12,000,000}{0.12-0}$ = £100,000,000

Value of Synergy = Value of Combined Entity – Individual Value of M plc and C plc

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Value of Synergy = £100,000,000 – (£48,000,000 + £35,555,556) = £16,444,444

(i) Minimum price per share C plc should accept from M plc is £5.95 (current book value).

(ii) Maximum price per share M plc shall be willing to offer to C plc shall be computed as follows:

$$= \frac{\text{Value of C plc as per Residual Cash Flow} + \text{Synergy Benefits}}{\text{No. of shares}}$$

$$= \frac{35,555,556 + 16,444,444}{5,000,000} = \frac{52,000,000}{5,000,000} = £10.40$$

(iii) Floor Value of per share of C plc shall be £4 (current market price) and it shall not play any role in decision for the acquisition of C plc as it is lower than its current book value.

12. (a) Existing share price of Hanky Ltd.

g = r x b

r = 15%

b = 20%

g = 0.15 x 0.2

= 0.03

$$\text{Ex dividend market value} = \frac{\text{Next year's dividend}}{k_e - g}$$

$$= \frac{6,50,00,000 \times 0.8 \times 1.03}{0.21 - 0.03} = ₹\ 29,75,55,556$$

$$\text{Value of one share} = \frac{₹29,75,55,556}{5000000} = ₹\ 59.51 \text{ per share}$$

Existing share price Shanky Ltd.

g = r x b

= 0.15 x 0.8 = 0.12

$$\text{Ex dividend market value} = \frac{\text{Next year's dividend}}{k_e - g}$$

$$= \frac{2,40,00,000 \times 0.2 \times 1.12}{0.24 - 0.12} = ₹\ 4,48,00,000$$

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Value of one share = $\frac{₹4,48,00,000}{1500000}$ = ₹ 29.87 per share

(b) Value of Hanky Ltd. after the takeover

Care must be taken in calculating next year's dividend and the subsequent growth rate. Next year's earnings are already determined, because both companies have already reinvested their retained earnings at the current rate of return. In addition, they will get cost savings of ₹ 85,00,000.

The dividend actually paid out at the end of next year will be determined by the new 35% retention and the future growth rate will take into account the increased return on new investment.

Growth rate for combined firm, g = 0.17 x 0.35 = 0.06

New cost of equity = 20%

Next year's earnings = ₹ 6,50,00,000 x 1.03 + ₹ 2,40,00,000 x 1.12 + ₹ 85,00,000

= ₹ 10,23,30,000

Next year's dividend = ₹ 10,23,30,000 x 0.65

= ₹ 6,65,14,500

Market value = $\frac{₹6,65,14,500}{0.20 - 0.06}$ = ₹ 47,51,03,571

(c) Maximum Hanky Ltd. should pay for Shanky Ltd.

Combined value = ₹ 47,51,03,571

Present Value of Hanky Ltd. = ₹ 29,75,55,556

= ₹ 17,75,48,015

13.

	₹
Debt capacity of merged company (2,00,00,000 × 0.30)	60,00,000
Less: Debt of A Ltd and T Ltd.	30,00,000
	30,00,000
Add: Marketable securities of both companies	40,00,000
	70,00,000

Since the combined liquidity of merged company shall remain comfortable, it shall be feasible to pay cash for acquiring the T Ltd. against tentative price of ₹ 65,00,000.

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14. **Calculation of NPV** (‘000)

Year	0	1	2	3
Inflation factor in India	1.00	1.10	1.21	1.331
Inflation factor in Africa	1.00	1.40	1.96	2.744
Exchange Rate (as per IRP)	6.00	7.6364	9.7190	12.3696
Cash Flows in ₹ ’000				
Real	-50000	-1500	-2000	-2500
Nominal (1)	-50000	-1650	-2420	-3327.50
Cash Flows in African Rand ’000				
Real	-200000	60000	80000	100000
Nominal	-200000	84000	156800	274400
In Indian ₹ ’000 (2)	-33333	11000	16133	22183
Net Cash Flow in ₹ ‘000 (1)+(2)	-83333	9350	13713	18855.50
PVF@20%	1	0.833	0.694	0.579
PV	-83333	7789	9517	10917

NPV of 3 years = -55110 (₹ ‘000)

15. First of we shall calculate expected return from share of Company X

(i) Average annual capital gain (%)

Let g = average annual capital gain, then:

₹ 203.51(1+g)^{¼} = ₹139

Then g = (203.51/139)^{¼} -1 = 0.10 i.e. 10%

(ii) Average annual dividend yield (%)

Year	Dividend/Share Price	Dividend Yield
2010	₹7.00/₹139	0.050
2011	₹8.50/ ₹147	0.058
2012	₹9.00/ ₹163	0.055
2013	₹9.50/ ₹179	0.053
2014 (Current Year)	₹10.00/ ₹203.51	0.049
		0.265

Average Yield = 0.265/5= 0.053 i.e. 5.3%

Thus with this data expected return of share of Company X can be given as follows:

$E(r_X)$ = Average Annual Capital Gain + Average Annual Dividend

= 10% + 5.3% = 15.3%

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Then we shall calculate expected return from market index as follows:

(i) Average annual capital gain (%)

$1300\ (1+g)^{1/4} = 1768$

Then $g = (1768/1300)^{1/4} - 1 = 0.08$ i.e. 8%

(ii) Average annual dividend yield (%)

3% + 5% + 5.5% + 4.75% + 5.5% = 23.75%/5 = 4.75%

Thus expected return on Market Index $E(r_M)$ = 8% + 4.75% = 12.75%

Average annual risk-free rate of return (Treasury Bond Return)

7% + 9% + 8% + 8% + 8% = 40%/5 = 8%

Now with the above information we compute Beta (β) of share company X using CAPM as follows:

$E(r_X) = r_f + \beta[E(r_M) - r_f]$

$15.3\% = 8\% + \beta[12.75\% - 8\%]$

$\beta = 1.54$

16. (i)

Period	R_X	R_M	$R_X - \bar{R}_X$	$R_M - \bar{R}_M$	$(R_X - \bar{R}_X)(R_M - \bar{R}_M)$	$(R_M - \bar{R}_M)^2$
1	20	22	5	10	50	100
2	22	20	7	8	56	64
3	25	18	10	6	60	36
4	21	16	6	4	24	16
5	18	20	3	8	24	64
6	-5	8	-20	-4	80	16
7	17	-6	2	-18	-36	324
8	19	5	4	-7	-28	49
9	-7	6	-22	-6	132	36
10	20	11	5	-1	-5	1
	150	120			357	706
	ΣR_X	ΣR_M			$\sum (R_X - \bar{R}_X)(R_M - \bar{R}_M)$	$\sum (R_M - \bar{R}_M)^2$

$\bar{R}_X = 15 \quad \bar{R}_M = 12$

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$$\sigma^2{}_M = \frac{\sum\left(R_M - \bar{R}_M\right)^2}{n} = \frac{706}{10} = 70.60$$

$$Cov_{X\,M} = \frac{\sum\left(R_X - \bar{R}_X\right)\left(R_M - \bar{R}_M\right)}{n} = \frac{357}{10} = 35.70$$

$$Beta_x = \frac{Cov_{X\,M}}{\sigma^2{}_M} = \frac{35.70}{70.60} = 0.505$$

(ii) $\bar{R}_X = 15$ $\bar{R}_M = 12$

$y = \alpha + \beta x$

$15 = \alpha + 0.505 \times 12$

Alpha (α) = 15 – (0.505 × 12)

= 8.94%

Characteristic line for security X = $\alpha + \beta \times R_M$

Where, R_M = Expected return on Market Index

$\therefore$ Characteristic line for security X = 8.94 + 0.505 R_M

17. First necessary adjustment of the data as reported by historical accounting system shall be made as follows:

	₹
Operating Profit	20,20,00,000
Add: Cost of unutilized Advertisement Expenditures	2,00,00,000
	22,20,00,000

Invested Capital (as per replacement cost) is ₹ 84 crore.

Accordingly,

EVA = Operating Profit – (Invested Capital x Cost of Capital)

= ₹ 22,20,00,000 – ₹ 84 crore x 11%

= ₹ 22.2 crore – ₹ 9.24 crore

= ₹ 12.96 crore

18. (1) $\beta_{company} = \beta_{equity} \times \frac{V_E}{V_0} + B_{debt} \times \frac{V_D}{V_0}$

Note: Since β_{debt} is not given it is assumed that company debt capital is virtually riskless.

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If company's debt capital is riskless than above relationship become:

$$\beta_{company} = \beta_{equity} \frac{V_E}{V_0} \quad \text{as } \beta_{debt} = 0$$

Here $\beta_{equity} = 1.5$;

V_E = ₹ 60 lakhs.

V_D = ₹ 40 lakhs.

V_0 = ₹ 100 lakhs.

$$\beta_{company} = 1.5 \times \frac{₹ \text{ 60 lakhs}}{₹ \text{ 100 lakhs}}$$

= 0.9

(2) Company's cost of equity = R_f + β_A × Risk premium

Where R_f = Risk free rate of return

β_A = Beta of company assets

Therefore, company's cost of equity = 8% + 0.9 × 10 = 17% and overall cost of capital shall be

$$= 17\% \times \frac{60,00,000}{100,00,000} + 8\% \times \frac{40,00,000}{100,00,000}$$

= 10.20% + 3.20% = 13.40%

Alternatively it can also be computed as follows:

Cost of Equity = 8% + 1.5 x 10 = 23%

Cost of Debt = 8%

WACC (Cost of Capital) = $23\% \times \frac{60,00,000}{1,00,00,000} + 8\% \times \frac{40,00,000}{1,00,00,000}$ = 17%

In case of expansion of the company's present business, the same rate of return i.e. 13.40% will be used. However, in case of diversification into new business the risk profile of new business is likely to be different. Therefore, different discount factor has to be worked out for such business.

19. Impact of Financial Restructuring

(i) First we shall find out the probability the venture capital project survives to the end of six years.

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Year	Probability Project survives
1	(1– 0.28) = 0.72
2	(1– 0.28)(1– 0.25)=0.72 × 0.75=0.54
3	(1– 0.28)(1– 0.25)(1-0.22)=0.72 × 0.75 × 0.78=0.4212
4	(1– 0.28)(1– 0.25)(1– 0.22)(1– 0.18)=0.72 × 0.75 × 0.78 × 0.82=0.3454
5	(1–0.28)(1–0.25)(1–0.22)(1–0.18)(1– 0.18) = 0.72 × 0.75 × 0.78 × 0.82 × 0.82 =0.2832
6	(1– 0.28)(1– 0.25)(1– 0.22)(1– 0.18)(1– 0.18) (1– 0.10) = 0.72 × 0.75 × 0.78 × 0.82 × 0.82 × 0.90=0.255

Thus, probability of project will fail = 1 – 0.255 = 0.745

(ii) Next using CAPM we shall compute the cost of equity to compute the Present Value of Cash Flows

$K_e = R_f + \beta (R_m - R_f)$

= 6% +7 (8% – 6%) = 20%

(iii) Now we shall compute the net present value of the project

The present value of cash inflow after 6 years

(₹600 Crore ×PVIF 20%)	₹ 201 Crore
Less:- Present value of Cash outflow	₹ 45 Crore
	₹156 Crore
Net Present Value of project if it fails	(₹ 45 Crores)
Hence, expected NPV = (0.255)(156) + (0.745)(-45)	₹6.255 Crores

Since expected NPV of the project is positive it should be accepted.

20. (a) Unlike the CAPM which is a single factor model, the APT is a multi factor model having a whole set of Beta Values – one for each factor. Arbitrage Pricing Theory states that the expected return on an investment is dependent upon how that investment reacts to a set of individual macro-economic factors (degree of reaction measured by the Betas) and the risk premium associated with each of those macro – economic factors. The APT developed by Ross (1976) holds that there are four factors which explain the risk premium relationship of a particular security. Several factors being identified e.g. inflation and money supply, interest rate, industrial production and personal consumption have aspects of being inter-related.

According to CAPM, $E(R_i) = R_f + \lambda_{\beta_i}$

Where, λ is the average risk premium $[E(R_m) - R_f]$

In APT, $E(R_i) = R_f + \lambda_1\beta_{i_1} + \lambda_2\beta_{i_2} + \lambda_3\beta_{i_3} + \lambda_4\beta_{i_4}$

Where, $\lambda_1, \lambda_2, \lambda_3, \lambda_4$ are average risk premium for each of the four factors in the model and $\beta_{i_1}, \beta_{i_2}, \beta_{i_3}, \beta_{i_4}$ are measures of sensitivity of the particular security i to each of the four factors.

(b) Such mergers involve firms engaged in unrelated type of business operations. In other words, the business activities of acquirer and the target are neither related to each other horizontally (i.e., producing the same or competiting products) nor vertically (having relationship of buyer and supplier).In a pure conglomerate merger, there are no important common factors between the companies in production, marketing, research and development and technology. There may however be some degree of overlapping in one or more of these common factors. Such mergers are in fact, unification of different kinds of businesses under one flagship company. The purpose of merger remains utilization of financial resources, enlarged debt capacity and also synergy of managerial functions.

(c) Normally acquisitions are made friendly, however when the process of acquisition is unfriendly (i.e., hostile) such acquisition is referred to as 'takeover'). Hostile takeover arises when the Board of Directors of the acquiring company decide to approach the shareholders of the target company directly through a Public Announcement (Tender Offer) to buy their shares consequent to the rejection of the offer made to the Board of Directors of the target company.

Take Over Strategies: Other than Tender Offer the acquiring company can also use the following techniques:

- Street Sweep: This refers to the technique where the acquiring company accumulates larger number of shares in a target before making an open offer. The advantage is that the target company is left with no choice but to agree to the proposal of acquirer for takeover.
- Bear Hug: When the acquirer threatens the target to make an open offer, the board of target company agrees to a settlement with the acquirer for change of control.
- Strategic Alliance: This involves disarming the acquirer by offering a partnership rather than a buyout. The acquirer should assert control from within and takeover the target company.
- Brand Power: This refers to entering into an alliance with powerful brands to displace the target's brands and as a result, buyout the weakened company.

(d) Factors affecting Investment Decisions in Portfolio Management

(i) Objectives of investment portfolio: There can be many objectives of making an investment. The manager of a provident fund portfolio has to look for security (low risk) and may be satisfied with none too higher return. An aggressive

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investment company may, however, be willing to take a high risk in order to have high capital appreciation.

(ii) Selection of investment

(a) What types of securities to buy or invest in? There is a wide variety of investments opportunities available i.e. debentures, convertible bonds, preference shares, equity shares, government securities and bonds, income units, capital units etc.

(b) What should be the proportion of investment in fixed interest/dividend securities and variable interest/dividend bearing securities?

(c) In case investments are to be made in the shares or debentures of companies, which particular industries show potential of growth?

(d) Once industries with high growth potential have been identified, the next step is to select the particular companies, in whose shares or securities investments are to be made.

(iii) Timing of purchase: At what price the share is acquired for the portfolio depends entirely on the timing decision. It is obvious if a person wishes to make any gains, he should "buy cheap and sell dear" i.e. buy when the shares are selling at a low price and sell when they are at a high price.

(e) The investment banker's work involved in a private placement is quite similar to sell-side M&A representation. The bankers attempt to find a buyer by writing the private Placement Memorandum (PPM) and then contacting potential strategic or financial buyers of the client.

Because private placements involve selling equity and debt to a single buyer, the investor and the seller (the company) typically negotiate the terms of the deal. Investment bankers function as negotiators for the company, helping to convince the investor of the value of the firm. Fees involved in private placements work like those in public offerings. Usually they are a fixed percentage of the size of the transaction.

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PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

QUESTIONS

Standards on Auditing, Statements and Guidance Notes

1. (a) KRP Ltd., at its annual general meeting, appointed Mr. X, Mr. Y and Mr. Z as joint auditors to conduct auditing for the financial year 2013-14. For the valuation of gratuity scheme of the company, Mr. X, Mr. Y and Mr. Z wanted to refer their own known Actuaries. Due to difference of opinion, all the joint auditors consulted their respective Actuaries. Subsequently, major difference was found in the actuary reports. However, Mr. X agreed to Mr. Y's actuary report, though, Mr. Z did not. Mr. X contends that Mr. Y's actuary report shall be considered in audit report due to majority of votes. Now, Mr. Z is in dilemma.

   (I) You are required to briefly explain the responsibilities of auditors when they are jointly and severally responsible in respect of audit conducted by them and also guide Mr. Z in such situation.

   (II) Explain the responsibility of auditors, in case, report made by Mr. Y's actuary, later on, found faulty.

   (b) Yummy Ltd., dealing in manufacturing and trading of milk butter, has a benchmark in its product for so many years. Tasty Ltd., a rival company to Yummy Ltd., has introduced its new product, peanut butter. Due to being health conscious, the consumers have shifted from milk butter to peanut butter within few months. This has result into massive loss during the year to Yummy Ltd. due to non-selling of perishable milk products. The company has also started having negative net worth. It's production head, finance head and marketing head have also left the company. The company has no sound action plan to mitigate these situations. Kindly guide the auditor of Yummy Ltd., how he should deal with the situation.

2. LMN Ltd. supplies navy uniforms across the country. The company has 4 warehouses at different locations throughout the India and 5 warehouses at the borders. The major stocks are generally supplied from the borders. LMN Ltd. appointed M/s OPQ & Co. to conduct its audit for the financial year 2013-14. Mr. O, partner of M/s OPQ & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

   You are required to advise M/s OPQ & Co.,

   (i) How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?

   (ii) How an auditor is supposed to deal when attendance at physical inventory counting is impracticable?

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Audit Strategy, Planning and Programming

3. Your firm has been appointed as an auditor of YSPPP Ltd. The company operates 30 petrol stations throughout India. You are the senior in-charge of the audit for the year ending 31st March, 2014 and are engaged on the audit planning. The company's sites are long-established and supplying fuel, oil, air and water.

   Over the last few years, due to the intense price competition in petrol trading, the company has expanded its shops into mini-markets with a wide range of motor accessories, food, drinks and household products. The induction of mini-markets has increased the volume of cash transactions. This induction has also lead to scarcity of staff at each and every location. For that reason, part-time staffs are also recruited.

   Point-of-sale PCs have been installed at all the petrol stations, linked on-line via a network to the computer at head office. Sales and inventory data are entered directly from the PCs at branches.

   The company has an internal auditor, whose principal function is to monitor continuously and test the operation of internal controls throughout the organization. The internal auditor is also responsible for coordinating the year-end inventory count.

   Requirements:

   Prepare notes for a planning meeting with the audit partner which-

   (a) Identify, from the situation outlined above, circumstances particular to YSPPP Ltd. that should be taken into account while planning the audit, explaining clearly why these matters should be taken into account.

   (b) Describe the extent to which the work performed by the internal auditor may affect your planning, and the factors that could limit the use you may wish to make of his work.

Risk Assessment and Internal Control

4. (a) State briefly ten provisions of the Sarbanes-Oxley Act, 2002, which shall, if strictly applied to Indian Corporate, get successful results.

   (b) There are many objectives to maintain internal control systems. These include to ensuring that:

      (i) Transactions are executed through management authorization.

      (ii) All transactions are promptly recorded in an appropriate manner to permit the preparation of financial information and to maintain accountability of assets.

      (iii) Assets and records are safeguarded from unauthorized access, use or disposition.

      (iv) Assets are verified at reasonable intervals and appropriate action is taken with regard to the discrepancies.

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In case of absence of internal control system, errors, omissions, or misappropriation of assets are likely to occur. Therefore, auditors need to pay meticulous attention to both the designing and operation of internal control.

You are required to:

(i) Describe the types of errors, omissions or misappropriation of assets that can occur, in the perspective of trade receivables, where internal controls are fragile.

(ii) Give some examples of matters which auditor may consider while determining the significant deficiencies in internal control.

(iii) Explain, how an auditor may determine, while doing Risk Assessment, whether any risk is a significant risk.

(iv) Illuminate important points which an auditor need to keep in mind with regard to letter of weakness in internal control system.

Audit under CIS Environment

5. MW&F Associates has been appointed as an auditor of a Multinational Company TTS Ltd. The company is working in a CIS environment. You are a member of the audit team of MW&F Associates. The partner in charge of MW&F Associates wants you to train your audit team member about use of Computer Assisted Auditing Techniques (CAATs). You are required to:

(a) Explain the factors that a statutory auditor has to consider, in determining, whether to use Computer Assisted Auditing Techniques (CAATs).

(b) Indicate the control procedures which the auditor should adopt in applying CAAT (Computer Assisted Audit Technique) in an audit under CIS environment.

The Company Audit & Audit Report

6. (a) M/s Renault & Co., Chartered Accountants, appointed as a statutory auditor of R Ltd. for the financial year 2013-14. The company is also in need of some actuarial services. Consequently, the Board of Directors of the company offered the same to M/s Sona & Co., an associate to M/s Renault & Co., which has been duly accepted by the firm. Comment.

(b) Navy and Cavy Associates, a Chartered Accountant firm, has been appointed as Statutory Auditor of Poor Ltd. for the financial year 2013-2014. Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, is indebted for ₹ 6,00,000 to Wealthy Ltd., a subsidiary company of Poor Ltd. Comment.

(c) Orange Ltd. is an unlisted public company. Its balance sheet shows paid up share capital of ₹ 5 crore and public deposits of ₹ 100 crore. The company appointed M/s Santra & Co., a chartered accountant firm, as the statutory auditor in its annual general meeting held at the end of September, 2014 for 11 years.

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You are required to state the provisions related to- rotation of auditor and cooling off period as per the section 139(2) of the Companies Act, 2013 in case of an individual auditor or an audit firm, both, and comment upon the facts of the case provided above with respect to aforesaid provisions.

(d) Mr. Pratiq, a practicing Chartered Accountant, has been appointed as an auditor of Opus Ltd. He is holding securities of the company having face value of ₹ 89,000 only.

(i) You are required to state, whether Mr. Pratiq is qualified to be appointed as an auditor of Opus Ltd.

(ii) Would your answer be different, if instead of Mr. Pratiq; Mr. Quresh, the step-father of Mr. Pratiq, is holding the securities?

7. Comment on the following situations:

(a) Zank Ltd. has flexi deposit linked current account with various banks. Cheques are issued from the current account and as per the requirements of funds, the flexi deposits are encashed and transferred to current accounts. As of 31st March, 2014 certain cheques issued to vendors are not presented for payment resulting in the credit balance in the books of the company. The management wants to present the book overdraft under current liabilities and flexi deposits under cash & bank balances.

(b) Mr. SB, a practicing Chartered Accountant, was appointed by CON Ltd. as Statutory Auditor. While doing the audit of CON Ltd., Mr. SB observed that certain loans and advances were made without proper securities; certain trade receivables and trade payables were adjusted *inter se*; and personal expenses were charged to revenue.

(c) Gracious Ltd. has made a contribution of ₹ 7.8 lacs during the financial year ended 31.3.14 to Samaj Seva Party, a political party, for running a teaching institute situated in the rural area, where most of the workers of the company reside. It is admitted that the benefit of the institute is mostly for the children of the workers of the company. The average net profit of the company during the three immediately preceding financial years was ₹ 100 lakhs.

(d) A firm of a father and a son is receiving ₹ 1 lakh towards job work done for ABC Ltd. during the year ending on 31.03.14. The total job work charges paid by ABC Ltd. during the year are over ₹ 25 lakhs. The father is a Managing Director of ABC Ltd. having substantial holding. The Managing Director told the auditor that since he is not involved in the activities of the firm and since the amount paid to it is insignificant; there is no need to disclose the transaction explicitly. He further contended that such a payment made in the last year was also not disclosed. Is Managing Director right in his approach?

(e) Divergence Pvt. Ltd. is an unlisted closely held company with turnover less than ₹ 50 crores. While finalizing the accounts, Mr. Nix, Director (finance), disputed the

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applicability of AS 20 to the company, on the basis of the fact that the company's shares are not listed on any recognised stock exchange in India.

8. (a) Mr. Man is a whole-time director of Manthan Ltd. who has a very good relation with the Director (Operations) of the company. Consequently, he entered into a purchase contract for supply of goods of ₹ 5,00,000 with the company without obtaining prior consent of the Board. What is the responsibility of the auditor in relation to the Companies Act, 2013?

(b) Mr. A, a practicing Chartered Accountant, audited the financial statements of C Ltd. for the previous year 2012-13 and expressed an unmodified opinion. C Ltd. was of the view that Mr. A is not conducting the audit properly and therefore, for the current year 2013-14, it appointed Ms. B, a leading practicing Chartered Accountant to conduct the audit and present Comparative Financial Statements. Ms. B, while performing the auditing procedures, found that C Ltd. has undercharged the wages of ₹ 10 lakhs during the previous year resulting in overstatement of profits. What are the further procedures, Ms. B is required to pursue?

(c) PK Ltd. has taken a term loan from a nationalized bank in 2012 for ₹ 350 lakhs repayable in 7 equal yearly instalments (including interest) of ₹ 50 lakhs beginning from 31st March, 2013 onwards. It had repaid the instalments due in 2013 & 2014, but defaulted in repayment of principal as well as interest for the current financial year 2015. Discuss the reporting responsibilities of the auditor of PK Ltd. in accordance with the Companies Act, 2013.

(d) The Balance Sheet of G Ltd as at 31st March, 2015 is as under. Comment on the presentation in terms of Schedule III and Accounting Standards.

Heading	Note No.	31st March, 15	31st March, 14
Equity & Liabilities			
Share Capital	1	XXX	XXX
Reserves & Surplus	2	0	0
Employee stock option outstanding	3	XXX	XXX
Share application money	4	XXX	XXX
Non-Current Liabilities		XXX	XXX
Deferred tax liability (Arising from Indian Income Tax)	5	XXX	XXX
Current Liabilities			
Trade Payables	6	XXX	XXX
Total		XXXX	XXXX
Assets			
Non-Current Assets			

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Fixed Assets-Tangible	7	XXX	XXX
CWIP (including capital advances)	8	XXX	XXX
Current Assets			
Trade Receivables	9	XXX	XXX
Deferred Tax Asset (Arising from Indian Income Tax)	10	XXX	XXX
Debit balance of Statement of Profit and Loss		XXX	XXX
Total		XXXX	XXXX

Liabilities of Auditor

9. (a) A Chartered Accountant in practice has been appointed as an auditor of a company which raised finance from the capital market on the basis of a prospectus issued a few years back. The main object for raising the finance was specified to be setting up a project on information technology.

The company advanced the sum so raised to various firms and private companies in which the directors of the company were a partner or a director respectively. These parties had no standing whatsoever with information technology. In the Balance Sheet, these advances appeared as a current asset under the head "Short-term Loans and Advances – unsecured, considered good". There was no mention to the notes to accounts about nature and purpose of such advances; and the auditor has issued routine audit report without any qualifications. On the very next day to the issuance of audit report, the directors and their related parties gone disappeared. The company, in which the auditor was conducting audit, has just vanished.

You are required to state whether the auditor will be held guilty for professional misconduct? Is there any liability subsists under any law?

(b) Mr. Fresh, a newly qualified chartered accountant, wants to start practice and he requires your advice, among other things, on criminal liabilities of an auditor under the Companies Act, 2013. Kindly guide him.

Audit Committee & Corporate Governance

10. (a) (i) Briefly explain the term 'Corporate Governance'.

(ii) You are required to elucidate the functions of the Audit Committee as per section 177 of the Companies Act, 2013.

(b) Disgust Limited, a company incorporated in India has six members in its Audit Committee. Due to recessionary conditions in India the revenue of the company is going down and there is slowdown in other activities of the company. Therefore, it was expected that there would not be significant work for members of the Audit Committee.

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Considering the overall recession in the company and the economy, the members of the Committee decided unanimously to meet only once at the year end. They reviewed monthly information system of the Company and found no errors.

As an auditor of Disgust Limited would you consider the decision taken by the Audit Committee to hold the meeting once in a year, is complying with the Clause 49 of the (SEBI) Listing Agreement? Also state the quorum requirements for such meetings.

Audit of Consolidated Financial Statements

11. H Ltd. owns 55% voting power in S Ltd. It however holds and discloses all the shares as "Stock-in-trade" in its accounts. The shares are held exclusively with a view to their subsequent disposal in the near future. H Ltd. represents that while preparing Consolidated Financial Statements, S Ltd. can be excluded from the consolidation. As a Statutory Auditor, how would you deal?

Audit of Banking Company & General Insurance Company

12. (a) You have been appointed as an auditor of Universal Bank, a nationalized bank. Universal Bank majorly deals in providing credit card facilities to its account holder. The bank is aware of the fact that there should be strict control over storage and issue of credit cards. How will you evaluate the Internal Control system in the area of Credit Card operations of a Bank?

    (b) Ordinary Insurance Ltd. has made a provision of 25% on unexpired risks reserve in its books. Comment.

Audit of Non Banking Financial Companies

13. (a) An auditor has been appointed for the audit of a loan financing company, registered as an NBFC. You are required to state special points to be kept in mind while auditing such company.

    (b) You are the auditor of IJK Ltd., an NBFC registered with RBI. How would you proceed to ensure the compliance of Prudential Norms directions by it?

Audit under Fiscal Laws

14. As a tax auditor, how would you report on the following situations?

    (a) Mr. Bhupesh, is a renowned criminal lawyer, practising in Meerut. During the previous year, he collected service tax of ₹ 25 lakhs but utilized it for his personal use. The Commissioner of Central Excise issued a show cause notice to him as to why the tax, collected by him, is not deposited to the government account. He appeared before the Commissioner and stated his inability to pay the sum due to financial crisis. The proceedings are still pending before the Commissioner.

    Mr. Bhupesh instructed his tax auditor not to disclose his service tax registration details, while filling particulars to be furnished in Form No. 3CD, believing that the income tax department might trace his scrutiny proceedings details pending before Commissioner of Central Excise which would bring disrepute to his profession.

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(b) BB Ltd., a non-resident company, is engaged in the business of extraction of mineral oils, having turnover of ₹ 20 lakhs during the financial year 2013-14. The company claims that its profits and gains chargeable to tax under the head "Profits and gains of business or profession" is lower than the deemed income chargeable under section 44BB of the Income Tax Act, 1961. Therefore, it decided to get its accounts audited under section 44AB of the Income tax Act, 1961.

(c) M/s. N.S. Enterprises, a manufacturing concern, sold a house property in Mumbai for a consideration of ₹ 48 lakh, to Mr. Gunaj on 1.8.2014. M/s. N. S. Enterprises had purchased the house property in the year 2012 for ₹ 40 lakh. The stamp duty value on the date of transfer, i.e., 1.8.2014, is ₹ 85 lakh for the house property.

(d) SL Pvt. Ltd. is a company engaged in the production of wool. Along with its production business, the company is also engaged in buying and selling of securities with the expectation of a favourable price change. It reports the following data for the current financial year:

S. No.	Particulars	Amount (in ₹)
1	Paid up Share Capital	100 lakhs
2	Capital Reserve	33 lakhs
3	Capital Redemption Reserve	45 lakhs
4	Revaluation Reserve	32 lakhs
5	Speculation Loss on account of Purchase and Sales of Securities	12 lakhs

(e) Saurabh International Ltd. (SIL) was engaged in providing certain services on which it did not pay any service tax. As per SIL, said services were not liable to service tax. However, Department issued a show cause notice to SIL demanding service tax alongwith interest worth ₹ 5,45,000 on the same and such demand was also confirmed. An appeal was filed to the Commissioner of Central Excise (Appeals) which passed an order which upheld the demand on SIL. SIL, being aggrieved by the order of the Commissioner of Central Excise (Appeals), decided to file an appeal to the CESTAT against such order. SIL has also requested the tax auditor not to report as those services were not liable for service tax and it has also filed an appeal for the same.

Cost Audit

15. (a) PS Ltd., a foreign company, having place of business in Delhi, is engaged in the production, trading, import and export of orthopaedic implants and pacemaker (temporary and permanent, both). The company's revenue from export is usually in foreign currency. Its total revenue classification for the current financial year is provided below:

Intra-state Sale ₹ 140 lakhs

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Inter-state Sale	₹ 155 lakhs
Export to US	₹ 490 lakhs
Export to UK	₹ 690 lakhs
Total Revenue	₹ 1475 lakhs

The management of the company is of the opinion that the company is not required to maintain cost records in their books of accounts. Consequently, there is no need to appoint cost auditor and conduct cost audit.

You are required to:

(i) Guide the management of the company with regard to maintenance of cost records and its audit.

(ii) Explain the manner of maintaining cost records briefly.

(b) Elucidate the provisions relating to submission of Cost Audit Report - to the Board and the Central Government as per the Companies Act, 2013.

Audit of Public Sector Undertakings

16. (a) Mr. X has been appointed as an Auditor of PSU Ltd., a Public Sector Undertaking, for the financial year 2014-15, though, government auditing is not his forte.

Thus, being an expert in the field of government audit, you are required to briefly explain him, the provisions related to the audit of government companies as per the Companies Act, 2013.

(b) Briefly explain the Areas of propriety audit under Section 143(1) of the Companies Act, 2013.

Internal Audit, Management and Operational Audit

17. (a) WWF Ltd. is a public company having ₹ 40 lacs paid up capital in previous financial year which raised to ₹ 60 lacs in current financial year under audit. The company had turnover of previous three consecutive financial years being ₹ 49 crores, ₹ 145 crores and ₹ 150 crores. During the previous year, WWF Ltd. borrowed a loan from a public financial institution of ₹ 110 crores but squared up ₹ 20 crores by the year end. The company does not have any internal audit system. In view of the management, internal audit system is not mandatory.

You are required to state-

(i) the provisions related to applicability of internal audit as per the Companies Act, 2013 and comment upon the contention of the management of the company.

(ii) who can be appointed as Internal Auditor?

(b) The operational auditor of a company observed a totaling error in invoice of ₹ 500. He has not taken care of the same saying that this is out of scope of his work. Comment.

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Investigation and Due Diligence

18. (a) Your client is considering taking over a manufacturing concern and desires, in the course of due diligence review, you to look specifically for any hidden liabilities and overvalued assets. State the major areas you would scrutinize for the above.

    (b) Briefly explain the investigation into the affairs of a company as envisaged under Section 210 of the Companies Act, 2013.

Professional Ethics

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

    (a) Mr. Clever, a Chartered Accountant, prepared a project report for one of his client, Mr. King, to obtain long term loan of ₹ 100 lakhs from a scheduled bank and decided to charge fees @10% of the loan approved. Subsequently, the bank approved the loan amounting to ₹ 80 lakhs. Consequent to the approval of loan by the bank, Mr. Clever raised an invoice for his services @10% of the loan approved, as decided.

    (b) Ms. Preeti is a practicing Chartered Accountant. Mr. Preet is a practicing Advocate representing matters in the court of law. Ms. Preeti and Mr. Preet decided to help each other in the matters involving their professional expertise. Accordingly, Ms. Preeti recommends Mr. Preet in all tax litigation matters in the court of law and Mr. Preet consults Ms. Preeti in all matters related to finance and other related matters, which comes to him in arguing various cases in the court of law. Consequently, they started sharing some part in the profits of their professional work.

    (c) A special notice has been issued for a resolution at 3rd annual general meeting of Fiddle Ltd. providing expressly that CA Smart shall not be re-appointed as an auditor of the company. Consequently, CA Smart submitted a representation in writing to the company as provided under section 140(4)(iii) of the Companies Act, 2013. In the representation, CA Smart incorporated his independent working as a professional throughout the term of office and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the Company.

    (d) Mr. Brainy, a Chartered Accountant in practice, is the auditor of Fair Ltd. He advised the Managing Director of the company to include 'orders under negotiation' in sales, to reflect higher profit and better financial position for obtaining bank loans in future. Mr. Brainy, thereafter, gave clean reports on the balance sheet prepared accordingly without examining the accounts.

Other Miscellaneous Chapters

20. Write short notes on the following:

    (a) Types of Market under NEAT System.

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

    (c) General steps to be followed while conducting a risk based audit.

    (d) Areas of Control for Reporting Stage of Peer Review.

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SUGGESTED ANSWERS/HINTS

1. (a) (I) **Difference of Opinion Among Joint Auditors:** SA 299 on, "Responsibility of Joint Auditors" deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:

(i) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;

(ii) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors;

(iii) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;

(iv) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute;

(v) for ensuring that the audit report complies with the requirements of the relevant statute;

(vi) it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;

(vii) the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors;

(viii) each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

Normally, the joint auditors are able to arrive at an agreed report. However where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express their own opinion through a separate report. A joint auditor is not bound by the views of majority of joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

In the instant case, there are three auditors, namely, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd. For the valuation of gratuity scheme of the Company they referred their own known Actuaries. Mr. Z (one of the

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joint auditor) is not satisfied with the report submitted by Mr. Y's referred actuary. He is not agreed with the matters to be covered by the report whereas Mr. X agreed with the same.

Hence, as per SA 299, Mr. Z is suggested to express his own opinion through a separate report whereas Mr. X and Mr. Y may provide their joint report for the same.

(II) Using the work of an Auditor's Expert: As per SA 620 "Using the Work of an Auditor's Expert", the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans etc., however, the auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert.

The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500.

Further, in view of SA 620, if the expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods must be ensured by the auditor and if the expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data in the circumstances must be verified by the auditor.

In the instant case, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd., referred their own known Actuaries for valuation of gratuity scheme. Actuaries are an auditor's expert as per SA 620. Mr. Y's referred actuary has provided the gratuity valuation report, which later on found faulty. Further, Mr. Z is not agreed with this report therefore he submitted a separate audit report specifically for such gratuity valuation.

In such situation, it was duty of Mr. X, Mr. Y and Mr. Z, before using the gratuity valuation report of Actuary, to ensure the relevance and reasonableness of assumptions and methods used. They were also required to examine the relevance, completeness and accuracy of source data used for such report before expressing their opinion.

Mr. X and Mr. Y will be held responsible for grossly negligence and using such faulty report without examining the adequacy of expert actuary's work whereas Mr. Z will not be held liable for the same due to separate opinion expressed by him.

(b) Inability to Continue as a Going Concern: As per SA 570 on "Going Concern", it is the responsibility of the Auditor to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude

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whether there is a material uncertainty about the entity's ability to continue as a going concern. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. In evaluating management's assessment, the auditor shall consider whether management's assessment includes all relevant information of which the auditor is aware as a result of the audit.

In the instant case, Yummy Ltd. has suffered massive loss due to introduction of a substitute of its product by its rival company, Tasty Ltd., and having negative net worth also. Besides this, its production head, finance head and marketing head have also left the company. The company, in addition, has no action plan to mitigate these situations. Thus there are clear indications that there is danger to entity's ability to continue in future. Considering the fact that there is no sound plan of action from the management to mitigate these factors and to put the company back on the recovery, the going concern assumption does not hold appropriate.

Therefore, the auditor should ask the management for its adequate disclosure in the financial statement and include the same in his report. However, if the management fails to make adequate disclosure, the auditor should express a qualified or adverse opinion.

If the result of the inappropriate assumption used in the preparation of financial statements is so material and pervasive as to make the financial statements misleading, the auditor should express an adverse opinion.

2. (i) Special Consideration with Regard to Inventory: As per SA 501 "Audit Evidence-Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(a) Attendance at physical inventory counting, unless impracticable, to:

(1) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;

(2) Observe the performance of management's count procedures;

(3) Inspect the inventory; and

(4) Perform test counts; and

(b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

(ii) Attendance at Physical Inventory Counting Not Practicable: In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the matter of difficulty, time, or cost

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involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Further, where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In some cases, though, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 on Modifications to the Opinion in the Independent Auditor's Report, requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

3. (a) **Planning an Audit:** As per SA 300 "Planning an Audit of Financial Statements", the objective of the auditor is to plan the audit so that it will be performed in an effective manner. For this, the auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit and that guides the development of the audit plan. The auditor is also required to update and change the overall audit strategy and the audit plan as necessary during the course of the audit.

In the instant case, YSPPP Ltd. is a company which operates 30 petrol stations throughout India. The company's sites are long-established and supplying fuel, oil, air and water. Over the last few years, due to the intense price competition in petrol trading, the company has expanded its shops into mini-markets as discussed in question. This induction has also lead to scarcity of staff; therefore, part-time staffs were also recruited. Point-of-sale PCs are also linked on-line via a network to the computer at head office. However, sales and inventory data are entered directly from the PCs at branches.

Circumstances particular to YSPPP Ltd. that should be taken into account while planning the audit, along with explanation for consideration is as under:

Circumstances	Why taken into account
➢ Multiple business locations.	➢ Increases inherent risk (e.g. if the organizational structure is loose and difficult to manage).
➢ Intense price competition.	➢ May lead to uneconomic price discounting, possibly threatening viability of business.
➢ Recent expansion of outlets into mini-markets.	➢ Increases complexity of business and may lead to loss of management control.

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➢ Perishable nature and limited shelf-life of food and drinks inventories.	➢ Increase risk of over statement of inventory values.
➢ Large volume of cash transactions.	➢ Increases risk of incomplete income recording.
➢ Nature of the business (garage environment).	➢ Increases risk of loss of inventories and cash due to theft or staff pilferage. ➢ May limit effectiveness of physical security controls (e.g. over access to terminals).
➢ Direct input via PCs at branches.	➢ Increases risk of misstatement, as batch controls will not be feasible and scope for other input controls may be limited.
➢ Small number of staff at each location (e.g. one or two).	➢ Limits scope for segregation of duties within branches and therefore increases control risk.
➢ Branch-based nature of business.	➢ Limits effectiveness of management control over activities of individual branches thereby increasing control risk.
➢ Use of part-time staff and high staff turnover.	➢ May inhibit effectiveness of controls within branches.

(b) Effect of Work of Internal Auditor on Audit Planning:

(i) The internal auditor's identification and documentation of areas of weakness will give direction to areas requiring increased substantive procedures.

(ii) Work of the internal auditor may assist in selection of branches for audit visits, (e.g. where control failures have occurred).

(iii) The internal auditor may attend year-end inventory counts at one or more branches, potentially reducing the number of branches to be visited by us.

(iv) Work performed by the internal auditor may provide evidence to confirm operation of control procedures, on which we may seek to rely to reduce the extent of our own procedures.

(v) Documentation of systems and controls by the internal auditor may reduce extent of our planning visits, as walkthrough checks may be sufficient to confirm systems documentation.

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4. (a) **Following are some Provisions of the Sarbanes-Oxley Act of 2002**, which, if enacted in India may be fruitful is respect of Indian corporate:

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

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

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

(iv) Additional disclosures imposed on financial reporting.

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

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

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

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

(ix) Strict action against white collar crime.

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

(b) (i) Types of Error, Omission or Misappropriation Which Can Occur in the Area of Trade Receivables, Where Internal Controls are Fragile, are provided below:

(1) Invoices raised for incorrect amounts- Invoices may be raised at lower price. This may particularly occur when there is a conspiracy between the sales department and the customer. This misappropriation may understate the trade receivables.

(2) Invoices raised to incorrect customers- Goods may be sold to customers without verifying their credit worthiness. There is greater possibility of dues being converted into bad debts.

(3) Failure to record invoice- The sales department may forget to record the invoice. This is an error of omission. This will lead to understatement of sales and trade receivables along with overstatement of closing inventory.

(4) Invoices recorded in different customer name- The invoices may be recorded in different customer name. There shall not be any discrepancy in total of trade receivables balance, but individual trade receivable account will not tally.

(5) Failure to record amount received from trade receivable- It may happen that the finance manager failed to record the amount received in cash. This omission may occur when amount received but not in office hours, amount received by the person not authorised to receive, amount

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received but not knowing on whose behalf, etc. This will lead to understatement of cash balance and overstatement of trade receivable balances.

(6) Inadequate follow up for recovery of dues- Regular follow up is required for recovery of dues from the customers. Absence of which, convert the dues receivable into bad debts. This leads to unnecessary loss of profit.

(ii) Matters considered for determining Significant Deficiencies in Internal Control: As per SA 265, "Communicating Deficiencies in Internal Control to those Charged with Governance and Management", significant deficiency in internal control means a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.

Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process; for example:
  - General monitoring controls (such as oversight of management).
  - Controls over the prevention and detection of fraud.
  - Controls over the selection and application of significant accounting policies.
  - Controls over significant transactions with related parties.
  - Controls over significant transactions outside the entity's normal course of business.
  - Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).
- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
- The interaction of the deficiency with other deficiencies in internal control.

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(iii) Significant Risk: As per SA 315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment", significant risk is an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

(1) Whether the risk is a risk of fraud;

(2) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;

(3) The complexity of transactions;

(4) Whether the risk involves significant transactions with related parties;

(5) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and

(6) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

When the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk.

(iv) Letter of Weakness: Material weaknesses are defined as absence of adequate controls on flow of transactions that increases the possibility of errors and frauds in the financial statements of the entity. The auditor should communicate such material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

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

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

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

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

5. (a) Consideration of Factors in Use of CAATs: In determining whether to use CAATs, the auditor should consider the following factors:

(i) Availability of sufficient IT knowledge and expertise- It is essential that members of the audit team should possess sufficient knowledge and experience to plan, execute and use the results of CAAT. The audit team should have sufficient knowledge to plan, execute and use the results of the particular CAAT adopted.

(ii) Availability of CAATs and suitable computer facilities and data in suitable format- The auditor may plan to use other computer facilities when the use of CAATs on an entity's computer is uneconomical or impractical, for example, because of an incompatibility between the auditor's package programme and entity's computer.

(iii) Impracticability of manual tests due to lack of evidence- Some audit procedures may not be possible to perform manually because they rely on complex processing (for example, advanced statistical analysis) or involve, amounts of data that would overwhelm any manual procedure.

(iv) Impact on effectiveness and efficiency in extracting a data- It includes selection of samples, applying analytical procedures, time involved in application of CAAT, etc.

(v) Time constraints in certain data, such as transaction details, are often kept for a short time and may not be available in machine-readable form by the time auditor wants them. Thus, the auditor will need to make arrangements for the retention of data required, or may need to alter the timing of the work that requires such data.

(b) Control Procedure While Applying Computer Assisted Auditing Techniques (CAATs): Computer Assisted Auditing Techniques (CAATs) involve performing audit procedures while conducting audit through the computer. Audit software and Test Data are two common types of CAATs. Using CAATs involves taking various measures including monitoring so that the use of CAATs by the auditor provides reasonable assurance that the audit objectives and detailed specifications of CAATs have been met. It is to be seen that CAATs are not manipulated by staff of the entity. The specific procedures necessary to control the use of CAATs will depend on the particular application.

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Procedures Carried Out by the Auditor to Control CAATs Applications may include:

(i) participating in the design and testing of CAAT;

(ii) checking, if applicable, the coding of the program to ensure that it conforms with the detailed program specifications;

(iii) asking the entity's staff to review the operating system instructions to ensure that the software will run in the entity's computer installation;

(iv) running the audit software on small test files before running it on the main data files;

(v) checking whether the correct files were used, for example, by checking external evidence, such as control totals maintained by the user, and that those files were complete;

(vi) obtaining evidence that the audit software functioned as planned, for example, by reviewing output and control information; and

(vii) establishing appropriate security measures to safeguard the integrity and confidentiality of the data.

When using a CAAT, the auditor may require the cooperation of the entity's staff who have extensive knowledge of the computer installation. In such circumstances, the auditor should have reasonable assurance that the entity's staff did not improperly influence the results of the CAAT.

6. (a) Services Not To Be Rendered By Auditor: This provision is newly inserted by section 144 of the Companies Act, 2013. Section 144 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely (i) accounting and book keeping services; (ii) internal audit; (iii) design and implementation of any financial information system; (iv) actuarial services; (v) investment advisory services; (vi) investment banking services; (vii) rendering of outsourced financial services; (viii) management services; and (ix) any other kind of services as may be prescribed.

Further section 141(3)(i) of the Companies Act, 2013 also disqualify a person for appointment as an auditor of a company whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

Additionally, in accordance with section 141(4) of the Act, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned above after his appointment, he shall vacate his office as such auditor and such vacation

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shall be deemed to be a casual vacancy in the office of the auditor.

In the given case, M/s Renault & Co., Chartered Accountants, was appointed as an auditor of R Ltd. Further, the company offered actuarial services to M/s Sona & Co., an associate to M/s Renault & Co., which has also been duly accepted by the firm. Therefore, M/s Renault & Co. is disqualified to hold office as an auditor of R Ltd. under section 141(3)(i), as its associate is involved in providing such services, to R Ltd., as mentioned in section 144 of the Companies Act, 2013.

Subsequently, M/s Renault & Co. shall have to vacate the office of auditor of R Ltd. accordingly.

(b) Indebtness to the Subsidiary Company: As per sub-section (3)(d)(ii) of Section 141 of the Companies Act, 2013 along with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 5 lakhs.

Also, as per sub-section 4 of Section 141 of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

In the present case, Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, has been indebted to Wealthy Ltd., a subsidiary company of Poor Ltd., for ₹ 6 lakhs.

Therefore, the firm, Navy and Cavy Associates would be disqualified to be appointed as statutory auditor of Poor Ltd. as per section 141(3)(d)(ii), which is the holding company of Wealthy Ltd., because Mr. Savy, the relative of Mr. Navy, a partner in Navy and Cavy Associates, has been indebted to Wealthy Ltd. for an amount exceeding the minimum approved limit.

(c) Rotation of Auditor & Cooling Off Period Provisions: The provision related to Rotation of Auditor & Cooling Off Period is newly inserted by section 139(2) of the Companies Act, 2013 read with Rule 5 of the Companies (Audit & Auditors) Rules, 2014, which is discussed as under:

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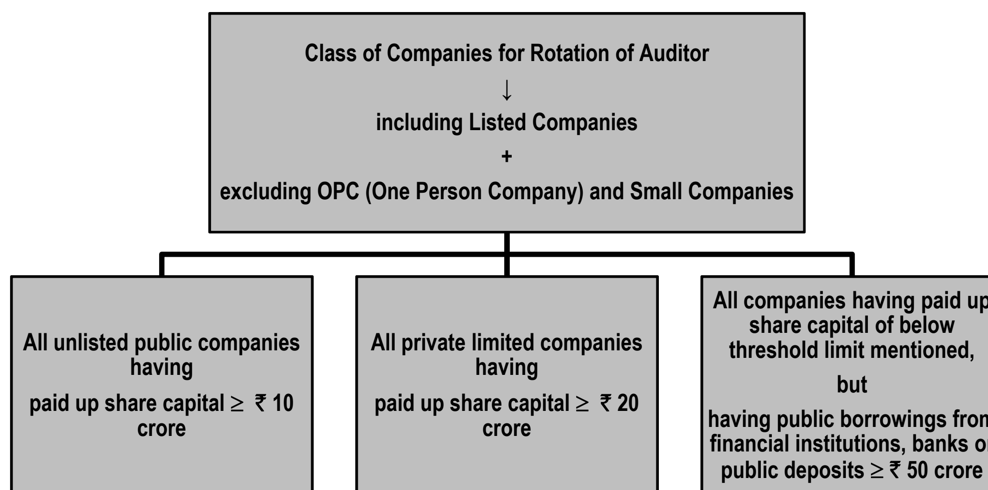

The provisions related to rotation of auditor are applicable to those companies which are prescribed in Companies (Audit and Auditors) Rules, 2014, which prescribes the following classes of companies excluding one person companies and small companies, namely:-

(i) all unlisted public companies having paid up share capital of ₹ 10 crore or more;

(ii) all private limited companies having paid up share capital of ₹ 20 crore or more;

(iii) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of ₹ 50 crores or more.

As per Section 139(2) of the Companies Act, 2013, no listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint-

(a) an individual as auditor for more than one term of 5 consecutive years; and

(b) an audit firm as auditor for more than two terms of 5 consecutive years.

In the given case, Orange Ltd. is an unlisted public company having paid up share capital of ₹ 5 crore and public deposits of ₹ 100 crore. The company has appointed M/s Santra & Co., a chartered accountant firm, as the statutory auditor in its AGM held at the end of September, 2014 for 11 years.

The provisions relating to rotation of auditor will be applicable as the public deposits exceeds ₹ 50 crore. Therefore, Orange Ltd. can appoint M/s Santra & Co. as an auditor of the company for not more than one term of five consecutive years twice i.e. M/s Santra & Co. shall hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2019 and thereafter can be re-

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appointed as auditor for one more term of five years i.e. upto year 2024. The appointment shall be subject to ratification by members at every annual general meeting of the company. As a result, the appointment of M/s Santra & Co. made by Orange Ltd. for 11 years is void.

Cooling off period: As per the proviso to section 139(2) of the Companies Act, 2013-

(1) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of his term;

(2) an audit firm which has completed its term under clause (b), shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such term.

Therefore, M/s Santra & Co. shall not be re-appointed as Auditor in Orange Ltd. for further term of 5 years i.e. upto year 2029.

(d) Disqualification due to Holding of Securities: According to section 141(3)(d)(i) of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

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

Further, the term "relative" has been defined under the Companies Act, 2013 which means anyone who is related to another as members of a Hindu Undivided Family; husband and wife; Father (including step- father), Mother (including step-mother), Son (including step- son), Son's wife, Daughter, Daughter's husband, Brother (including step- brother), Sister (including step- sister).

In the present situation,

(i) Mr. Pratiq is holding securities in Opus Ltd., which is not allowed as per the provisions of section 141(3)(d)(i) of the Act. Therefore, Mr. Pratiq will be disqualified to be appointed as an auditor of Opus Ltd.

(ii) Mr. Quresh, the step-father of Mr. Pratiq, is holding the securities in Opus Ltd.

It may be noted that step-father is included in the definition of the term "relative" as per the Companies Act, 2013. Further, proviso to section 141(3)(d)(i) of the Act allows a relative of the auditor to hold securities in the company of face value not exceeding of ₹ 1,00,000.

Here, Mr. Quresh is holding securities for face value of ₹ 89,000 which is below the limit as prescribed under the said proviso.

Therefore, Mr. Pratiq will not be disqualified to be appointed as an auditor of Opus Ltd.

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7. **(a) Presentation of Book Overdraft as per Schedule III to the Companies Act, 2013:** The instructions in accordance with which current assets being "cash and cash equivalents" should be made out to Part I of Schedule III to the Companies Act, 2013 states as follows-

(i) Cash and cash equivalents shall be classified as:

(1) Balances with banks;

(2) Cheques, drafts on hand;

(3) Cash on hand;

(4) Others (specify nature).

(ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

(iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

(iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

(v) Bank deposits with more than 12 months maturity shall be disclosed separately.

From the facts of the case, it is evident that in substance the position is that the composite bank balance including the balance in flexi deposit accounts are positive, even though physical set-off has not been made as on the balance sheet date. Further the bank has got the right to set off of flexi deposits against the cheques issued and hence it would be more informative and useful to the readers of the financial statements to disclose the book credit balance as a set-off from the flexi deposit accounts. The disclosure of the said book credit balance as book overdraft under the head current liabilities as proposed by the management is not correct.

(b) Enquiring into Certain Matters: Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry in respect of specified matters during the course of his audit. Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. It is to be noted that the auditor is required to make only enquiries and not investigate into the matters referred to therein.

Clause (a) of Section 143(1) requires the auditor to enquire: "Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members".

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If the auditor finds that the loans and advances have not been properly secured, he may enter an adverse comment in the report but cannot probably doubt the true view of the accounts by reference to this fact so long the loans and advances are properly described and presented in terms of part I of Schedule III to the Companies Act. Further the auditor needs to enquire whether or not the terms on which the loans or advances have been made are prejudicial to the interests of the company or its members. If it is, he should qualify his report.

If trade receivables and trade payables are adjusted *inter se*, this amounts to merely book entries. The auditor, as per clause (b) of section 143(1), should enquire "whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company". This proposition has got to be enquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards.

Regarding Personal Expenses, Clause (e) of section 143(1) requires the auditor to enquire "Whether personal expenses have been charged to revenue account". The charging to revenue of such personal expenses, either on the basis of the company's contractual obligations, or in accordance with accepted business practice, is perfectly normal and legitimate or does not call for any special comment by the auditor. Where, however, personal expenses not covered by contractual obligations or by accepted business practice are incurred by the company and charged to revenue account, it would be the duty of the auditor to report thereon. It suffices to say that if the auditor finds that personal expenses have been charged to revenue and if the amounts are material, he should qualify his report also.

In the instant case, Mr. SB, the statutory auditor of CON Ltd., needs to enquire in the light of above provisions. If, as a result of the enquiries, he is satisfied then there is no further duty to report on these matters and if not, then he may report accordingly.

(c) Restrictions Regarding Political Contribution: Section 182 of the Companies Act, 2013 deals with prohibitions and restrictions regarding political contributions. According to this section, a government company or any other company which has been in existence for less than three financial years cannot contribute any amount directly or indirectly to any political party. In other cases, aggregate contribution in any financial year should not exceed 7½ % of average net profit during the three immediately preceding financial years.

In the given case, Gracious Ltd. has made a contribution of ₹ 7.8 lacs to Samaj Seva Party, a political party. The average net profit of the company during the three immediately preceding financial years is ₹ 100 lakhs and the 7½ % of this works out to ₹ 7.5 lacs.

As the company has contributed ₹ 7.8 lacs, there is a violation of the provisions of Section 182 of the Companies Act, 2013 although the children of its workers are benefited. Therefore, the auditor would have to qualify his report accordingly.

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(d) Related Party Disclosures: As per definition given in the AS 18 " Related Party Disclosures" 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. Related party transaction means a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

In the instant case, the managing director of ABC Ltd. is a partner in the firm with his son which has been paid ₹ 1 lakh as job work charges. The managing director is having a substantial holding in ABC Ltd. The case is squarely covered by AS 18. According to AS-18, in the case of related party transactions, 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."

Further, SA 550 on Related Parties, also prescribes the auditor's responsibilities and audit procedures regarding related party transactions.

The approach of the managing director is not tenable under the law and accordingly all disclosure requirements have to be complied with in accordance with the AS 18. Auditor should insist to make proper disclosure as per the AS and if management refuses, the auditor shall have to modify his report. Also it has to be seen whether section 184 of the Companies Act, 2013 regarding disclosure of interest by director has been complied with. If it is not complied with, the auditor needs to modify the report appropriately.

(e) Applicability of Accounting Standard: AS 20, "Earning Per Share", came into effect in respect of accounting periods commencing on or after 1-4-2001 and is mandatory in nature, from that date, in respect of enterprises whose equity shares or potential equity shares are listed on a recognised stock exchange in India. As such AS 20 does not mandate an enterprise, which has neither equity shares nor potential equity shares which are so listed, to calculate and disclose earnings per share, but, if that enterprise discloses earnings per share for complying with the

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requirements of any statute or otherwise, it should calculate and disclose earnings per share in accordance with AS 20.

Further, Part II of Schedule III to the Companies Act, 2013, requires, among other things, disclosure of earnings per share. Accordingly, every company, which is required to give information under Part II of Schedule III to the Companies Act, 2013, should calculate and disclose earning per share in accordance with AS 20, whether or not its equity shares or potential equity shares are listed on a recognised stock exchange in India.

Accordingly, Divergence Pvt. Ltd. should compute and disclose EPS according to AS 20. Therefore, the contention of Mr. Nix, Director (Finance) of the company, is incorrect. The auditor will have to ensure that EPS is disclosed as per AS 20 or else the auditor should appropriately modify the audit report accordingly.

8. (a) Responsibility of Auditor in Relation to the Companies Act, 2013: As per Section 188 of the Companies Act, 2013, no company shall enter into any contract or arrangement with a related party to sale, purchase or supply of any goods or materials, except with the consent of the Board of Directors given by a resolution at a Board Meeting. Further, it is provided that no contract or arrangement, in the case of a company having specified paid-up share capital, or transactions exceeding prescribed sum, shall be entered into except with the prior approval of the company by a special resolution.

The contracts or arrangements mentioned above are those for which the register(s) are maintained under section 189 of the Companies Act, 2013 .The scope of the auditor's inquiry under this clause is restricted to such transactions referred to in sections 184 and 188 of the Act.

The auditor should, while reporting, in the first instance, determine whether the aggregate value of all the transactions entered into with any of the companies/firms/parties covered in the register maintained under section 189 of the Act exceed the value of rupees five lakhs in the year. If so, the auditor has to examine whether each of the transactions entered into with such a company/firm/party have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time. Further, the auditor while reporting should clearly bring out the reasons as to why no adverse comment was considered necessary.

The contracts referred to in section 188 are for sale, purchase or supply of any goods, materials or services and contract of underwriting the subscription of any securities or derivatives of the company between a Company and its director or, its relative, a firm in which the director or relative is a partner, any other partner in such a firm or a private company of which the director is a member or director. The auditor will have to obtain the list of such parties which are covered by section 188 mentioned above.

Hence, the auditor should ensure that all the above mentioned provisions have been compiled with.

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(b) Misstatement in Prior Period Financial Statements Audited by a Predecessor Auditor: According to SA 710 "Comparative Information—Corresponding Figures and Comparative Financial Statements", if the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:

(1) That the financial statements of the prior period were audited by a predecessor auditor;

(2) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and

(3) The date of that report,

unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements.

However, if the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor shall communicate the misstatement with the appropriate level of management and those charged with governance and request that the predecessor auditor be informed. If the prior period financial statements are amended, and the predecessor auditor agrees to issue a new auditor's report on the amended financial statements of the prior period, the auditor shall report only on the current period.

In the given case, Mr. A has issued an audit report without modification for the previous year 2012-13. While Ms. B found a material discrepancy of undercharging wages of ₹ 10 lakhs during the year 2012-13. Hence, Ms. B is required to communicate the matter to the management and request them to inform the same to Mr. A. After revision or non-revision of the prior period's financial statements, Ms. B may report accordingly as stated above.

(c) Reporting Requirement as per Schedule III to the Companies Act, 2013: As per the general instructions for preparation of Balance Sheet, provided under Schedule III to the Companies Act, 2013, terms of repayment of term loans and other loans is required to be disclosed in the notes to accounts. It also requires specifying the period and amount of continuing default as on the balance sheet date in repayment of loans and interest, separately in each case.

In the given case, PK Ltd. has taken a loan from a nationalized bank three years back in 2012. It was regular in payment of instalments (including interest) for last two years but defaulted for the current financial year 2015. Therefore, it needs to be reported in the notes to accounts.

The draft report for above matter is as under:

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"PK Ltd. has taken a loan during the year 2012, from a nationalized bank amounting to ₹ 350 lakhs @ X% p.a. which is repayable by yearly installment of ₹ 50 lakhs for 7 years.

The company has defaulted in repayment of dues including interest to a nationalized bank during the financial year 2014-15 amounting to ₹ 50 lakhs which remained outstanding as at March 31, 2015."

(d) Following Errors are noticed in Presentation as per Schedule III:

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

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

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

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

(v) Deferred Tax Liability has been correctly shown under Non-Current Liabilities. But, Deferred Tax Assets and Deferred Tax Liabilities, both, cannot be shown in Balance Sheet because only the net balance of Deferred Tax Liability or Asset is to be shown.

(vi) Under the main heading of Non-Current Assets, Fixed Assets are further classified as under:

(1) Tangible assets

(2) Intangible assets

(3) Capital work in Progress (CWIP)

(4) Intangible assets under development.

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

(5) Deferred Tax Asset shall be shown under Non-Current Asset. It should be the net balance of Deferred Tax Asset after adjusting the balance of deferred tax liability.

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9. (a) **Liability for Misconduct:** Schedule III to the Companies Act, 2013 requires specific disclosure of loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member. Thus, the company has failed to comply with the requirements of Schedule III vitiating true and fair view.

Further, the Companies Act, 2013 specifically deals with transactions in which particular directors are interested. Section 188 specifies that Board's consent is required for certain contracts to be entered into with related parties. Section 184 requires disclosure of interest by director and also lays down the procedure to be followed in this regard. Section 189 of the Companies Act, 2013 requires that every company shall keep one or more registers in which particulars of all contracts or arrangements, to which Section 184 or Section 188 applies, shall be entered separately.

Thus, it is quite natural that all these particulars should have been recorded in such registers since the company advanced monies to various parties "related" to directors.

In the given case, the company has advanced the sum to the parties that are related to the Directors of the company and showed the same under the head "Short-term Loans and Advances – unsecured, considered good" rather than specific disclosure under the notes to accounts. The auditor of the company also issued clean audit report without any qualifications. It appears that the auditor did not perform his duties properly.

Therefore, as per the explanation provided above, the auditor has specific obligation to report under the Companies Act, 2013. Thus, he is liable under the Companies Act, 2013 and may be penalized under section 147 since he has performed his duties in a negligent manner. Further, the auditor would also be held guilty for professional misconduct under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 which states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

(b) **Criminal Liability of an Auditor under the Companies Act, 2013**: The circumstances in which an auditor can be prosecuted under the Companies Act and the penalties to which he may be subjected are briefly stated below-

(i) **Criminal liability for Misstatement in Prospectus-** As per Section 34 of the Companies Act, 2013, where a prospectus, issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorises the issue of such prospectus shall be liable under section 447.

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This section shall not apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.

(ii) Punishment for False Statement - According to Section 448 of the Companies Act, 2013, if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement-

(1) which is false in any material particulars, knowing it to be false; or

(2) which omits any material fact, knowing it to be material,

he shall be liable under section 447.

Punishment for Fraud - As per Section 447 of the Companies Act, 2013, without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than 6 months but which may extend to 10 years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

It may be noted that where the fraud in question involves public interest, the term of imprisonment shall not be less than 3 years.

Explanation — For the purposes of this section—

(i) "fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

(ii) "wrongful gain" means the gain by unlawful means of property to which the person gaining is not legally entitled;

(iii) "wrongful loss" means the loss by unlawful means of property to which the person losing is legally entitled.

10. (a) (i) Corporate Governance: Corporate governance is the system by which companies are directed and controlled by the management in the best interest of the shareholders and others ensuring greater transparency and better and timely financial reporting. The Board of Directors are responsible for governance of their companies. A number of reports and codes of corporate governance have been published internationally.

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The Securities and Exchange Board of India (SEBI) had set up a Committee under the Chairmanship of Shri Kumar Manglam Birla to formulate the code of corporate governance. The Securities and Exchange Board of India (SEBI) with the objective to align its provisions to the recently notified provisions of the Companies Act, 2013, ('the Act') has specifically reviewed clause 49 of the Listing Agreement, to adopt leading industry practices on corporate governance and to make the corporate governance framework more effective. The revised clause 49 on corporate governance shall be applicable to all listed companies with effect from 1 October 2014, except for the clause relating to the constitution of a Risk Management Committee which shall apply to the top 100 listed companies by market capitalisation, as at the end of the immediate previous financial year.

Various clauses deal with composition of board, setting-up of audit committee including scope thereof, remuneration of directors, meetings of Board, contents of management discussions and analysis report, etc.

Clause 49 also prescribes that there shall be a separate section on Corporate Governance in the annual reports of company, with a detailed compliance report on Corporate Governance. Non compliance of any mandatory requirement i.e. which is part of the listing agreement with reasons thereof and the extent to which the non-mandatory requirements have been adopted, should be specifically highlighted. Further, the entity is required to obtain a certificate from the statutory auditor of the entity as regards compliance of conditions of corporate governance as stipulated in that clause.

A monitoring cell set up by SEBI, will assess compliance by companies with the requirements of clause 49 and report non-compliances to SEBI within 60 days from the end of each quarter. This shows the strong intent of SEBI to not only bring in regulations, but also put in place a monitoring mechanism.

[Student may note that SEBI has revised Clause 49 vide its Circular dated April 17, 2014 with effect from 1st October 2014.]

(ii) Functions of the Audit Committee as per Section 177 of the Companies Act, 2013: The Audit Committee performs various important functions like investigating the matters referred by board, discuss about internal control system etc. Section 177 of the Companies Act, 2013 deals with the terms of reference as well as functions of the audit committee which are as under:

(A) As per Section 177(4), every Audit Committee shall act according to the terms of reference specified in writing by the Board which includes—

(1) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;

(2) review and monitor the auditor's independence and performance, and effectiveness of audit process;

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(3) examination of the financial statement and the auditors' report thereon;

(4) approval or any subsequent modification of transactions of the company with related parties;

(5) scrutiny of inter-corporate loans and investments;

(6) valuation of undertakings or assets of the company, wherever it is necessary;

(7) evaluation of internal financial controls and risk management systems;

(8) monitoring the end use of funds raised through public offers and related matters.

(B) The Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

(C) The Audit Committee shall have authority to investigate into any matter in relation to the items specified referred above to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.

(D) Every listed company or such class or classes of companies, as may be prescribed, shall establish a vigil mechanism for directors and employees to report genuine concerns in such manner as may be prescribed.

(b) Holding of Meeting and Review Requirements as per Clause 49 of the (SEBI) Listing Agreement: One of the requirement as stipulated under clause 49 **[Clause 49 (III) (B)]** (on which Section 177 of the Companies Act, 2013 relating to audit committee, is silent) is – The Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall lapse between two meetings.

The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

In this case, Disgust Limited is a company incorporated in India and have 6 members in it's Audit Committee. Contention of audit committee members to meet only once due to recessionary conditions in India, at the year end is not in line with the clause 49 of the (SEBI) Listing Agreement .

Besides, there is a mandatory review requirement as per Clause 49 (III) (E), according to which the Audit Committee shall mandatorily review the following information:

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(1) Management discussion and analysis of financial condition and results of operations;

(2) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;

(3) Management letters / letters of internal control weaknesses issued by the statutory auditors;

(4) Internal audit reports relating to internal control weaknesses; and

(5) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

In the instant situation, though, the Audit Committee has reviewed monthly information system, but, failed to comply with the above requirements mentioned at point no. 1 to 5 of Clause 49 (III) (E) of Listing Agreement.

11. **Consolidation of Financial Statement:** AS 21 "Consolidated Financial Statements", states that a subsidiary should be excluded from consolidation when:

(i) Control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future; or

(ii) Subsidiary operates under severe long term restrictions which significantly impair its ability to transfer funds to the parent.

Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares held as 'stock-in-trade' are acquired and held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary and the investments in such subsidiaries should be accounted for in accordance with AS 13 "Accounting for Investments".

However, as per Section 129(3) of the Companies Act, 2013 read with Rule 6 of the Companies (Accounts) Rules, 2014, where a company having subsidiary, which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act.

In this case, H Ltd's intention is to dispose off the shares in the near future as shares are being held as 'stock in trade' and it is quite clear that the control is temporary, however for the compliance of provisions related to consolidation of financial statements given under the Section 129(3) of the Companies Act, 2013 read with Companies (Accounts) Rules, 2014, H Ltd. is required to consolidate the financial statements as per the provisions on consolidated financial statements provided in Schedule III to the Act.

(Note: Students are advised to refer Section 129(3) of the Companies Act, 2013 along with Rule 6 of the Companies (Accounts) Rules, 2014 for detailed understanding)

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12. (a) Evaluation of Internal Control System in the Area of Credit Card Operations in a Bank:

(i) There should be effective screening of applications with reasonably good credit assessments.

(ii) There should be strict control over storage and issue of cards.

(iii) There should be a system whereby a merchant confirms the status of unutilized limit of a credit-card holder from the bank before accepting the settlement in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.

(iv) There should be system of prompt reporting by the merchants of all settlements accepted by them through credit cards.

(v) Reimbursement to merchants should be made only after verification of the validity of merchant's acceptance of cards.

(vi) All the reimbursements (gross of commission) should be immediately charged to the customer's account.

(vii) There should be a system to ensure that statements are sent regularly and promptly to the customer.

(viii) There should be a system of monitor and follow-up of customers' payments.

(ix) Items overdue beyond a reasonable period should be identified and attended carefully. Credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.

(x) There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

(b) Unexpired Risks Reserve: The need for unexpired risks reserve arises from the fact that all policies are renewed annually except in specific cases where short period policies are issued. Since the insurers close their accounts on a particular date, not all risks under policies expire on that date.

In other words, at the closing date, there is an unexpired liability under various policies which may occur during the remaining term of the policy beyond the year end.

The minimum amount of unexpired risks reserve to be created is determined as per the Insurance Act, 1938 at a specified percentage of net premium as under:

(i) for marine hull insurance – 100% of net premium.

(ii) For fire, marine cargo and miscellaneous business – 50% of net premium.

Provisions of the Income Tax Act, 1961 and the Income Tax Rules, 1962 permit deduction of above reserves at the prescribed rates.

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In the given case, the Auditor of Ordinary Insurance Ltd. should qualify his report as the company has made a provision of only 25% against the prescribed minimum of 50% or 100% as mentioned above, thereby resulting in overstatement of profit.

13. (a) Audit of a Loan Financing Company: Special points to be kept in mind while auditing a loan financing company, an NBFC, are given below:

(i) Auditor should examine whether each loan or advance has been properly sanctioned. He should verify the conditions attached to the sanction of each loan or advance i.e. limit on borrowings, nature of security, interest, terms of repayment, etc.

(ii) Auditor should verify the security obtained and the agreements entered into, if any, with the concerned parties in respect of the advances given. He must ascertain the nature and value of security and the net worth of the borrower/guarantor to determine the extent to which an advance could be considered realisable.

(iii) Obtain balance confirmations from the concerned parties.

(iv) As regards bill discounting, verify that proper records/documents have been maintained for every bill discounted/rediscounted by the NBFC. Test check some transactions with reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.

(v) Check whether the NBFC has not lent/ invested in excess of the specified limits to any single borrower or group of borrowers as per NBFC Prudential Norms Directions.

(vi) Check whether the NBFC has not advanced any loans against the security of its own shares.

(vii) In case of companies which are engaged in the business of providing short term funds in the ICD market, the auditor should ascertain whether the NBFC has a regular system for ascertaining the credit worthiness of the clients prior to placed by the company are being rolled over and whether there is any risk of non-recovery. In addition, he should ascertain that the NBFC is receiving interest regularly in respect of these ICDs. Roll over of ICDs and non-realisation of interest and principal amounts should be thoroughly checked to determine whether the ICD is required to be treated as a NPA.

(viii) Auditor should verify whether the NBFC has an adequate system of proper appraisal and follow up of loans and advances. In addition, he may analyze the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPAs.

(ix) Check the classification of loans and advances (including bills purchased and discounted) made by an NBFC into Standard Assets, Sub-Standard Assets,

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doubtful assets and loss assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms Directions.

(x) An auditor should also verify whether provision for bad and doubtful debts has been disclosed separately in the Balance Sheet and the same have not been netted off against the income or against the value of assets as required by the NBFC Prudential Norms Directions.

(b) Compliance of Prudential Norms by NBFC:

(i) The auditor has to verify the compliance of prudential norms relating to (1) Income recognition; (2) Income from investments; (3) Asset classification; (4) Provision for bad and doubtful debts; (5) Capital adequacy norm; (6) Prohibition of granting loans against its own shares; (7) Prohibition on loans and investments for failure to repay public deposits and (8) Norms for concentration of credit etc.

(ii) The auditor shall ensure that Board of the NBFC shall frame a policy for granting demand/call loans and implement the same.

(iii) The auditor should verify the classification of advances and loans as standard/ substandard/doubtful/loss and that proper provision has been made in accordance with the directions.

(iv) Auditor should ensure that unrealised income from non-performing assets has not been taken to Statement of Profit and Loss.

(v) The auditor should check all NPAs of the previous years to verify whether during the current year any payments have been received or still they continue to be NPA during the current year also.

14. (a) Reporting Requirement Under Clause (4) of Form 3CD: Mr. Bhupesh has defaulted in payment of service tax for the previous year. Consequently, the Commissioner of Central Excise issued a show cause notice for such non-payment of tax. The arguments are still going on between the department and assessee. He also restrained his tax auditor from disclosing service tax registration details in tax audit report.

Provisions and Explanations: A tax auditor is required to report under Clause (4) of Form 3CD, which requires him to mention the registration number or any other identification number, if any, allotted, in case the assessee is liable to pay indirect taxes like excise duty, service tax, sales tax, customs duty, etc.

Part A of Form No. 3CD generally requires the auditor to give the factual details of the assessee. Thus, the auditor is primarily required to furnish the details of registration numbers as provided to him by the assessee.

The reporting is however, to be done in the manner or format specified by the e-filing utility in this context. The information may be obtained and maintained in the following format:-

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Sr. No	Relevant Indirect tax Law which requires registration	Place of Business/ profession/ service unit for which registration is in place/ or has been applied for:-	Registration/ Identification number
1	2	3	4

Furthermore, the auditor has to keep in mind the provisions of Standard on Auditing 580 "Written Representation". In case the auditor prima facie is of the opinion that any indirect tax laws is applicable on the business or profession of the assessee but the assessee is not registered under the said law, the auditor should report the same appropriately.

Conclusion: Therefore, the tax auditor of Mr. Bhupesh is required to furnish service tax registration number under Clause (4) of the Form 3CD. Thus, contention of Mr. Bhupesh not to disclose the service tax details is not tenable.

(b) Reporting Requirement Under Clause (8) and (12) of Form 3CD: BB Ltd., is a non resident company which is engaged in the business of extraction of mineral oils, hence, its income is chargeable in accordance with the provisions of section 44BB of the Income Tax Act, 1961. But it has turnover of ₹ 20 lakhs during the financial year 2013-14. Therefore, the company does not need to get its accounts audited under section 44AB of the Income Tax Act, 1961 as it is below the prescribed limit applicable for auditing of accounts. However, company is claiming lower income in comparison to deemed income under section 44BB of the said Act, thus, the company needs to get its accounts audited.

Provisions and Explanations: Under Clause (8) of Form 3CD, the tax auditor is required to mention the relevant clause of section 44AB under which the audit has been conducted. In case the assessee is carrying on business and his total sales, turnover or gross receipts as the case may be, exceeds one crore in the relevant previous year, the auditor is required to mention clause (a) under this head. If the assessee is carrying on profession and his gross receipts exceed twenty five lakh rupees in the relevant previous year, the auditor is required to mention clause (b) under this head. Likewise, if the audit under section 44AB is being conducted by virtue of provisions of section 44AE, 44BB and 44BBB, the auditor is required to mention clause (c). For audit being conducted by virtue of provisions of section 44AD, clause (d) is to be mentioned under this head.

Further, as per Clause (12) of Form 3CD, if the profit and loss account of the assessee includes any profits and gains assessable on presumptive basis, the tax auditor has to indicate the amount and the relevant sections (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, Chapter XII-G, First Schedule or any other relevant section).

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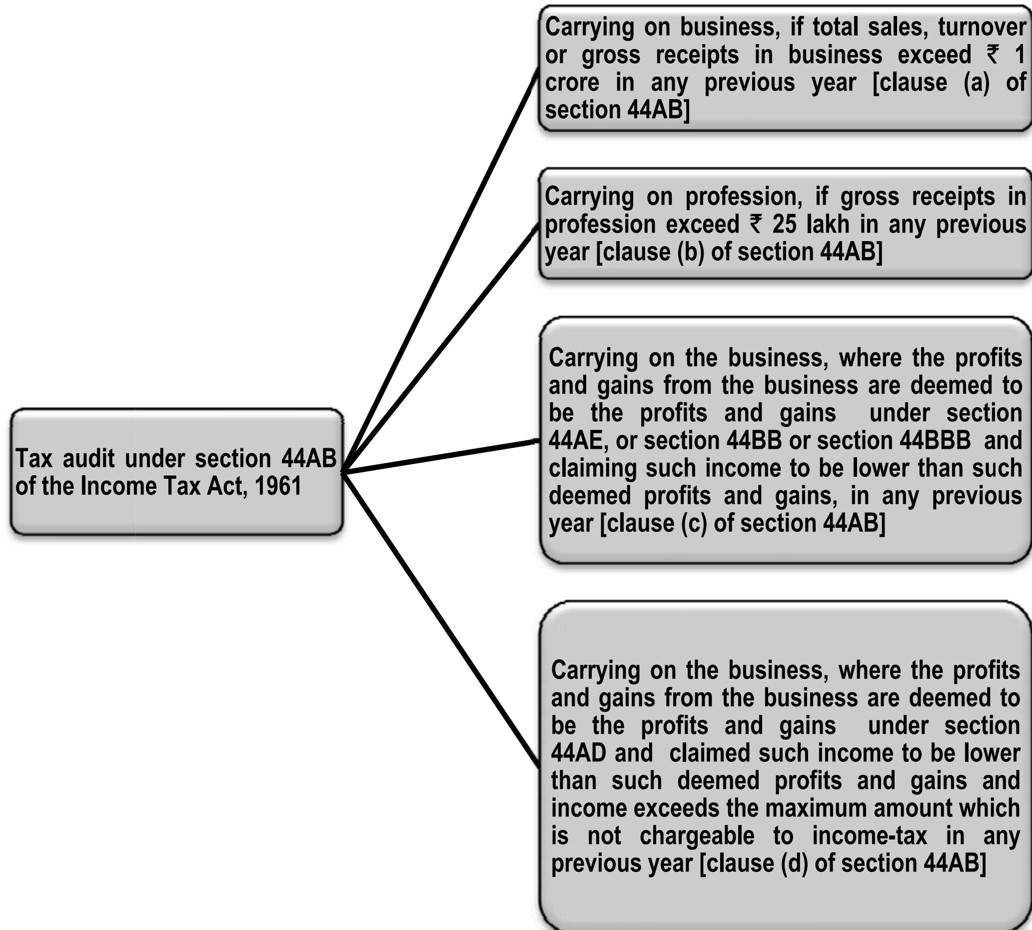

Diagram representing various clauses of section 44AB of the Income Tax Act, 1961 under which a tax audit is required to be conducted

Conclusion: As per the facts of the case, provisions and explanations given above, the tax auditor of BB Ltd. is required to mention clause (c) of section 44AB, under clause (8) of Form no. 3CD.

In addition to above, the tax auditor has to indicate, under Clause (12) of Form No. 3CD, the amount of profits and gains assessable on presumptive basis under section 44BB of the Income Tax Act i.e. the amount of profits and gains credited/debited to the Profit & Loss Account.

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

Provisions and Explanations: As per Clause 17 of Form 3CD, the tax auditor is required to furnish detailed information in case if any land or building or both is

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transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, as under:

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

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

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

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

(d) **Reporting Requirement Under Clause (32)(e) of Form 3CD:** SL Pvt. Ltd. is engaged in production business and side by side dealing in buying and selling of securities with the intention of speculation. During the current financial year, the company has made Speculation Loss of ₹ 12 lakhs.

Provisions and Explanations: A tax auditor has to furnish the details of speculation loss incurred during the previous year, under Clause 32(e) of Form 3CD, regarding whether the company is deemed to be carrying on a speculation business as referred in explanation to section 73.

The Explanation to section 73 provides that where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources" or a company the principal business of which is the business of trading in shares or banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

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Conclusion: Therefore, the tax auditor of SL Pvt. Ltd. is required to furnish the details under Clause 32(e) of Form 3CD with respect to the speculation loss of ₹ 12 lakhs made during the year.

(e) **Reporting Requirement Under Clause (41) of Form 3CD:** In the instant case, Saurabh International Ltd. (SIL) is engaged in providing certain services on which it did not paid any service tax. Therefore Department issued a show cause notice and demand for Service Tax along with interest thereon. SIL has also filed an appeal mentioning that said services are not liable to service tax, but Central Excise (Appeals) has passed an order confirming the demand and SIL being aggrieved by the order of Commissioner of Central Excise (Appeals) decided to file an appeal against the same. SIL also requested the tax auditor not to report on the same as the concerned services were not liable for any service tax and they have also decided to file an appeal to CESTAT against the order of Commissioner of Central Excise (Appeals).

Provisions and Explanations: As per Clause 41 of Form 3CD, the tax auditor should furnish the details of demand raised or refund issued during the previous year under any tax laws other than Income Tax Act, 1961 and Wealth tax Act, 1957 along with details of relevant proceedings.

Therefore, the tax auditor should obtain a copy of all the demand/ refund orders issued by the governmental authorities during the previous year under any tax laws other than Income Tax Act and Wealth Tax Act alongwith its proceeding. It may be noted that even though the demand/refund order is issued during the previous year, it may pertain to a period other than the relevant previous year. In such cases also, reporting has to be done under this clause.

Conclusion: In the instant case, reporting of the demand raised by Department and proceeding relating to it including appeal filed by SIL and decision thereon is required to be made by tax auditor as per Clause 41 of Form 3CD. Hence request of SIL, not to report on the same is not acceptable.

15. (a) (i) **Applicability of Provisions Related to Cost Records and Audit:** The provisions relating to cost records and audit are governed by section 148 of the Companies Act, 2013 read with Companies (Cost Records and Audit) Rules, 2014. The audit conducted under this section shall be in addition to the audit conducted under section 143.

Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies (including Foreign Companies) required to include cost records in their books of account. One of the types of companies prescribed under this rule is the company (including foreign company other than those having only liaison offices) engaged in the production, import and supply or trading of following medical devices, such as heart valves; orthopaedic implants; pacemaker (temporary and permanent).

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However, the requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3, and,

(1) whose revenue from exports, in foreign exchange, exceeds 75 per cent of its total revenue; or

(2) which is operating from a special economic zone.

In the given case, PS Ltd. is a foreign company and engaged in the production, trading, import and export of orthopaedic implants and pacemaker (temporary and permanent, both). Its total revenue for the current financial year is ₹ 1475 lakhs, out of which, export, in foreign currency, comprises ₹ 1180 lakhs (₹ 490 lakhs + ₹ 690 lakhs). The proportion of the company's export to its total revenue is 80% [(₹ 1180 lakhs/ ₹ 1475 lakhs)*100].

Therefore, PS Ltd. is required to include cost records in their books of account in accordance with Rule 3 of the Companies (Cost Records and Audit) Rules, 2014. However, the company is not required to conduct cost audit as its revenue from exports, in foreign exchange, exceeds 75 per cent of its total revenue.

(ii) Manner of Maintaining Cost Records- Rule 5 of the Companies (Cost Records and Audit) Rules, 2014, requires every company under these rules including all units and branches thereof, to maintain cost records in Form CRA-1. The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

(b) Manner of Submission of Cost Audit Report to the Board- The cost auditor shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, in Form CRA-3. He shall forward his report to the Board of Directors of the company within a period of 180 days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.

Manner of Submission of Cost Audit Report to the Central government- The company shall within 30 days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014. If, after considering the cost audit report referred to under this section and the, information and explanation furnished by the company as above, the Central Government is of the opinion, that any further information or explanation is

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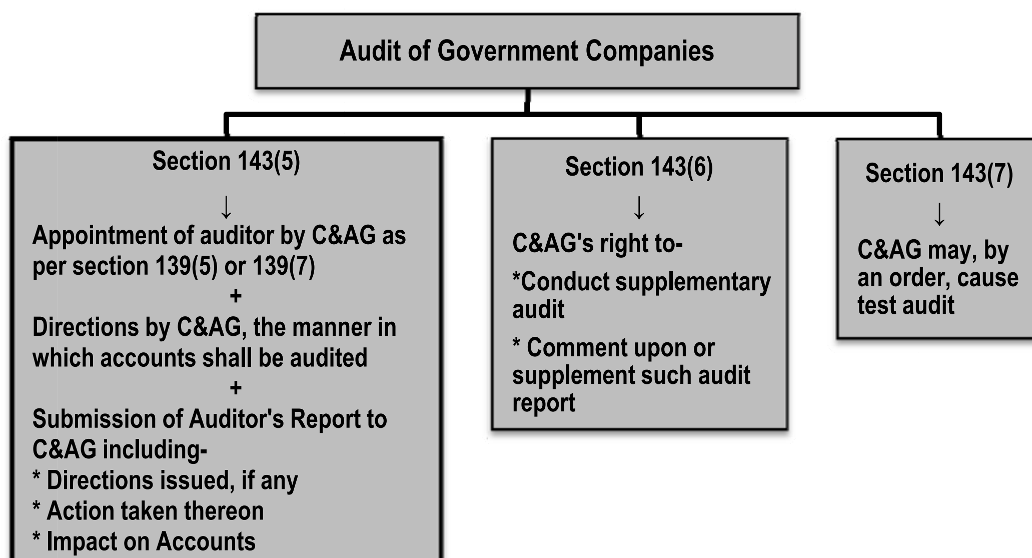
necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

16. (a) Provisions related to Audit of Government Companies as per the Companies Act, 2013:



Following are the provisions related to audit of government companies-

(i) **Appointment of Auditors under Section 139(5) and 139(7) read with section 143(5) of the Companies Act, 2013 -** Statutory auditors of Government Company are appointed or re-appointed by the Comptroller and Auditor General of India. There is thus a departure from the practice in vogue in the case of private sector companies where appointment or re-appointment of the auditors and their remuneration are decided by the members at the annual general meetings.

The C&AG may direct the appointed auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

(ii) **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

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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.

(iii) **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 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.

(iv) **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.

(b) Areas of Propriety Audit under Section 143(1): Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry into certain specific areas. In some of the areas, the auditor has to examine the same from propriety angle as to:

(1) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

(2) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company; Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made;

(3) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;

(4) whether loans and advances made by the company have been shown as deposits;

(5) whether personal expenses have been charged to revenue account;

(6) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in

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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.

A control has been set up to verify the receipt of cash in case of allotment of shares for cash. Further, if cash is not received, the books of accounts and statement of affairs shows the true picture.

17. (a) (i) Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, following class of companies (prescribed in Rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

(A) every listed company;

(B) every unlisted public company having-

(1) paid up share capital of fifty crore rupees or more during the preceding financial year; or

(2) turnover of two hundred crore rupees or more during the preceding financial year; or

(3) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or

(4) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and

(C) every private company having-

(1) turnover of two hundred crore rupees or more during the preceding financial year; or

(2) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In the given case, WWF Ltd. is a public company. The company borrowed a loan from a public financial institution of ₹110 crores during the previous year. At the year end, the loan outstanding after being squared up is ₹ 90 crores (₹ 110 crores - ₹ 20 crores) which is less than the minimum prescribed limit of ₹ 100 crores for applicability of internal audit. Although, the outstanding loan at previous year end is ₹ 90, it was ₹ 110 crores at some point of time which is the requirement of the section (refer Rule 13(B)(3) as mentioned above).

Hence, WWF Ltd. has the statutory liability to appoint an Internal Auditor and mandatorily conduct internal audit. Consequently, the contention of the management of the company is not tenable.

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(ii) **Who can be Appointed as Internal Auditor?** As per section 138, the internal auditor shall either be a chartered accountant, whether engaged in practice or not, or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies. The internal auditor may or may not be an employee of the company.

In addition, the Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

It may also be noted that the Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

(b) **Scope of Operational Audit:** Operational auditing is a systematic process involving logical, structured and organized series of procedures. It concentrates on effectiveness, efficiency and economy of operations and therefore it is future oriented. It does not end with the reporting of the findings but also recommends the steps for improvement in future.

The main objective of operational auditing is to verify the fulfillment of plans and sound business requirements as also to focus on objectives and their achievement objectives. The operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems, and prospects and its environment. Above all, his mind should be open and active so as to be able to perceive problems and prospects, and grasp technical matters.

In carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues. He will have to get the assistance of norms and standards in every operating field to be able to objectively judge a situation. The norms and standards should be such as are generally acceptable or developed by the company itself.

To a traditional internal auditor, a loss of ₹ 500 caused by a wrong totaling of invoice is important and this is that he looks for. But for an auditor engaged in the review of operations, carrying out of a proper maintenance programme of the machines is of greater importance because considerable production loss due to machine breaks down can thus be prevented. In both the cases, the auditor's objective is to see that the business and its profitability do not suffer from avoidable loss, but, nevertheless, there is a distinct difference in approach. But it should not be assumed, that, since an operational auditor is concerned with the audit of operations and review of operating conditions, he is not concerned with the financial aspects of transaction and controls.

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Hence, contention of operational auditor that totaling error in invoice of ₹ 500 is out of scope is not correct as operational audit is being carried out to ensure that all the management functions like planning, organizing, staffing, directing and controlling are working effectively and efficiently. Such kind of error is very much in scope because such an existence of error indicates that control system (controlling function) is not sound.

18. (a) Major Areas to Examine in course of Due Diligence Review: 'Due Diligence' is a term that is often heard in the corporate world these days in relation to corporate restructuring. The purpose of due diligence is to assist the purchaser or the investor in finding out all he can, reasonably about the business he is acquiring or investing in prior to completion of the transaction including its critical success factors as well as its strength and weaknesses.

Due diligence is an all pervasive exercise to review all important aspects like financial, legal, commercial, etc. before taking any final decision in the matter. As far as any hidden liabilities or overvalued assets are concerned, this shall form part of such a review of Financial Statements. Normally, cases of hidden liabilities and overvalued assets are not apparent from books of accounts and financial statements. Review of financial statements does not involve examination from the view point of extraordinary items, analysis of significant deviations, etc.

However in order to investigate hidden liabilities the auditor should pay his attention to the following areas:

(i) The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.

(ii) The company may have given “Letters of Comfort” to banks and Financial Institutions. Since these are not “guarantees”, these may not be disclosed in the Balance sheet of the target company.

(iii) The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.

(iv) Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation.

(v) Tax liabilities under direct and indirect taxes.

(vi) Long pending sales tax assessments.

(vii) Pending final assessments of customs duty where provisional assessment only has been completed.

(viii) Agreement to buy back shares sold at a stated price.

(ix) Future lease liabilities.

(x) Environmental problems/ claims/ third party claims.

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(xi) Unfunded gratuity/ superannuation/ leave salary liabilities; incorrect gratuity valuations.

(xii) Huge labour claims under negotiation when the labour wage agreement has already expired.

(xiii) Contingent liabilities not shown in books.

The auditor shall have to specifically examine the following areas in the case of Overvalued Assets:

(i) Uncollected/uncollectable receivables.

(ii) Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.

(iii) Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.

(iv) Assets carried at much more than current market value due to capitalization of expenditure/ foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.

(v) Litigated assets and property.

(vi) Investments carried at cost though realizable value is much lower.

(vii) Investments carrying a very low rate of income/ return.

(viii) Infructuous project expenditure/ deferred revenue expenditure etc.

(ix) Group Company balances under reconciliation etc.

(x) Intangibles of no value.

(b) Investigation into the Affairs of a Company as Envisaged under Section 210 of the Companies Act, 2013: Where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company-

(i) on the receipt of a report of the Registrar or inspector;

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

(iii) in public interest,

it may order an investigation into the affairs of the company.

Further, where an order is passed by a court; or the Tribunal requiring investigation, the Central Government shall order an investigation into the affairs of that company.

For the above purposes, the Central Government would 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.

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19 (a) **Charging of Fees Based on Percentage:** As per Clause (10) 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 charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulations made under this Act.

In the given case, Mr. Clever has prepared a project report, to obtain a long term loan, for Mr. King. However, he decided to raise the invoice of his service @10% of the loan to be sanctioned in future, which is basically contingent upon the findings. Therefore, Mr. Clever will he held guilty for professional misconduct under the abovementioned clause.

(b) **Sharing and Accepting of Part of Profits with an Advocate:** According to Clause (2) 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 pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute, for the purpose of rendering such professional services from time to time in or outside India.

Furthermore, Clause (3) of Part I of the First Schedule to the said Act states that a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he accepts any part of the profits of the professional work of a person who is not a member of the Institute.

However, a practicing member of the Institute can share fees or profits arising out of his professional business with such members of other professional bodies or with such other persons having such qualifications as prescribed by the Council under Regulation 53-A of the Chartered Accountants Regulations, 1988. Under the said regulation, the member of "Bar Council of India" is included.

Therefore, Mr. Preet, an advocate, a member of Bar Council, is allowed to share part of profits of his professional work with Ms. Preeti. Hence, Ms. Preeti, a practicing Chartered Accountant, will not be held guilty under any of the abovementioned clauses for paying and accepting part of profits from Mr. Preet.

(c) **Soliciting Clients:** As per Clause (6) 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 solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders.

Further, section 140(4)(iii) of the Companies Act, 2013, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of

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the company and to be read out at the meeting. However, the content of letter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so chooses, his willingness to continue as auditor, if re- appointed by the shareholders.

Thus, the incorporation as an independent professional, made by CA Smart, while submitting representation under section 140(4)(iii) of the Companies Act, 2013 and indication of willingness to continue as an auditor if reappointed by shareholders, does not leads to solicitation.

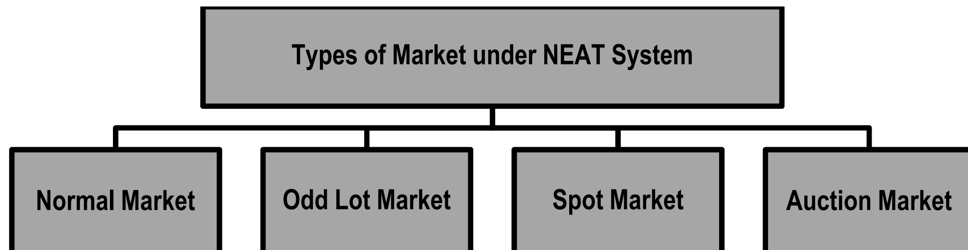
Therefore, CA Smart will not be held guilty for professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

(d) Grossly Negligent and Bringing Disrepute to the Institute: Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

Furthermore, Clause (2) of Part IV of the First Schedule to the said Act states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

In the given case, Mr. Brainy, a Chartered Accountant in practice, is grossly negligence in conduct of his professional duties by issuing clean reports on the balance sheet without examining the accounts. Further, he has also brought disrepute to the profession by advising unethical practice to the managing director of the company. Therefore, Mr. Brainy will be held guilty for professional and other misconduct under abovementioned Clauses to the Chartered Accountants Act, 1949.

20. (a) Types of Market: The NEAT system has four main types of market. They are-



Normal Market: All orders which are of regular lot size or multiples thereof are traded in the normal market. For shares which are traded in the compulsory dematerialised mode the market lot of these shares is one. Normal market consists of various book types wherein orders are segregated as regular lot orders, special

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term orders, negotiated trade orders and stop loss orders, depending on their order attributes.

Odd Lot Market: An order is called an odd lot order if the order size is less than regular lot size; such orders are traded in the odd-lot market. These orders do not have any special terms or attributes attached to them. In an odd-lot market, both the price and quantity of both the orders (buy and sell) should exactly match for the trade to take place.

Spot Market: Spot orders are similar to the normal market orders except that spot orders have different settlement periods vis-à-vis normal market. These orders do not have any special terms or attributes attached to them.

Auction Market: In the auction market, auctions are initiated by the Exchange on behalf of trading members for completing the settlement process.

(b) 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), of the said Act, 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.

(c) General Steps in the Conduct of Risk-Based Audit – Risk-based audit (RBA) is an approach to audit that analyzes audit risks, sets materiality thresholds based on audit risk analysis and develops audit programmes that allocate a larger portion of audit resources to high-risk areas.

RBA consists of four main phases starting with the identification and prioritization of risks, to the determination of residual risk, reduction of residual risk to acceptable

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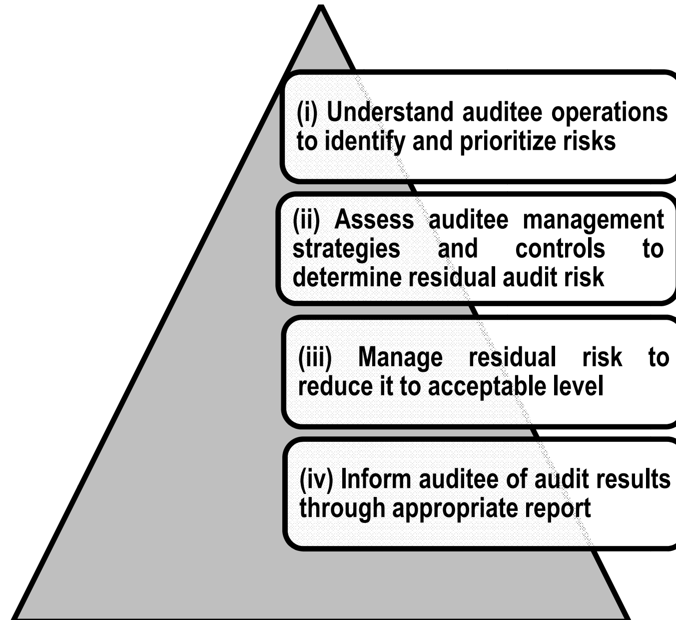
level and the reporting to auditee of audit results. These are achieved through the following:



(i) Understanding auditee operations involves processes for reviewing and understanding the audited organization's risk management processes for its strategies, framework of operations, operational performance and information process framework, in order to identify and prioritize the error and fraud risks that impact the audit of financial statements. The environment in which the auditee operates, the information required to monitor changes in the environment, and the process or activities integral to the audited entity's success in meeting its objectives are the key factors to an understanding of agency risks. Likewise, a performance review of the audited entity's delivery of service by comparing expectations against actual results may also aid in understanding agency operations.

(ii) Assessment of management risk strategies and controls is the determination as to how controls within the auditee are designed. The role of internal audit in promoting a sound accounting system and internal control is recognized, thus the SAI should evaluate the effectiveness of internal audit to determine the extent to which reliance can be placed upon it in the conduct of substantive tests.

(iii) Management of residual risk requires the design and execution of a risk reduction approach that is efficient and effective to bring down residual audit risk to an acceptable level. This includes the design and execution of necessary audit procedures and substantive testing to obtain evidence in support of transactions and balances. More resources should be allocated to

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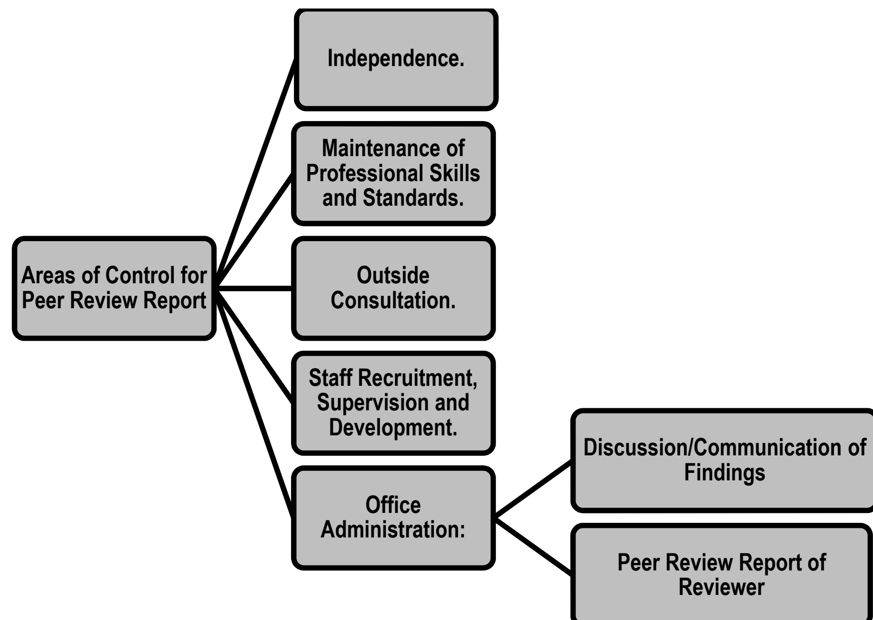
areas of high audit risks, which were earlier known through the analytical procedures undertaken.

(iv) The results of audit shall be communicated by the auditor to the audited entity. The auditor must immediately communicate to the auditee reportable conditions that have been observed even before completion of the audit, such as weaknesses in the internal control system, deficiencies in the design and operation of internal controls that affect the organization's ability to record, process, summarize and report financial data.

(d) Areas of Control for Reporting Stage of Peer Review: The Peer Review Report should state that the system of quality control for the assurance services of the Practice Unit for the period under review has been designed so as to carry out the assurance services in a manner that ensures compliance with Technical, Professional and Ethical Standards.

The Peer Review Report shall address the compliance report or otherwise on the following areas of controls:



(i) Independence.

(ii) Maintenance of Professional Skills and Standards.

(iii) Outside Consultation.

(iv) Staff Recruitment, Supervision and Development.

(v) Office Administration:

(1) Discussion/Communication of Findings

(A) After completing the on-site review, the Reviewer, before making his

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Report to the Board, shall communicate his findings to the Practice Unit if in his opinion, the systems and procedures are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification.

(B) The Practice Unit shall within 15 days after the date of receipt of the findings, make any submissions or representations, in writing to the Reviewer.

(2) Peer Review Report of Reviewer

(A) At the end of an on-site review if the Reviewer is satisfied with the reply received from the Practice Unit, he shall submit a Peer Review Report to the Board along with his initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

(B) In case the Reviewer is of the opinion that the response by the Practice Unit is not satisfactory, the Reviewer shall accordingly submit a modified Report to the Board incorporating his reasons for the same. The Reviewer shall also submit initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

(C) In case of a modified report, The Board shall order for a "Follow On" Review after a period of one year from the date of issue of report as mentioned in (B) above. If the Board so decides, the period of one year may be reduced but shall not be less than six months from the date of issue of the report.

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PAPER – 4: CORPORATE AND ALLIED LAWS

PART – I: RELEVANT AMENDMENTS APPLICABLE FOR MAY, 2015

Applicability of relevant Amendments/Circulars/Notifications/Regulations etc.

(A) Applicability of Relevant Amendments/ Circulars/ Notifications/ Regulations etc.

1. The Companies Act, 2013

The Companies Act, 2013: The relevant notified Sections of the Companies Act, 2013 up to 30th September, 2014 will be applicable for May, 2015 Examination and for other legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authority cut-off date will be six months.

The Study material (October 2014 edition) of Corporate and Allied Laws relevant for May 2015 examinations contains all relevant amendments/ circulars/ Notifications etc. in the Companies Act, 2013 which were issued by the Ministry of Corporate Affairs (MCA) up to 30th September, 2014. Below are some more amendments/ circulars/ Notifications etc. issued between 1st October, 2014 and 31st October, 2014 which are also applicable for the said examinations:

(i) The MCA vide Notification No. G.S.R. 722(E) dated 14th October, 2014 has issued *the Companies (Audit and Auditors) Amendment Rules, 2014 and thereby the Companies (Audit and Auditors) Rules, 2014* are being amended by insertion of Rule 10A. The said Notification is available at http://www.mca.gov.in/Ministry/pdf/Amendment_Rules_03112014.pdf

(ii) The MCA vide Notification No. G.S.R. 723(E) dated 14th October, 2014 has issued *the Companies (Accounts) Amendment Rules, 2014 and thereby the Companies (Accounts) Rules, 2014* are being amended by insertion of further provisos in Rule 6. The said Notification is available at http://www.mca.gov.in/Ministry/pdf/Amendment_Rules_03112014_I.pdf

(iii) The MCA vide General Circular 38/2014 dated 14th October, 2014, has clarified about the manner of handling the deposit of ₹ one lakh received under sub-section (I) of section 160 of the Companies Act, 2013 by companies registered under section 8 of the Companies Act, 2013 if the depositor fails to secure more than twenty five per cent of the total valid votes. It is thereby provided that the Board of directors of section 8 companies is to decide as to whether the deposit made by or on behalf of the person failing to secure more than twenty-five percent of the valid votes is to be forfeited or refunded. The said Circular is available at http://www.mca.gov.in/Ministry/pdf/General_Circular_38-2014.pdf

(iv) The MCA vide General Circular 39/2014 dated 14th October, 2014, has clarified on the manner of presentation of notes in Consolidated Financial Statement (CFS). The said circular provides that Schedule III to the Act read with the applicable Accounting Standards does not envisage that a company while preparing its CFS merely repeats the disclosures made by it under stand-alone accounts being

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consolidated. In the CFS, the company would need to give all disclosures relevant for CFS only. The said circular is available at http://www.mca.gov.in/Ministry/pdf/General_Circular_39-2014.pdf

(v) The MCA vide Notification No. G.S.R. 741(E) dated 24th October, 2014, has amended Schedule VII to the Companies Act, 2013, whereby, contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and contribution to the Clean Ganga Fund setup by the Central Government for rejuvenation of river Ganga have also been included in the activities which may be included by companies in their Corporate Social Responsibility policies. The said circular is available at http://www.mca.gov.in/Ministry/pdf/Amendment_Notification_24102014.pdf

2. **The SEBI Act, 1992:** The Ministry of Law and Justice vide Notification dated 25th August, 2014 has issued Securities Laws (Amendment) Act, 2014 which is available at the following link http://www.sebi.gov.in/cms/sebi_data/attachdocs/1409135096979.pdf

3. **SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009**: SEBI vide Notification dated 25th August, 2014 has issued SEBI (Issue of Capital and Disclosure Requirement) (Second Amendment) Regulations, 2014 which is available at the following link http://www.sebi.gov.in/cms/sebi_data/attachdocs/1409120871432.pdf

(B) Non-Applicability of the following chapters for the said examinations:

S.No.	Subject Matter
(i)	Chapter 9 of the study material (October, 2014 edition) covering provisions relating to Revival and Rehabilitation of Sick-Industrial Companies.
(ii)	Chapter 15 of the study material (October, 2014 edition) covering provisions relating to the National Company Law Tribunal and Appellate Tribunal.

PART – II: QUESTIONS AND ANSWERS

QUESTIONS

SECTION – A: COMPANY LAW

Declaration and payment of dividend

1. The Board of Directors of Neema Tools Limited recommended dividend on 20th February, 2014 and the same was approved and declared by the company in its Annual General Meeting held on 31st May, 2014 and was paid to the shareholders on 15th June, 2014. But dividend was not paid to Mr. Goyameer, a shareholder. The company adjusted the amount of dividend against a sum due to it from Mr. Goyameer. Decide, under the provisions of the Companies Act, 2013 the liability of the company in this regard?

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Accounts and audit

2. (a) The Board of Directors of Vishwakarma Electronics Limited consists of Mr. Ramesh, Mr. Suresh (Directors) and Mr. Indersen (Managing Director). The company has also employed a full time Secretary.

   The financial statements of the company were signed by Mr. Ramesh and Mr. Suresh. Examine whether the authentication of financial statements of the company was in accordance with the provisions of the Companies Act, 2013?

   (b) Explaining the provisions of the Companies Act, 2013, answer the following:

   (i) Manner in which the companies are required to present the financial statements.

   (ii) What kinds of companies are exempted from the preparation of the above statements in terms of nature and the contents?

   (iii) State the consequences and the penalties in case the company does not comply with the accounting standards?

3 (a) Mr. Prince, A Chartered Accountant, holding certificate of practice from the Institute of Chartered Accountants of India has been appointed as auditor of ABC Limited, which is a public limited company. Mr. Y, a relative of Mr. Prince, hold security in the company, the face value of which is ₹ 5,000. Explaining the provisions of the Companies Act, 2013 answer the following:

   (i) Examine the validity of Mr. Prince's appointment as auditor in the above company.

   (ii) What would be your answer in case Mr. Prince is already the auditor of 10 companies?

   (iii) What shall be your answer in case Mr. Prince has some business relationship with a subsidiary company of ABC Limited and is rendering consulting services to the subsidiary company?

   (b) AB & Co. is an audit firm comprising of two partners Mr. A and Mr. B holding appointments as an auditor in 41 private companies out of which paid-up capital of 20 companies exceeds 50 Lakhs. XYZ Private Limited wants to appoint AB & Co. as its auditor. Decide whether this is in consonance with the provisions as contained in the Companies Act, 2013.

Appointment and qualification of Directors

4 (a) Authorised by Articles, the Board of Directors of Paras Medicines Limited made the following appointments:

   (i) Mr. Anderson, who could not be appointed as director in the general meeting, appointed as Additional Director.

   (ii) In pursuance of an agreement with a financial institution, Mr. Black is appointed as a Nominee Director.

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(iii) Mr. Mohan appointed as alternate Director for a period of three months. Mr. Mohan is already holding alternate directorship for some other director in this company.

Decide the validity of the above appointments under the provisions of the Companies Act, 2013. Also point out whether the acts done by the said directors are valid under the Companies Act, 2013?

(b) The Board of directors of XYZ Ltd. filled up a casual vacancy caused by the death of Mr. P by appointing Mr. C as a director on 3rd April, 2014. Unfortunately Mr. C expired on 15th May, 2014 after working about 40 days as a director. The Board now wishes to fill up the casual vacancy by appointing Mrs. C in the forthcoming meeting of the Board. Advise the Board in this regard as per the provisions under the Companies Act, 2013.

5 (a) Mr. Influential is already a director of 19 companies out of which 10 are public limited companies and 9 are private companies. He is being appointed as a director of another company named Expensive Remedies Ltd. Advise Mr. Influential in regard to the following:

(i) Restrictions on the number of directorships to be held by an individual and whether he can accept the new appointment in view thereof.

(ii) What are the companies to be excluded for the purpose of calculating the ceiling on the appointment of directors in a public company?

(b) Mr. Raj, a director of POL Ltd., submitted his resignation from the post of director to the Board of Directors on 30th June, 2014 and obtained a receipt thereof on the same day. The Board of Directors of POL Ltd. neither accepted the resignation nor did it file the required form with the Registrar of Companies. You are required to state whether Mr. Raj ceases to be the Director of POL Ltd. and if yes, since when?

Appointment and Remuneration of Managerial Personnel

6 (a) The Article of Association of a listed company have fixed payment of sitting fee for each Meeting of Directors subject to maximum of ₹ 30,000. In view of increased responsibilities of independent directors of listed companies, the company proposes to increase the sitting fee to ₹ 45,000 per meeting. Advise the company about the requirement under Companies Act, 2013 to give effect to the proposal.

(b) Advise Super Specialities Ltd. in respect of the following proposals under consideration of its Board of directors:

(i) Appointment of Managing Director who is more than 70 years of age;

(ii) Payment of commission of 4% of the net profits per annum to the Independent directors of the company;

(iii) Payment of remuneration of ₹ 40,000 per month to the whole time director of the company running in loss and having an effective capital of ₹ 95.00 lacs.

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Meetings of Board and its powers

7 (a) Board of Director of GHI Limited are to appoint a 'Stakeholders Relationship Committee' as required under the provisions of the Companies Act, 2013. The Board decides to constitute the committee with the following directors of the company who are the non-executive directors:

Mr. Wise

Mr. Intelligent

Mr. Green

Mr. Blue

You are required to:

(i) Draft a resolution appointing the 'Stakeholders Relationship Committee'.

(ii) Which companies are required to constitute the 'Stakeholders Relationship Committee' under the provisions of the Companies Act, 2013?

(b) In order to meet the expansion requirement, the Board of Directors of MNR Limited by passing a resolution decides to borrow from the company's bankers an additional sum of ₹ 200 crores, as long term loan. The company gives you the following financial information:

	₹
Equity Share Capital	100 crores
Preference Share Capital	50 crores
General Reserve	25 crores
Debenture Redemption Reserve	25 crores
Provision for Taxation	12 crores

Existing long term loan from company's bankers is ₹ 25 crores.

Examining the provisions of the Companies Act, 2013, the company seeks your advice about the extent to which the company can borrow from its bankers and also state whether the Board of Directors proposal to borrow ₹ 200 crores is valid.

8 (a) Analyse and Advise with reference to the provisions of the Companies Act, 2013, the following situations:

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

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

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(b) XYZ Ltd. was incorporated on 1st January, 2012. On 1st November, 2014 a political party approaches the company for a contribution of ₹ ten lakhs for political purpose. Advise in respect of the following:

(i) Is the company legally authorised to give this political contribution?

(ii) Will it make any difference, if the company was in existence on 1st October, 2011?

(iii) Can the company be penalised for defiance of provisions in this regard?

Inspection, Inquiry and Investigation

9 (a) What are the circumstances in which an inspector appointed under section 210 of the Companies Act, 2013, can investigate into affairs of related companies?

(b) What provisions are applicable in respect of the Inspector's report on investigation as enumerated under Section 223 of the Companies Act, 2013?

Compromise, Arrangements and Amalgamations

10 (i) A meeting of members of ABC Limited was convened under the orders of the Court to consider a scheme of compromise and arrangement. Notice of the meeting was sent in the prescribed manner to all the 700 members holding in the aggregate 20,00,000 shares. The meeting was attended by 400 members holding 13,00,000 shares. 160 members holding 10,00,000 shares voted in favour of the scheme. 150 members holding 2,40,000 shares voted against the scheme. The remaining members abstained from voting. Examine with reference to the relevant provisions of the Companies Act, 1956 whether the scheme is approved by the requisite majority.

(ii) Does the scheme of compromise or arrangement require approval of preference shareholders?

Prevention of Oppression and Mismanagement

11 Examine the merits of the following petitions made under Sections 397 and 398 of the Companies Act, 1956 in the light of judicial pronouncements made in this regard:

(i) A group of shareholders holding 12% of the issued share capital of Unique Products Limited have filed a petition before the Company Law Board alleging various acts of illegal, invalid and irregular transactions entered into in the name of the Company.

(ii) Speciality Chemicals Private Limited is controlled by two groups of members. The group holding majority of shares made an application to Company Law Board alleging oppression by the minority group.

Winding Up

12 (a) Modern Textiles Limited incurred huge losses during the last three financial years and its financial position was bad. The Company created a legal mortgage on some of its immovable properties in favour of a bank on 1st September, 2013 in the hope

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that by keeping good faith with the bank it could get further advances from the bank and the same could be utilized to revive the Company. Some creditors filed winding up petition in the court on 15th January, 2014. The court passed an order of winding up on 1st August, 2014. Answer the following with reference to the provisions of the Companies Act, 1956:

(i) What is meant by 'Fraudulent Preference'? State the effect of 'Fraudulent Preference'.

(ii) Whether the creation of legal mortgage by the Company in favour of the bank would amount to fraudulent preference?

(b) A listed Public Company was ordered to be wound up by the order of the Bombay High Court. While ordering the winding up, the Court ordered the Official Liquidator to submit a preliminary report to the Court as per the provisions contained in the Companies Act. State briefly the details to be given in the preliminary report of the Official Liquidator.

Producer Companies

13 (a) Mr. Z an expert in modern agriculture practices is willing to lend his services as a director of M/s. Lord Krishna Cotton Producer Company Ltd. registered under Section 581C of the Companies Act, 1956. Advise Mr. Z as to how he can be appointed as a director including (1) The total number of directors that can be appointed (2) The tenure of the directors (3) The time limit within which the appointment should be made (4) the co-option of directors and (5) the voting powers of such co-opted directors**.**

(b) A producer company was incorporated on 1st September, 2014. At present the paid-up share capital of the company is ₹ 10 lakhs consisting of 1,00,000 equity shares of ₹ 10 each fully paid-up held by 200 individuals and 20 producers institutions. You are required to answer the following with reference to the provisions of the Companies Act, 1956:-

(i) What is the time limit for holding the First Annual General Meeting and the subsequent Annual General Meetings?

(ii) What is the Quorum for the Annual General Meeting?

(iii) State the manner in which the voting rights of the members are determined.

(iv) Is it possible to remove a member?

Companies Incorporated outside India

14 (a) Explain the provisions of the Companies Act, 2013 relating to the filing of documents by a company incorporated outside India, having a place of business in Mumbai. State whether failure on the part of such a company to comply with the provisions of the Act, shall affect the validity of any contract entered into by the company. Also state whether the company is entitled to bring any suit in respect of any such contract.

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(b) Under Section 387 of the Companies Act, 2013, what are the particulars required to be contained in a prospectus to be issued by an existing foreign company?

Offences and Penalties/E-Governance/Special Courts

15 (a) What is Director Identification Number (DIN) and what scanned documents are required to be attached with eform DIR-3?

(b) What are the powers of the Central Government under the Companies Act, 2013 regarding:

(i) Appointment of company prosecutors

(ii) Appeal against acquittal

Miscellaneous provisions

16 (a) What do you mean by wrongful withholding of property under the Companies Act, 2013 and what is the prescribed penalty for it?

(b) Mr. Shri Nivasan has a unique business idea emerging from research and development in new commercial area, however, it is a future project and recently has no significant transactions, business activities in this regard. Mr. Shri Nivasan wants to know about the concept under Companies Act, 2013 to form a company whose business activities would be commenced subsequently.

Corporate Secretarial Practice-Drafting of Resolution, Minutes, Notices and Reports

17 Answer any **one** of the following:

(i) Board of Directors of DBM Limited held a board meeting on 2nd May, 2014 at its registered office. You are required to state the salient points to be taken into account while drafting the minutes of the said board meeting.

(ii) Draft a board resolution for appointment of Mr. Paul as the managing director for 5 years with effect from 1st June, 2014 of DBM Limited passed in the above stated board meeting.

The Securities and Exchange Board of India (SEBI)

18 (a) A group of complainants have alleged that Mr. Z, a Member of the Securities and Exchange Board of India (SEBI) has pecuniary interest in some of the cases that came up before the Board and that he misused his position and therefore, he should be removed from his office. The complainants seek your advice. Advise.

(b) A group of investors are upset with the functioning of two leading stock brokers of Calcutta Stock Exchange and want to make a complaint to SEBI for intervention and redressal of their grievances. Explain briefly the purpose of establishing SEBI and what type of defaults by the stock brokers come within the purview of SEBI Act, 1992.

19. The Balance Sheet of Royal Ltd. as at 31-03-2015 disclosed the following details:

(i) Authorised share capital ₹ 400 crores

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(ii) Paid up share capital ₹ 150 crores

(iii) Reserves and surplus ₹ 750 crores

The company has issued in the year 2010, Fully Convertible Debentures of ₹ 100 crores which are due for conversion in the year 2015. The company proposes, after the conversion of Debentures to issue Bonus shares in the ratio of 1: 1. Explain briefly the requirements of the Securities and Exchange Board of India (SEBI) Regulations to be followed by the company in this regard.

Securities Contracts (Regulation) Act, 1956

20 (a) The shares of Maya Ltd. were listed in Mettle Stock Exchange. The stock exchange delists the shares of the company. The aggrieved company approaches you to know the remedy available to the company. Give your suggestion to the company keeping in view the provision of the Securities Contracts (Regulation) Act, 1956.

(b) Crystal Ltd. is holding 33% of the paid up equity capital of Chennai Stock Exchange. The company appoints Glass Ltd. as its proxy who is not a member of the Chennai Stock Exchange, to attend and vote at the meeting of the stock exchange. Examine whether the Chennai Stock Exchange can restrict the appointment of Glass Ltd. as proxy for Crystal Ltd. and further restrict, the voting rights of Crystal Ltd. in the Chennai Stock Exchange.

Foreign Exchange Management Act, 1999

21 (a) Examining the provisions of the Foreign Exchange Management Act, 1999, state as to when shall a person residing in India shall be treated as 'Person Resident in India'. Further state whether in the following situations, the person concerned shall be included within the meaning of 'Person Resident in India':

(i) Mr. Naveen who has gone out of India for carrying business outside India during the preceding year.

(ii) Mr. Maurya, a person resident outside India controls an Office in India of a company.

(b) Mr. Reyansh, an Indian National desires to obtain foreign exchange for the following purposes:

(i) Remittance of US Dollar 50,000 out of winnings on a lottery ticket.

(ii) US Dollar 100,000 for sending a tour of a cultural group to USA.

(iii) US Dollar 50,000 for meeting the expenses of his business tour to Europe.

Advise him, if he can get the Foreign Exchange and under what conditions.

The Competition Act, 2002

22 (a) An enterprise is not satisfied with the decision of the Competition Commission. Advise whether any remedy is available to the aggrieved party against the decision of the Competition Commission under the Competition Act, 2002?

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(b) Examining the provisions of the Competition Act, 2002, state as to when can the Competition Commission inquire into certain agreements. What factors shall the Commission take into account while determining whether an agreement has an appreciable adverse effect on competition?

Interpretation of Statutes, Deeds and Documents

23 (a) Explain the Rule of "Reasonable construction under the interpretation of Statute, Deeds etc".

(b) Explain the rule of "Ejusdem Generis" with reference to the interpretation of statutes. State the cases in which this rule is not applicable.

Banking Regulation Act, 1949, The Insurance Act, 1938, The Insurance Regulatory and Development Authority Act, 1999, The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

24 (a) Referring to the provisions of the Banking Regulation Act, 1949, answer the following:

(i) What are the powers of the Central Government to acquire any Banking company?

(ii) State the matters that may be included in the scheme of acquisition prepared by the Central Government.

(b) With reference to the provisions of Insurance Act, 1938 as amended by Insurance Regulatory and Development Authority Act, 1999, state the norms in respect of paid up equity capital for carrying out the business of an insurer. Also state the items that are excluded in determining the amount of paid up equity capital of an insurer under the said Acts.

Prevention of Money Laundering Act, 2002

25 X has been arrested for committing an offence, under the Prevention of Money Laundering Act, 2002. The offence is punishable with imprisonment for a term exceeding three years. Can he be released on bail? Discuss.

SUGGESTED ANSWERS/HINTS

1. **Payment of dividend (Section 127 of the Companies Act, 2013):** Section 127 of the Companies Act, 2013 lays down that dividend has to be paid within 30 days from the date of its declaration. Failure to pay or post dividend warrant within 30 days constitutes an offence under the Act and renders every director of the company, if he is knowingly a party to the default, punishable with simple imprisonment for a term which may extend to two years and also to a fine of one thousand rupees for every day during which such default continues and the company shall be liable to pay simple interest at the rate of eighteen per cent per annum during the period for which such default continues.

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The Section further provideds that no offence shall be deemed to have been committed in the case where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder.

In the instant case, dividend was declared on 31st May, 2014 and was paid on 15th June, 2014 i.e. within 15 days. The time limit prescribed by section 127 of the said Act is 30 days so no offence is committed.

Further, no dividend was paid to Mr. Goyameer as the company adjusted the amount of dividend against a sum due to it from Mr. Goyameer. Section 127 expressly authorizes the company to lawfully adjust the amount of dividend against any sum due to it from the shareholder.

So, in the instant case, the adjustment of amount of dividend is also not violative of the Companies Act, 2013.

2 **(a)** Under section 134(1) of the Companies Act, 2013 the financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by at least:

(i) The chairperson of the company where he is authorised by the Board; or

(ii) Two directors out of which one shall be managing director and

(iii) The Chief Executive Officer, if he is a director in the company,

(iv) The Chief Financial Officer and the company secretary of the company, wherever they are appointed.

In the instant case, the financial statements have been signed by Mr. Ramesh and Mr. Suresh, the directors. In view of Section 134(1) of the Companies Act, 2013, Mr. Indersen, the Managing Director should be one of the two signing directors. Since the company has also employed a full time Secretary, he should also sign the financial statement.

(b) (i) In accordance with the provisions of the Companies Act, 2013 as contained in Section 129(1), the financial Statements of a company shall be prepared in such a manner so that these:

(a) Give a true and fair view of the state of affairs of the company or companies.

(b) Comply with the accounting standards notified under Section 133 of the Act.

(c) Shall be in the form or forms as may be provided for different class or classes of companies in Schedule III to the Act.

(d) However, the items contained in such financial statements shall be in accordance with the accounting standards.

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(ii) The above provisions relating to nature and content of financial statement shall not apply to following companies:

(a) Insurance companies.

(b) Banking companies.

(c) Company engaged in the generation or supply of electricity.

(d) Any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

(iii) According to section 129(5) of the Act, in case the financial statements of a company are not prepared in compliance with the Accounting Standards, the company shall disclose in its financial statements the following viz.

(a) The extent to which the financial statements do not comply with Accounting Standards i.e. deviation from the Accounting Standards.

(b) The reasons for such deviation i.e. what has led the company to deviate from the Accounting Standards.

(c) The financial effects, if any, arising out of such deviation.

As per section 129(7) of the Act, if a company contravenes the provisions relating to preparation of financial statements, the Managing Director, the Whole-time Director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with:

(a) Imprisonment for a term which may extend to 1 year; or

(b) Fine which shall not be less than ₹ 50,000 which may extend to ₹ 5 lacs; or

(c) Both with imprisonment as well as the fine.

3 (a) (i) In accordance with the provisions of Companies Act, 2013 as contained in Section 141(3)(d), a person who, or his relative or partner, is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company cannot be appointed as an auditor of the company. However, if that relative is holding the security or interest in the company of face value not exceeding ₹ 1,00,000 as prescribed under the *Companies (Audit and Auditors) Rules, 2014,* a person can be appointed as an auditor of the company even though he is related to the person holding security or interest.

Therefore, the appointment of Mr. Prince as an auditor is valid, since Mr. Y, a relative of Mr. Prince holds securities of the value not more than ₹ 1,00,000 (₹, 5,000 in the given case).

(ii) In the second case, Mr. Prince is already the auditor of 10 companies. As per

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Section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company if a person is in full time employment elsewhere or a person or partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies. In this case since Mr. Prince is auditor in only 10 companies, he can accept the appointment as an auditor in 10 more companies.

(iii) In the third case, in accordance with the provisions of the Act as contained in Section 141(3)(e), a person or a firm who, whether directly or indirectly has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed under the *Companies (Audit and Auditors) Rules, 2014*, shall be disqualified from being appointed as an auditor of a company. Therefore, Mr. Prince cannot be appointed as an auditor of the company in the given case, since he is having some business relationship with a subsidiary of ABC Limited.

(b) As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company if a person is in full time employment elsewhere or a person or partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies. Private companies shall also been included in the provisions with respect to ceiling on number of audits.

As per section 141(3)(g), the limit of 20 company audits is per person. In the case of an audit firm having 2 partners, the overall ceiling will be $2 \times 20 = 40$ company audit. 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.

Therefore, in the instant case, AB & Co. is an audit firm comprising of two partners Mr. A and Mr. B holding appointments as an auditor in 41 private companies out of which paid-up capital of 20 companies exceeds 50 Lakhs. Therefore, XYZ Private Limited cannot appoint AB & Co. as its auditor since they are holding appointments as an auditor in 41 private companies which exceeds overall ceiling of 40. Thus, in above case such appointment shall not be in order. There is no relevance of paid up share capital in the above case.

4 (a) (i) **Appointment of Mr. Anderson as an Additional Director who could not be appointed as director in the general meeting**

According to Section 161(1) of the Companies Act, 2013, the article of a company may confer on its Board of Directors the power to appoint any person as an additional director at any time. Such person shall not be appointed as an additional director who fails to get appointed as a director in a general meeting. In the instant case, Mr. Anderson failed to get appointed as director in the general meeting. So his appointment as additional director is not valid.

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(ii) **Appointment of Mr. Black as a Nominee Director, in pursuance of an agreement with a financial institution**

According to Section 161(3) of the Companies Act, 2013, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a government company subject to the articles of the company.

In the instant case the appointment of Mr. Black as a nominee director is valid.

(iii) **Appointment of Mr. Mohan as alternate Director for a period of three months. Mr. Mohan is already holding alternate directorship for some other director in this company.**

According to Section 161(2) of the Companies Act, 2013, the Board of Director of a company, if so authorized by its articles or by a resolution passed by the company in general meeting, appoint a person, not being a person holding any alternate directorship for any other director in the company to act as alternate director for a director during his absence from India for a period of not less than three months.

In the instance case, Mr. Mohan is already holding the alternate directorship for some other director in the company and hence his appointment as alternate director by the Board of Directors is not valid.

Validity of acts of director: According to Section 176 of the Companies Act, 2013, no act done by a person as a director shall be deemed to 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. But once the director's appointment has been noticed by the company to be invalid or to have terminated, nothing in this section shall be deemed to give validity to any act done by the director after words.

(b) Section 161(4) of the Companies Act, 2013 provides that in the case of a public company, if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board.

Provided that any person so appointed shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.

In view of the above provisions, in the given case, the appointment of Mr. C in place of the deceased director Mr. P was in order. In normal course, Mr. C could have held his office as director up to the date to which Mr. P would have held the same.

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However, Mr. C expired on 15th May, 2014 and again a vacancy has arisen in the office of director owing to death of Mr. C who was appointed by the board to fill up the casual vacancy resulting from Mr. P's demise. Vacancy arising on the Board due to vacation of office by the director appointed to fill a casual vacancy in the first place, does not create another casual vacancy as section 161 (4) clearly mentions that such vacancy is created by the vacation of office by any director appointed by the company in general meeting. Hence, the Board cannot fill in the vacancy arising from the death of Mr. C.

The Board may however appoint Mrs. C as an additional director under section 161 (1) of the Companies Act, 2013 provided the articles of association authorises the board to do so, in which case Mrs. C will hold the office until the conclusion of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

5 **(a)** (i) Under section 165 (1) of the Companies Act, 2013, no person, after the commencement of this Act, shall hold office as a director including any alternate directorship, in more than twenty companies at the same time.

Provided that the maximum number of public companies in which a person can be appointed as a director shall not exceed ten.

Explanation to section 165 (1) clarifies that for reckoning the limit of public companies in which a person can be appointed as director, directorship in private companies that are either holding or subsidiary company of a public company shall be included.

In the said question, Mr. Influential is already a director in 10 public companies and as Expensive Remedies Ltd is a public company, he cannot be appointed as a director therein, even though his total directorships are less than 20.

(ii) For calculating the limit of 10 public companies, a private company which is neither a subsidiary nor a holding company of a public company will be excluded in terms of the explanation to section 165 (1) of the Companies Act, 2013.

(b) Section 168(2) of the Companies Act, 2013 states that the resignation of a director shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later. The effectiveness of the resignation of the director is not in any way connected to its acceptance by the Company or the Board nor is it linked to the filing of required form with the Registrar.

However, under the Proviso to section 168 (1), the resigning director is also required to file with the Registrar a copy of his resignation and the reasons of his resignation in form DIR 11 within 30 days of the date of his resignation.

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Hence, if the company has failed to file the form DIR 12 as required by the *Companies (Appointment & Qualifications of Directors) Rules, 2014,* the effectiveness of his resignation will not be impacted.

Therefore, in the given case, the resignation of Mr. Raj is valid and he will cease to be a director of POL Ltd. with effect from the date of notice i.e. 30th June 2014 as he has obtained the receipt of the notice on the same day.

6 **(a)** Section 197(5) of the Companies Act, 2013 provides that a director may receive remuneration by way of fee for attending the Board/Committee meetings or for any other purpose as may be decided by the Board, provided that the amount of such fees shall not exceed the amount as may be prescribed. The Central Government through rules prescribed that the amount of sitting fees payable to a director for attending meetings of the Board or committees thereof may be such as may be decided by the Board of directors or the Remuneration Committee thereof which shall not exceed the sum of rupees 1 lakh per meeting of the Board or committee thereof. Further, the Board may decide different sitting fee payable to independent and non-independent directors other than whole-time directors.

From the above, it is clear that fee to independent directors can be increased from ₹ 30,000 to ₹ 45,000 per meeting by passing a Board Resolution.

(b) (i) Under the proviso to section 196 (3)(a) of the Companies Act, 2013, a person who has attained the age of seventy years may be employed as managing director, whole-time director or manager by the approval of the members by a special resolution passed by the company in the general meeting and the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person.

(ii) Under section 197 (7) of the Companies Act, 2013, independent directors may be paid profit related commission as may be approved by the members. However, under section 197 (1) the limit of total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven per cent of the net profits of that company for that financial year computed in the manner laid down in section 198. Further, the third proviso to section 197 (1) provides that except with the approval of the company in general meeting, the remuneration payable to directors who are neither managing directors or whole-time directors shall not exceed one per cent. of the net profits of the company, if there is a managing or whole-time director or manager; or three per cent of the net profits in any other case Therefore, in the given case, the commission of 4% is beyond the limit specified, and the same should be approved by the members by ordinary resolution.

(iii) If, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including managing or whole time director or manager, any remuneration exclusive of any fees payable to directors except in accordance with the provisions of Schedule V. Section II of

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Part II of schedule V provides that where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may, without Central Government approval, pay remuneration to the managerial person not exceeding ₹ 30 Lakhs for the year if the effective capital of the company is negative or upto ₹ 5 Crores. In the present case the proposed remuneration can be paid without the approval of Central Government.

7 (a) (i) 'Stakeholders Relationship Committee' under the provisions of the Companies Act, 2013 is appointed by the Board of Directors by passing resolution at its meeting. The resolution is as under:

“Resolved that the 'Stakeholders Relationship Committee' be and is hereby constituted as under:

Mr. Wise	Non-Executive Director (Chairperson).
Mr. Intelligent	Non-Executive Director
Mr. Green	Non-Executive Director
Mr. Blue	Non-Executive Director

The Committee further resolves to appoint Mr. Wise as the Committee's Chairman and Mr. Wise be and is hereby appointed as Chairman.

The Committee resolves authorising the Company Secretary to take necessary steps to complete the formalities relating to the above resolution.”

Dated ________, 2015 Sd/

FOR BOARD OF DIRECTORS

(ii) The Board of Directors of a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at anytime during a financial year shall constitute a Stakeholders Relationship Committee consisting of a Chairperson who shall be a non-executive director and such other members as may be decided by the Board. [Section 178(5) of the Companies Act, 2013]

The Committee shall consider and resolve the grievances of security holders of the company [Section 178(6)].

The Chairperson of each of the committee constituted under the provisions of this Act or, in his absence any other member of the committee authorised by him in this behalf shall attend the general meetings of the company. [Section 178(7)].

In case of any contravention of the provisions of Section 177 and this section, the company shall be punishable with fine which shall not be less than ₹ One lakh but which may extend to ₹ 5 lakhs and every officer of the company who is in default shall be punishable with imprisonment for a term which may

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extend to one year or with fine which shall not be less than ₹ 25,000 but which may extend to ₹ One lakh or with both. [Section 178(8)]

However, non-consideration of resolution of any grievance by the Stakeholders Relationship Committee in good faith shall not constitute a contravention of this section. [Proviso to section 178(8)]

7 (b) Section 180 of the Companies Act, 2013 provides that the Board of directors of a company can exercise certain powers only with the consent of the company accorded by a special resolution passed at the company's general meeting.

Board of directors of the company can borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed the aggregate of the company's paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business, only with the consent of the company accorded by a special resolution passed at a general meeting. Every such special resolution shall specify the total amount up to which moneys may be borrowed by the Board of Directors.

In the given case, the aggregate of paid-up share capital + free reserves is ₹ 100 crores+ ₹ 50 crores + ₹ 25 crores, i.e. ₹ 175 crores i.e. the maximum amount can be borrowed by the directors. As per resolution, the Board wants to borrow additional sum of ₹ 200 crores. Company has already borrowed ₹ 25 crores as existing long term loan. Since the amount of additional borrowing i.e. ₹ 200 crores is in excess of the above limit of ₹ 175 crores, the Board can borrow only by passing a special resolution passed in the general meeting of the company.

The Board of Directors of the company are, therefore, advised to get a special resolution passed in the company's general meeting and the resolution should also specify the amount that can be borrowed by the Board.

8 (a) (i) According to section 174(1) of the Companies Act, 2013, the quorum for a meeting of the Board of Directors of a company shall be one third of the total strength of Board (any fraction contained in the said one third being rounded of as one) or two directors whichever is higher. The total strength is to be derived after deducting the number of directors whose offices are vacant. Therefore, where total number of directors is 9 and 2 offices of the directors have fallen vacant, we find: 1/3 of (9-2) = 1/3 of 7 = 2 1/3 directors which will be rounded off as 3. Therefore, being higher than 2, 3 directors would constitute the quorum for the Board meetings.

(ii) Under section 174(3) of the Companies Act, 2013, if at any time the number of the remaining directors exceeds or is equal to two thirds of the total strength of the Board of Directors, the number of the remaining directors who are non-interested but present at the meeting, not being less than two shall constitute the quorum. Accordingly in the given problem, there are in all 15 directors and the Board meeting commences with all the 15 directors. During the meeting, an item comes up for discussion in respect of which 13 happen to be

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"interested" directors. In this case, in spite of the excess of the interested directors being more than two-thirds, the prescribed minimum number of non-interested directors constituting the quorum, namely, 2 are present at the meeting and can transact the particular item of business.

(b) (i) In terms of section 182 (1) of the Companies Act, 2013, the company is legally not authorized to make a political contribution unless it has been in existence for three financial years or more. Since XYZ Ltd. has not completed three years of existence on 1st November 2014, it is not eligible to give political contribution.

(ii) Yes, because in that case, XYZ limited will complete three financial years of its existence by 1st October, 2014, therefore, will be eligible to give political contribution under section 182 (1) of the Companies Act, 2013 on 1st November, 2014. However, the amount of contribution in the aggregate in a financial year shall not exceed 7.5% of its average net profits during the three immediately preceding financial years. Further, no such contribution shall be made by a company unless a resolution authorising the making of such contribution is passed at a meeting of the Board of Directors.

(iii) Under section 182 (4) of the Companies Act, 2013 if a company makes any contribution in contravention of the provisions of section 182, the company shall be punishable with fine which may extend to five times the amount so contributed and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to five times the amount so contributed.

9 (a) Investigation into affairs of related companies: According to section 219 of the Companies Act, 2013, if an inspector appointed under section 210 or section 212 or section 213 to investigate into the affairs of a company considers it necessary for the purposes of the investigation, can also investigate the affairs of—

(i) any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company;

(ii) any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time, the managing director or the manager of the company;

(iii) any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors; or

(iv) director or manager or employee.

(b) Section 223 of the Companies Act, 2013 deals with Inspector's report. The following provisions are applicable in respect of the Inspector's report on investigation:

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(i) **Submission of interim report and final report [Sub section (1)]:** An inspector appointed under this Chapter (Chapter XIV- Inspection, Inquiry and Investigation) may, and if so directed by the Central Government shall, submit interim reports to that Government, and on the conclusion of the investigation, shall submit a final report to the Central Government.

(ii) **Report to be writing or printed [Sub section (2)]:** Every report made under sub section (1) above, shall be in writing or printed as the Central Government may direct.

(iii) **Obtaining copy of report [Sub section (3)]:** A copy of the above report may be obtained by making an application in this regard to the Central Government.

(iv) **Authentication of report [Sub section (4)]:** The report of any inspector appointed under this Chapter shall be authenticated either—

(a) by the seal of the company whose affairs have been investigated; or

(b) by a certificate of a public officer having the custody of the report, as provided under section 76 of the Indian Evidence Act, 1872,

and such report shall be admissible in any legal proceeding as evidence in relation to any matter contained in the report.

(v) **Exceptions:** Nothing in this section shall apply to the report referred to in section 212 of the Companies Act, 2013.

10 (i) Compromise or Arrangement: The scheme must be approved by a resolution passed with the special majority stipulated in section 391(2) of the Companies Act, 1956, namely a majority in number representing three-fourths in value of the creditors, or members, or class of members, as the case may be, present and voting either in person or, by proxy.

The majority is dual, in number and in value. The three-fourths value is to be computed with reference to paid-up capital held by members present and voting at the meeting.

In this case, out of 700 members, 400 members attended the meeting, but only 310 members voted at the meeting. As 160 members voted in favour of the scheme the requirement relating to majority in number (i.e. 156) is satisfied. 310 members who participated in the meeting held 12,40,000, three-fourth of which works out to 9,30,000 while 160 members who voted for the scheme held 10,00,000 shares. As both the requirements are fulfilled, the scheme is approved by the requisite majority. (It is presumed that all the shares are fully paid-up).

(ii) Preference shareholders: The term 'member' includes preference shareholders also. Further, preference shareholders are a class of members and their rights may be affected differently in the proposed scheme of arrangement. Hence their approval is also required.

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If the Court directs separate meeting of preference shareholders and equity shareholders, then the scheme should be approved by requisite majority in both such meetings held as per directions of the Court.

11 (i) According to Sections 397 and 398 of the Companies Act, 1956, a group of shareholders of Unique Products Limited must hold more than 10% of the issued share capital of the Company or satisfy other requirements under section 399(1) of the Companies Act, 1956. Since, the group holds 12% of the issue capital they are entitled to file a petition before the Company Law Board under sections 397 and 398 of the Companies Act, 1956 by alleging that the affairs of the Company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members of the Company. However, on the basis of *Seth Mohanlal Ganpatram V. Shri Sayaji Jubilee Colton and Jute Mills Company Ltd*., mere illegal, invalid or irregular transactions entered into in the name of the company do not constitute a ground for invoking the provisions of section 397 unless it is proved that they are oppressive to any shareholder or prejudicial to the interest of the company or to the public interest.

Thus, in the present case, the petition filed by the group of shareholders will fail unless they can prove to the satisfaction of the Company Law Board that the acts complained of in the petition are oppressive and prejudicial to the interest of the company and the public interest. And that to wind up the company would unfairly prejudice such member or members, but that otherwise those facts would justify the making of a winding up order on the ground that it was just and equitable that the Company should be wound up.

(ii) **Right not confined to minority**: According to section 399 of the Companies Act, 1956, the right to apply for relief under section 397 or 398 is given to 100 members or 1/10th of the total number of members or any member or members holding not less than 1/10 of the issued share capital of the company. There is nothing in this section which suggests even indirectly that unless the application is made by minority shareholders it is not maintainable. The right to apply is, therefore, not confined to oppressed minority of the shareholders alone. As per *Re Sindhri Iron Foundry (P) Ltd.,* the oppressed majority also might apply for relief under section 397. Therefore, the petitioners are likely to succeed in getting relief provided the other condition laid down in section 397 (i.e. that to wind up the company would unfairly prejudice such members, but that otherwise the facts would justify the making of a winding-up order on just and equitable ground) is satisfied.

12 (a) (i) **Fraudulent Preference**: According to the provisions of Section 531 of the Companies Act, 1956, all transfers of property, movable or immovable, made by delivery of goods or payment of money etc., if made by an insolvent person within 3 months before the presentation of insolvency petition, would be held to be a fraudulent preference of its creditors and would be invalid. Similarly, in the case of a company all such transfers, if made within 6 months before the commencement of its winding-up, would be deemed to be a fraudulent

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preference of its creditors, and would be invalid.

(ii) **Creation of legal mortgage by the company in favour of the bank**: In the present case, the Modern Textiles Limited created a legal mortgagee on some of its immovable properties in favour of a bank on 1st September, 2013 in the hope that by keeping good faith with the bank it could get further advances from the bank and the same could be utilized to revive the company.

For the purpose of proving a fraudulent preference, two things need be shown, viz.:

(a) that in the case of a winding-up by or subject to the supervision of the Court, the transaction took place within 6 months before the presentation of the petition and in the case of voluntary winding-up, the transaction took place within 6 months of passing of resolution for winding-up; and

(b) that the main motive in the mind of the company, acting through its directors, was to prefer one creditor to the other.

Thus, to prove fraudulent preference, it shall have to be established that the dominant motive was to commit an act of dishonesty. To find a case of fraudulent preference, the dominant motive in the mind of the company as represented by the directors or the general body of shareholders, as the case may be, must be to prefer the creditors. The dominant motive attending the transaction has to be ascertained, and if it is tainted with an element of dishonesty, questions of fraud arise. In validating such payment the question is not whether the company is or is not damaged by the payment, but whether it was made with a bona fide view to assisting the company.

Thus, the creation of legal mortgage on some of its immovable properties with the bank is not a fraudulent preference because it has been done in the good faith so that the company could get further advances from the bank. It is a transaction in good faith.

(b) According to section 455 of the Companies Act, 1956, as soon as the winding up order is received by the official Liquidator, a preliminary report is required to be submitted to the court. This report should be submitted as soon as the Liquidator receives the Statement of Affairs from the persons who were directors of the company at the time of winding up.

The preliminary report should contain the following details:

(i) The amount of capital issued, subscribed and paid up.

(ii) The estimated amount of assets and liabilities giving separately (a) cash and negotiable securities; (b) debts due from contributories; (c) debts due to the company and securities, if any, available in respect thereof; (d) moveable and immovable properties belonging to the company; (e) unpaid calls.

(iii) If the company has failed, the causes of the failure.

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(iv) The opinion of the Liquidator as to whether any further enquiry is desirable as to any matter relating to promotion, formation or failure of the company or the conduct of the business thereof.

The Official Liquidator has also the power to make a further report if in his opinion the company was formed with a view to commit a fraud or a fraud has been committed in respect of any matter which in his opinion is desirable to bring to the notice of the court.

13 (a) According to section 581P (1) of the Companies Act, 1956 the members who sign the memorandum and the articles may designate (not less than five) as first directors and who shall govern the affairs of the company until the directors are appointed at the Annual General Meeting.

(1) According to section 581-0 every producer company shall have at least five and not more than fifteen directors.

(2) The period of office of director shall be not less than one year and not exceeding 5 years as may be specified in the articles. [Section 581P (3)]

(3) The election of directors shall be conducted within 90 days from the date of registration of the producer company. [Section 581P (2)]

(4) The directors are normally elected and appointed by the members in the Annual General Meeting. The Board may also co-opt one or more expert directors as an additional director. Such directors cannot exceed 1/5th of the total number of directors.

(5) The expert directors shall not have the right to vote in the election of Chairman but shall be eligible to be elected as Chairman if it is provided by the articles.

Thus Mr. Z can be appointed as expert director but he will not have any voting right in the election of chairman of the Board of directors.

(b) **Annual General Meeting** – The first annual general meeting of a producer company shall be held within 90 days of incorporation i.e. on or before 29th November, 2014 in this case [Section 581ZA(2)]. In the case of subsequent Annual General Meetings gap between two Annual General Meetings must not be more than 15 months. Registrar of Companies may extend the time for holding any Annual General Meeting other than the first Annual General Meeting by a period not exceeding 3 months for any special reason [Section 581ZA(1)].

Quorum Unless the articles of association of the producer company provide for a larger number, 1/4th of the total number of members of the producer company shall be the quorum for its annual general meeting. In this case the company has got 220 members. Hence the quorum is 55 (Section 581ZA(9)]

Voting rights of members: It depends on the type of membership. Where the membership consists of individuals and producer institutions, (as in this case) voting rights should be computed on the basis of a single vote for every member [Section 581D(1)(c)]

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Removal of member: No person, who has any business interest which is in conflict with business of the producer company, shall become a member of that company (Section 581D(4)]. A person who has become a member of the producer company acquires any business interest which is in conflict with the business of the producer company, shall cease to be a member of that company and be removed as a member in accordance with the articles (Section 581D(5)].

14 (a) In accordance with the provisions of the Companies Act, 2013, as contained in Section 380, every company incorporated outside India (i.e. Foreign Company) shall, within 30 days of the establishment of its place of business in India, deliver to the Registrar for registration:

(i) A certified copy of the charter, statutes or memorandum and articles of the company or other instrument constituting or defining the constitution of a company and, if the instrument is not in the English language, a certified translation thereof in the English language.

(ii) The full address of the registered or principal office of the company.

(iii) A list of the directors and secretary of the company containing such particulars as may be prescribed.

(iv) The name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company.

(v) The full address of the office of the company in India which is deemed to be its principal place of business in India.

(vi) Particulars of opening and closing of a place of business in India on earlier occasion or occasions.

(vii) Declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and

(viii) Any other information as may be prescribed.

Further, in accordance with the provisions of Section 393 of the Act, any failure by a company to comply with the provisions of the Act shall not affect the validity of any contract, dealing or transaction entered into by the company or its liability to be sued in respect thereof, but the company shall not be entitled to bring any suit, claim any set-off, make any counter claim or institute any legal proceeding in respect of any such contract, dealing or transaction, until the company has complied with the provisions of the Act applicable to it.

(b) Under section 387 (1) of the Companies Act, 2013 no person shall issue, circulate or distribute in India any prospectus offering to subscribe for securities of a company incorporated or to be incorporated outside India, unless the prospectus is

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dated and signed, and contains particulars with respect to the following matters namely:

(i) the instrument constituting or defining the constitution of the company;

(ii) the enactments or provisions by or under which the incorporation of the company was effected;

(iii) the address in India where the said instrument, enactments or provisions, or copies thereof can be inspected. If the same are not in the English language, a certified translation thereof in the English language should be available for inspection;

(iv) the date on which and the country in which the company would be or was incorporated; and

(v) whether the company has established a place of business in India and, if so, the address of its principal office in India; and

(vi) the matters specified under section 26 (so far as they are applicable) which lays down the matters to be included in a prospectus issued by an Indian Company.

In terms of the proviso to section 387 (1) the above referred points (i), (ii) and (iii), shall not be applicable if the prospectus is issued more than 2 years after the date at which the company is entitled to commence business.

15 (a) Director Identification Number (DIN): 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.

Scanned documents required to be attached with eform DIR-3:

(i) High resolution photograph of the applicant.

(ii) PAN is mandatory now. So copy of pan is mandatory for identity, name, father's name and date of birth. Proof of father's name is not required in the case of foreign nationals.

(iii) Copy of passport is mandatory as an id proof in the case of foreign nationals.

(iv) Present Address proof which should not be older than 2 months

(v) Verification as per form DIR-4 as per the format given on the website.

(b) (i) Power of Central Government to appoint company prosecutors: Section 443 of the Companies Act, 2013 lays down the provisions seeking to provide that the Central Government may appoint company prosecutors with the same powers as given under the Cr. PC on Public Prosecutors.

(1) Appointment of company prosecutors: The Central Government may appoint (generally, or for any case, or in any case, or for any specified class of cases in any local area) one or more persons, as company prosecutors for the conduct of prosecutions arising out of this Act; and

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(2) **Powers and Privileges:** The persons so appointed as company prosecutors shall have all the powers and privileges conferred on Public Prosecutors appointed under section 24 of the Cr. PC.

(ii) Appeal against acquittal:

(1) According to section 444 of the Companies Act, 2013, the Central Government may, in any case arising under this Act, direct –

(a) any company prosecutor, or

(b) authorise any other person either by name or by virtue of his office,

to present an appeal from an order of acquittal passed by any court, other than a High Court.

(2) Appeal presented by such prosecutor or other person shall be deemed to have been validly presented to the appellate court.

16 (a) Section 452 of the Companies Act, 2013 provides for penalty for wrongful withholding of property. According to this section:

(i) If any officer or employee of a company—

(a) wrongfully obtains possession of any property, including cash of the company; or

(b) having any such property including cash in his possession, wrongfully withholds it or knowingly applies it for the purposes other than those expressed or directed in the articles and authorised by this Act,

he shall, on the complaint of the company or of any member or creditor or contributory thereof, be punishable with fine which shall not be less than ₹ 1 lakh but which may extend to ₹ 5 lakh.

(ii) The Court trying an offence may also order such officer or employee to deliver up or refund, within a time to be fixed by it, any such property or cash wrongfully obtained or wrongfully withheld or knowingly misapplied, the benefits that have been derived from such property or cash or in default, to undergo imprisonment for a term which may extend to 2 years.

(b) According to section 455(1) of the Companies Act, 2013:

(i) A company is formed and registered under this Act for the purpose of a future project or to hold an asset or intellectual property and has no significant accounting transaction.

(ii) Such company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.

(iii) The Registrar shall allow the status of a dormant company to the applicant and issue a certificate after considerating of the application.

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(iv) The Registrar shall maintain a register of dormant companies in such form as may be prescribed.

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

A dormant company shall have such minimum number of directors, file such documents and pay such annual fee as may be prescribed to the Registrar to retain its dormant status in the register and may become an active company on an application made in this behalf accompanied by such documents and fee as may be prescribed. However, the Registrar shall strike off the name of a dormant company from the register of dormant companies, which has failed to comply with the requirements of this section.

17 (i) While drafting the minutes of a board meeting, following salient points should be kept in mind:

(a) the minutes may be drafted in a tabular form or they may be drafted in the form of a series of paragraphs, numbered consecutively and with relevant headings.

(b) the place, date and time of the meeting should be stated.

(c) The chairman of the meeting must be mentioned. The general phrase used in the Minutes is "Mr.---, chairman of the meeting took the chair and called the meeting to order".

(d) the minutes should clearly mention the attendance and the constitution of the meeting, i.e., persons present and the capacity in which present, e.g. name of the person chairing the meeting, names of the directors and secretary, identifying them as director or secretary, names of persons in attendance like auditor, internal auditor etc. The minutes should also contain the subject of leave of absence granted, if any, to any of the board members.

(e) The adoption of the Minutes of the previous Board Meeting must be the first item on the Agenda by the directors giving their approval and the Chairman signing the Minutes as proof of approval of the Minutes.

(f) Conduct of the business at the meeting should be recorded in the chronological sequence as per the Agenda.

(e) In respect of each item of business the names of the directors dissenting or not concurring with any resolution passed at the board meeting should be mentioned.

(f) Reference about interested directors abstaining from voting is also required to be stated in the minutes.

(g) Chairman's signature and date of verification of minutes as correct.

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(ii) Resolution passed at the meeting of board of directors of DBM Limited held at its registered office situated at ……………………… on 2nd May, 2014 at ………… A.M.

"RESOLVED that subject to the approval by the shareholders in a general meeting and pursuant to the applicable provisions of the Companies Act, 2013, Mr. Paul be and is hereby appointed as the Managing Director of the Company with effect from 1st June, 2014 for a period of five years on a remuneration approved by the Remuneration Committee as enumerated below:

(1) Salary: ₹ ……………………… per month

(2) Perquisites, Benefits and Facilities ……………………………

RESOLVED FURTHER that Mr. Paul, so long as he functions as the Managing Director of the Company shall not be entitled to any sitting fee for attending the meeting of the board of directors or any committee thereof and that he shall not be liable to retire by rotation.

RESOLVED FURTHER that the Secretary of the company be and is hereby directed and authorized to file necessary returns with the Registrar of Companies and to do all other necessary things required under the provisions of the Companies Act, 2013."

SECTION – B: ALLIED LAWS

18 (a) Removal of Member of the SEBI (Section 6 of the Securities and Exchange Board of India Act, 1992)

According to section 6 of the Securities and Exchange Board of India Act, 1992, the Central Government shall have the power to remove a member appointed to the Board, if he:

(i) is, or at any time has been adjudicated as insolvent;

(ii) is of unsound mind and stands so declared by a competent court;

(iii) has been convicted of an offence which, in the opinion of the Central Government, involves a moral turpitude.

(iv) has, in the opinion of the Central Government so abused his position as to render his continuance in office detrimental to the public interest.

Before removing a member, he will be given a reasonable opportunity of being heard in the matter.

In the present case, a group of complainants have alleged that Mr. Z, a member of the SEBI has pecuniary interest in some of the cases that came up before the Board and he misused his position and therefore, he should be removed from his office.

Here, above complainants may approach the Central Government for removal of Mr. Z, a member of the SEBI and if the Central Government is of the opinion that Mr. Z has so abused his position as to render his continuation in office detrimental to the

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public interest, the Central Government may remove Mr. Z from his office after giving him a reasonable opportunity of being heard in the matter.

(b) The Securities and Exchange Board of India (SEBI) was established primarily for the purpose of

(i) to protect the interests of investors in securities

(ii) to promote the development of securities market

(iii) to regulate the securities market and

(iv) For matters connected therewith and incidental thereto.

The following defaults by stock brokers come within the purview of SEBI Act:

(i) Any failure on the part of the stock broker to issue contract notes in the form and in the manner specified by the Stock Exchange.

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

(iii) Any collection of charges by way of brokerage in excess of the brokerage as specified in the regulations. (Section 15 F, SEBI Act, 1992)

19 Bonus Issue (Chapter IX of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009)

Chapter IX of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 contains the regulations (Regulations 92 to 95) for issue of bonus shares. Royal Ltd. can issue bonus shares in the ratio of 1:1 as follows:

1. The Articles of Royal Ltd. must authorize it to issue the bonus shares and capitalization of reserve. If there is no provision in the Articles authorizing the company, firstly, the Articles shall be amended by passing a special resolution.

2. Steps for determining whether any increase in authorised share capital is required:

   (a) Paid up share capital as on 31st March, 2015: ₹ 150 crores.

   (b) Paid up capital (after conversion of ₹ 100 crores fully convertible debentures, assuming that these debentures shall be converted into share capital of ₹ 100 crores) ₹ 250 crores (150+100).

   (c) Proposed bonus issue - 1 share for every 1 share held.

   (d) Post bonus issue capital: ₹ 500 crores (250+250).

   Since the Authorised share capital of the company is only ₹ 400 crores, it has to take steps to increase the amount to ₹ 500 crores or beyond by complying with the provisions laid down in the Companies Act.

3. Sources of bonus shares: Reserves and surplus (free reserves built out of the genuine profits can be used for issue of bonus issue): ₹ 750 Crores

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Since the source of issue of bonus shares (₹ 750 crores) is sufficient to issue bonus shares (₹ 250 crores), the proposed issue can be made.

4. Other legal requirements for issue of Bonus shares are as under:
   (a) A resolution shall be passed by the Board in a duly convened Board meeting.
   (b) The bonus issue shall be made within 15 days of passing the Board resolution.
5. The bonus issue can be made if there is no default in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof; and payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus, etc.

20 (a) Section 21A of Securities Contracts (Regulation) Act, 1956 contains the provision relating to delisting of securities. As per this section

(1) A recognized Stock Exchange may delist the securities after recording reasons therefor, from any recognized stock exchange on any ground or grounds as may be prescribed under this Act.

(2) The Securities of a company shall not be delisted unless the company concerned has been given a reasonable opportunity of being heard.

(3) A listed company may file an appeal before the Securities Appellate Tribunal (SAT) against the decision of the recognized stock exchange delisting the securities within fifteen days from the date of the decision of recognized stock exchange delisting the securities.

(4) Securities Appellate Tribunal may, if it is satisfied that the company was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period of not exceeding one month.

So here, the company may make an appeal to the Securities Appellate Tribunal against the delisting within fifteen days or such extended period not exceeding one month after showing sufficient cause of not filing within fifteen days.

(b) Section 7A of the Securities (Contracts) Regulation Act, 1956 provides that a recognised stock exchange is empowered to amend rules to provide for all or any of the following matters:

(i) Restriction of voting right to members only.

(ii) Regulation of voting rights by specifying that each member is entitled to one vote only irrespective of number of shares held.

(iii) Restriction on right of members to appoint proxy.

As such Chennai Stock Exchange can restrict the appointment of Glass Ltd., as proxy, if rules of the exchange so provide. If it is not so provided, rules may be amended and after getting approval of the Central Government regarding amendment, it can restrict appointment of proxies.

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Chennai Stock Exchange can also restrict the voting rights of Crystal Ltd. if rules of the exchange so provide. If it is not so provided, rules maybe amended and after getting approval of Central Government regarding amendment, it can restrict the voting rights of Crystal Ltd appointment of proxies.

21 (a) In accordance with the provisions of FEMA, 1999, as contained in Section 2 (v), 'person resident in India' means:

1. A person residing in India for more than 182 days during the course of the preceding financial year but does not include-
   (a) person who has gone out of India or who stays outside India, in either case-
      (i) For or on taking up employment outside India, or
      (ii) For carrying on outside India a business or vocation outside India, or
      (iii) For any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;
   (b) A person who has come to or stays in India, in either case, otherwise than:
      (i) For or on taking up employment in India, or
      (ii) For carrying on in India a business or vocation in India, or
      (iii) For any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period.
2. Any person or body corporate registered or incorporated in India.
3. An office, branch or agency in India owned or controlled by a person resident outside India.
4. An office, branch or agency outside India owned or controlled by a person resident in India.

Accordingly, answer to the sub-questions are:

1. In this case Mr. Naveen shall not be a 'personal resident in India'
2. In the second case, Mr. Maurya shall be called a 'person resident in India'.

(b) Under provisions of section 5 of the Foreign Exchange Management Act, 1999 certain rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account transactions, Foreign Exchange can be drawn with prior permission of the Central government or Reserve Bank of India.

(i) Remittance out of lottery winnings, is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000.

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(ii) Foreign Exchange meeting expenses of cultural tour can be withdrawn by any person after obtaining permission from Government of India, Ministry of Human Resources Development, (Department of Education and culture) as prescribed in Second Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence, in respect of item (ii), Mr. Reyansh can withdraw the Foreign Exchange after obtaining such permission.

(iii) The type of payment as envisaged is covered under Third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000 and for withdrawing foreign Exchange exceeding US Dollar 25,000 for a business tour irrespective of period of stay Mr. Reyansh will require the prior permission of the Reserve Bank of India.

In all the cases, where remittance of Foreign Exchange is allowed, either by general or specific permission, the remitter has to obtain the Foreign Exchange from an Authorised Person as defined in Section 2(c) read with Section 10 of the Foreign Exchange Management Act, 1999.

22 (a) Remedy against the decision of competition commission (sections 53B and 53T of the Competition Act, 2002)

Appeal to Appellate Tribunal

1. According to section 53B of the Competition Act, 2002, the Central Government or the State Government or a local authority or enterprise or any person, aggrieved by any direction, decision or order referred to in section 53A may prefer an appeal to the Appellate Tribunal.
2. Every such appeal shall be filed within a period of sixty days from the date on which a copy of the direction or decision or order made by the Commission is received by the Central Government or the State Government or a local authority or enterprise or any person referred to in that sub-section and it shall be in such form and be accompanied by such fee as may be prescribed.
3. The Appellate Tribunal may entertain an appeal after the expiry of the said period of sixty days if it is satisfied that there was sufficient cause for not filing it within that period.
4. On receipt of an appeal, the Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the direction, decision or order appealed against.
5. The Appellate Tribunal shall send a copy of every order made by it to the Commission and the parties to the appeal.
6. The appeal filed before the Appellate Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal within six months from the date of receipt of the appeal.

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Appeal to Supreme Court (Section 53T)

The Central Government or any State Government or the Commission or any statutory authority or any local authority or any enterprise or any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to them. The Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from, filing the appeal within the said period, allow it to be filed after the expiry of the said period of sixty days.

(b) The competition Commission under the provisions of section 19(1) of the Competition Act, 2002 is empowered to inquire into any alleged contravention of the provisions contained in Section 3(1) or Section 4(1) either on its own or on:

(a) Receipt of any information in such manner and accompanied by such fee as may be determined by regulations, from any person, consumer or their association or trade association; or

(b) A reference made to it by the Central Government or a State Government or a statutory authority.

ADVERSE EFFECTS:

According to section 19(3) of the Competition Act, 2002, the Commission shall, while determining whether an agreement has an appreciable adverse effect on competition, have due regard to all or any of the following factors, viz:

(a) Creation of barriers to new entrants in the market

(b) Driving existing competitors out of the market.

(c) Foreclosure of competition by hindering entry into the market.

(d) Accrual of benefits to consumers.

(e) Improvements in production or distribution of goods or provision of services.

(f) Promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

23 (a) The rule of reasonable construction lays down that the words of a statute must be construed *'ut us maquis valeat quampareat'* meaning thereby that words of statute must be construed so as to a sensible meaning. Generally the words or phrases of a statute are to be given their ordinary meaning. In the case of *Dr. A.L. Mudaliar vs. LIC of India (1963) (SC*), it was held that the Memorandum of Association of a company must be read fairly and its import derived from a reasonable interpretation of the language which it employs. Further, in order to determine whether a transaction is intra vires the objects of a company, the objects clause should be reasonably construed; neither with rigidity nor with laxity. [*Waman Lal Chotanlal Parekh vs. Scindia Steam Navigation Co. Ltd.(l944)*].

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If the court finds that giving a plain meaning to the words will not be a fair or reasonable construction, it becomes the duty of the court to depart from the dictionary meaning and adopt the construction which will advance the remedy and suppress the mischief provided the court does not have to resort to conjecture or surmise. A reasonable construction will be adopted in accordance with the policy and object of the statute.

(b) **Rule of Ejusdem Generis:** The term ejusdem generis means of the same kind or species. Simply stated the rule means where any Act enumerates different subjects, general words following specific words are to be construed with reference to the words that precede them. The general words are to be taken as applying to things of the same kind as the specific words previously mentioned unless there is something to show that a wider sense was intended. Thus, the rule of 'ejusdem generis' means that where specific words are used and after these specific words, some general words are used, the general words would take their colour from the specific words used earlier, eg: where an Act permitted keeping of dogs, cats, cows, buffaloes and other animals, the expression 'other animals' would not include wide animals like lions and tigers, but would only mean domesticated animals like horses, etc.

However, there are certain cases/circumstances on which this rule cannot be applied in the interpretation of statutes. The general principle of 'ejusdem generis' applies only where the specific words are all of the same nature. When they are of different categories, then the meaning of general words following these specific words remain unaffected. These general words would not take colour from the earlier specific words.

Again if the particular words used exhaust the whole genus (category), then the general words are to be construed as covering a larger genus.

Further, the Courts have a discretion whether to apply the 'ejusdem generis' doctrine in a particular case or not. For instance, the 'just and equitable' clause in the winding up, powers of the Court is held to be not restricted by the first five situations in which the Court may wind up a company.

24 **(a)** (i) In accordance with the provisions of the Banking Regulation Act, 1949, as contained in Section 36AE, Central Government is empowered to acquire a Banking Company if it is of the opinion that the Banking Company has failed to comply the direction given to it by the Reserve Bank of India (RBI) relating to policy matters under Section 21 and 35A and/or the bank is being managed in a manner detrimental to the interest of the depositors or that of to the banking policy, or for better provision of credit generally or of credit to any particular section of the community or in any particular area; it is necessary to acquire the undertaking of such banking company, it (Central Government) may after consultation with RBI as it thinks fit, by notified order, acquire the undertaking of such banking company w.e.f. such date as may be specified (herein after referred as the appointed date) in this behalf by the Central Government. In

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case of such a notification, on the appointed date the undertaking of the acquired bank and its assets and liabilities shall stand transferred to, and vest in, the Central Government.

Before acquiring the undertaking of any banking company, the Central Government shall give a reasonable opportunity to the banking company proposed to be acquired of showing cause against the proposed action.

(ii) **MATTERS TO BE PROVIDED IN THE SCHEME:** The Scheme is prepared in consultation with the Reserve Bank of India (RBI). The scheme may provide for transfer of assets and liabilities of the acquired bank, constitution of the first Board of Management and matters incidental thereto, the service condition of the employees, compensation payable to the shareholders of the acquired bank and such other incidental, consequential and supplemental matters as may be necessary to complete the transfer.

(b) Requirement of Paid Up equity capital for insurance business: No insurer carrying on the business of life insurance, general insurance or re-insurance in India on or after the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall be registered unless he has, —

(i) a paid-up equity capital of rupees one hundred crores, in case of a person carrying on the business of life insurance or general insurance; or

(ii) a paid-up equity capital of rupees two hundred crores, in case of a person carrying on exclusively the business as a re-insurer:

Items to be excluded in determining the amount of paid up equity share capital: In determining the paid-up equity capital specified above, following item must be excluded-

(i) The deposit of 1% and 3 % of the gross premium with respect to life insurance and general insurance business in any financial year to be made by the insurer to the Reserve Bank of India.

(ii) In the case of re-insurance business, a deposit of sum of rupees twenty crores made by the insurer to the Reserve Bank of India.

(iii) Any preliminary expenses incurred in the formation and registration of the company, and

25 Bail In non-bailable offences (Section 45 of The Money Laundering Act, 2002)

1. Section 45 provides that the offences under the Act shall be cognizable and non-bailable. Notwithstanding anything contained in the Code of Criminal Procedure, 1973, no person accused of an offence punishable for a term of imprisonment of more than three years under Part A of the Schedule shall be released on bail or on his own bond unless-

   (i) The Public Prosecutor has been given an opportunity to oppose the application for such release; and

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(ii) Where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence that he is not likely to commit any offence while on bail.

2. Further, in case of any person who is under the age of 16 years or in case of a woman or in case of a sick or infirm person, the Special Court can direct the release of such person on bail.

3. The Special Court cannot take cognizance of any offence punishable under section 4 unless a complaint in writing is made by:-

   (a) The Director or

   (b) Any officer of the Central Government or a State Government authorised in writing in this behalf by the Central Government by a general or special order made in this behalf by that Government.

Thus, Mr. X has no right to be released on bail but the court may release him on bail in its discretion.

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