PAPER –1: FINANCIAL REPORTING

PART – I : RELEVANT AMENDMENTS, NOTIFICATIONS AND ANNOUNCEMENTS

A. Applicable for May, 2016 examination

1. Indian Accounting Standards

The topic of "Introduction of Indian Accounting Standards (Ind AS); Comparative study of ASs *vis-à-vis* Ind ASs; Carve outs/ins in Ind ASs *vis-à-vis* International Financial Reporting Standards (IFRSs)" had been included in the syllabus of Final Paper 1: Financial Reporting and is applicable from May, 2016 Examination.

2. Applicability of Ind AS 32, 107 and 109 on the topic 'Accounting and Reporting of Financial Instruments'

The entire IAS 39 "Financial Instruments: Recognition and Measurement", on which AS 30 "Financial Instruments: Recognition and Measurement" was based, has been replaced by IFRS 9 "Financial Instruments". Therefore, the Government of India opted to notify Ind AS 109 "Financial Instruments" in correspondence to IFRS 9 and not IAS 39. Also, AS 30, AS 31 and AS 32 on 'Financial Instruments' were earlier proposed to be made mandatory for Level I entities only. However, after notification of Ind AS in February, 2015, these entities will be applying the provisions stated in Ind AS 32, Ind AS 107 and Ind AS 109 and not AS 30, AS 31 and AS 32 for accounting of financial instruments. Therefore, it is felt appropriate to make applicable Ind AS 32, Ind AS 107 and Ind AS 109 in place of AS 30, AS 31 and AS 32 to the topic 'Accounting for Financial Instruments'.

Accordingly, it has been decided to make Ind AS 32 "Financial Instruments: Presentation", Ind AS 107 "Financial Instruments: Disclosures" and Ind AS 109 "Financial Instruments" applicable on the topic 'Accounting for Financial Instruments' instead of AS 30 "Financial Instruments: Recognition and Measurement", AS 31 "Financial Instruments: Presentation" and AS 32 "Financial Instruments: Disclosures" from May, 2016 examinations for Paper 1: Financial Reporting at the Final level.

3. Revised Regulatory Framework for NBFCs

RBI vide notification no. DNBR (PD)CC.No. 002/03.10.001/2014-15 dated November 10, 2014 has revised the regulatory provisions relating to the functioning of NBFCs (except primary dealers) in India. The changes introduced to the regulatory framework are delineated below.

a. Requirement of Minimum NOF of ₹ 200 lakh

Although the requirement of minimum NOF stands at ₹ 200 lakh, the minimum NOF for companies that were already in existence before April 21, 1999 was retained at ₹ 25 lakh but the revised regulatory framework has mandated all NBFCs to attain a minimum NOF of ₹ 200 lakh by the end of March 2017, as per the milestones given below:

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- ₹ 100 lakh by the end of March 2016
- ₹ 200 lakh by the end of March 2017

b. **Deposit Acceptance**

As per extant NBFCs Acceptance of Public Deposit (Reserve Bank) Directions, 1998, an unrated Asset Finance Company (AFC) having NOF of ₹ 25 lakh or more, complying with all the prudential norms and maintaining capital adequacy ratio of not less than fifteen per cent, is allowed to accept or renew public deposits not exceeding one and half times of its NOF or up to ₹ 10 crore, whichever is lower. AFCs which are rated and complying with all the prudential regulations are allowed to accept deposits up to 4 times of their NOF.

In order to harmonise the deposit acceptance regulations across all deposit taking NBFCs (NBFCs-D), existing unrated AFCs shall have to get themselves rated by March 31, 2016. Those AFCs that do not get an investment grade rating by March 31, 2016, will not be allowed to renew existing or accept fresh deposits thereafter. Further, it has also been decided to harmonise the limit for acceptance of deposits across the sector by reducing the same for rated AFCs from 4 times to 1.5 times of NOF, with effect from the date of this circular.

c. **Systemic Significance**

The threshold for defining systemic significance for NBFCs-ND has been revised in the light of the overall increase in the growth of the NBFC sector with asset size of ₹ 500 crore and above as per the last audited balance sheet.

With this revision in the threshold for systemic significance, NBFCs-ND shall be categorized into two broad categories viz.

i. NBFCs-ND (those with assets of less than ₹ 500 crore) and

ii. BFCs-ND-SI (those with assets of ₹ 500 crore and above).

d. **Multiple NBFCs**

NBFCs that are part of a corporate group or are floated by a common set of promoters will not be viewed on a standalone basis. The total assets of NBFCs in a group including deposit taking NBFCs, if any, will be aggregated to determine if such consolidation falls within the asset sizes of the above two categories.

e. **Prudential Norms**

The regulatory approach in respect of NBFCs-ND with an asset size of less than ₹ 500 crore will be as under:

(i) They shall not be subjected to any regulation either prudential or conduct of business regulations if they have not accessed any public funds and do not have a customer interface.

(ii) Those having customer interface will be subjected only to conduct of business regulations if they are not accessing public funds.

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(iii) Those accepting public funds will be subjected to limited prudential regulations but not conduct of business regulations if they have no customer interface.

(iv) Where both public funds are accepted and customer interface exist, such companies will be subjected both to limited prudential regulations and conduct of business regulations.

(v) Registration under Section 45 IA of the RBI Act will be mandatory.

All NBFCs-ND with assets of ₹ 500 crore and above, irrespective of whether they have accessed public funds or not, shall comply with prudential regulations as applicable to NBFCs-ND-SI. They shall also comply with conduct of business regulations if customer interface exists.

Prudential Regulations Applicable to NBFCs-ND with Assets less than ₹ 500 crore

NBFCs-ND with asset size of less than ₹ 500 crore are exempted from the requirement of maintaining CRAR and complying with Credit Concentration Norms.

A leverage ratio of 7 is being introduced for all such NBFCs-ND to link their asset growth with the capital they hold. For this purpose, leverage ratio is defined as Total Outside Liabilities / Owned Funds.

Prudential Regulations Applicable to NBFCs-ND-SI (asset of ₹ 500 crore and above) and all NBFCs-D

Tier 1 Capital

All NBFCs-ND which have an asset size of ₹ 500 crore and above, and all NBFCs-D, shall maintain minimum Tier 1 Capital of 10%. The compliance to the revised Tier 1 capital will be phased in as follows:

- 8.5% by end of March 2016.
- 10% by end of March 2017.

Asset Classification

In the interest of harmonisation, the asset classification norms for NBFCs-ND-SI and NBFCs-D are being brought in line with that of banks, in a phased manner, as given below.

Lease Rental and Hire-Purchase Assets shall become NPA:

i. if they become overdue for 9 months (currently 12 months) for the financial year ending March 31, 2016;

ii. if overdue for 6 months for the financial year ending March 31, 2017; and

iii. if overdue for 3 months for the financial year ending March 31, 2018 and thereafter.

Assets other than Lease Rental and Hire-Purchase Assets shall become NPA:

i. if they become overdue for 5 months for the financial year ending March 31, 2016;

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ii. if overdue for 4 months for the financial year ending March 31, 2017; and

iii. if overdue for 3 months for the financial year ending March 31, 2018 and thereafter.

For all loan and hire-purchase and lease assets, sub-standard asset would mean:

i. an asset that has been classified as NPA for a period not exceeding 16 months (currently 18 months) for the financial year ending March 31, 2016;

ii. an asset that has been classified as NPA for a period not exceeding 14 months for the financial year ending March 31, 2017; and

iii. an asset that has been classified as NPA for a period not exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

For all loan and hire-purchase and lease assets, doubtful asset would mean:

i. an asset that has remained sub-standard for a period exceeding 16 months (currently 18 months) for the financial year ending March 31, 2016;

ii. an asset that has remained sub-standard for a period exceeding 14 months for the financial year ending March 31, 2017; and

iii. an asset that has remained sub-standard for a period exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

For the existing loans, a one-time adjustment of the repayment schedule, which shall not amount to restructuring will, however, be permitted.

Provisioning for Standard Assets

The provision for standard assets for NBFCs-ND-SI and for all NBFCs-D has being increased to 0.40% (at present 0.25%). The compliance to the revised norm will be phased in as given below:

- 0.30% by the end of March 2016
- 0.35% by the end of March 2017
- 0.40% by the end of March 2018

Note: The revisions brought through this circular shall be applicable to NBFCs-MFI and registered Core Investment Companies also except wherever in conflict with the provision of Non-Banking Financial Company- Micro Finance Institutions (Reserve Bank) Directions, 2011 and Core Investment Companies (Reserve Bank) Directions, 2011 respectively, in which case the Directions ibid will be followed.

For a complete text of the circular please refer to the link: http://rbi.org.in/scripts/NotificationUser.aspx?Id=9327&Mode=0

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4. **Dividend Distribution Tax**

   (a) With effect from 1st Oct, 2014 dividend and income distribution tax is leviable on gross dividend / income and not on the net dividend / income distributed to shareholders and unit holders as per Income- tax Act, 1961.

   (b) The rate of DDT is fifteen per cent (excluding surcharge of 12% plus secondary and higher education cess is (2+1) 3%).

5. **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.

6. **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

7. **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.

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

8. **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.

9. **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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10. 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.

11. 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'.

12. 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 Account" in the enterprise's financial statements and amortized over the balance period

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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."

13. 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 book value of the security should continue to be reduced to the extent of the amount

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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.

14. Relevant Section of the Companies Act, 2013

The relevant Sections of the Companies Act, 2013 notified up to 30th October, 2015 are applicable for May, 2016 Examination.

15. 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.

16. 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.

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

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B. Not applicable for May, 2016 examination

The topic of "Overview of International Accounting Standards (IAS) / International Financial Reporting Standards (IFRS), Interpretations by International Financial Reporting Interpretation Committee (IFRIC), Significant differences vis-a-vis Indian Accounting Standards; Understanding of US GAAPs, Applications of IFRS and US" would be excluded from the syllabus of Final Paper 1: Financial Reporting and the same would not be applicable from November, 2015 Examination and onwards.

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

AS 1

1. (a) In the books of Pioneer Ltd. closing inventory as on 31.03.2015 amounts to ₹ 1,63,000 on the basis of FIFO method.

The company decides to change from FIFO method to weighted average method for ascertaining the cost of inventory from the year 2014-15. On the basis of weighted average method, closing inventory as on 31.03.2015 amounts to ₹ 1,47,000. Realisable value of the inventory as on 31.03.2015 amounts to ₹ 1,95,000.

Discuss disclosure requirement of change in accounting policy as per AS 1.

AS 2

(b) The following items were included in the inventory of Rich Ltd.

Product – A: Material cost, wages cost and overhead cost of each unit are ₹ 40, ₹ 30 and ₹ 20 respectively and each unit is sold at ₹ 110, selling expenses amounts to 10% of selling costs. 200 units of Product-A was included in the inventory.

Product – B: Material cost and wages cost of each unit are ₹ 45 and ₹ 35 respectively and normal selling rate is ₹ 150 each, however due to defect in the manufacturing process 800 units of Product-B were sold at ₹ 70 after balance sheet date.

Product – C: Material Cost, wages cost and overhead cost of each unit are ₹ 50, ₹ 40 and ₹ 30 respectively and each unit's normal selling price is 300% of material cost. However, due to manufacturing defects 1000 units of Product C could be sold @ ₹ 110 after incurring ₹ 8,000 towards repair expenditure.

You are requested to value closing inventory according to AS 2 after considering the above.

AS 3

2. (a) Prepare cash flow statement of Balance Ltd. for the year ended 31st March, 2015

with the help of the following information:

(1) Company sold goods for cash only.

(2) Gross profit ratio was 30% for the year, gross profit amounts to ₹ 3,82,500.

(3) Opening inventory was less than closing inventory by ₹ 35,000.

(4) Wages paid during the year ₹ 4,92,500.

(5) Office and selling expenses paid during the year ₹ 75,000.

(6) Dividend paid during the year ₹ 30,000 (including dividend distribution tax).

(7) Bank loan repaid during the year ₹ 2,15,000 (included interest ₹15,000).

(8) Trade payables on 31st March, 2014 exceed the balance on 31st March, 2015 by ₹ 25,000.

(9) Amount paid to trade payables during the year ₹ 4,60,000.

(10) Tax paid during the year amounts to ₹ 65,000 (Provision for taxation as on 31.03.2015 is ₹ 45,000).

(11) Investment of ₹ 7,00,000 sold during the year at a profit of ₹ 20,000.

(12) Depreciation on fixed assets amounts to ₹ 85,000.

(13) Plant and machinery purchased on 15th November, 2014 for ₹ 2,50,000.

(14) Cash and Cash Equivalents on 31st March, 2014 was ₹ 2,00,000.

(15) Cash and Cash Equivalents on 31st March, 2015 is ₹ 6,07,500.

AS 4

(b) F Ltd. has finalized their financial statements for the year ending 31st March, 2015 and approved by their approving authority on 30th June, 2015.

(1) A major fire broke out in the night of 31st May, 2015 destroying factory premises. Loss of property estimated to be ₹ 25 lakhs.

(2) On 15th May, 2015, one of the manufacturing unit was closed resulting shutdown cost of ₹ 25 lakhs.

(3) Negotiations with another company started in April 2015 for acquisition of two manufacturing units which may involve additional investment of ₹ 50 lakhs.

(4) On 30th April, 2015, a 100% subsidiary of F Ltd. declared dividend of ₹10 lakhs for the year ended 31st March, 2015.

(5) Foreign exchange loss during the period between 1st April, 2015 and 1st June 2015 has resulted into reduction of value of assets by ₹ 30 lakhs.

You are requested to state how to deal with the above information in the annual accounts.

AS 6

3. (a) A machinery with a useful life of 6 years was purchased on 1st April, 2012 for

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₹ 1,50,000. Depreciation was provided on straight line method for first three years considering a residual value of 10% of cost.

In the beginning of fourth year the company reassessed the remaining useful life of the machinery as 4 years and residual value was estimated at 5% of original cost.

The accountant recalculated the revised depreciation historically and charged the difference to profit and loss account. You are required to comment on the treatment by accountant and calculate the depreciation to be charged for the fourth year.

AS 7

(b) Five Star Construction Limited commenced a construction contract on 1st April, 2014. The fixed contract price agreed was ₹ 50,00,000. The company incurred ₹ 21,00,000 in 2014-15 for 40% work and received ₹ 19,00,000 as progress payment from the customer. The company estimated that a further ₹ 31,50,000 would be incurred to complete it. What amount should be charged to revenue for the year 2014-15 as per AS 7? Show the extract of Profit & Loss A/c and Customer A/c for the year 2014-15 in the books of the company.

AS 9

4. (a) X Limited sold goods worth ₹ 13 lakhs to Y. Y asked for a trade discount amounting to ₹ 1,06,000 and the same was agreed by X Limited. The sale was effected and goods were dispatched. On receipt of goods, Y has found that goods worth ₹ 1,34,000 are defective. Y returned defective goods to X Limited and made payment amounting to ₹ 10,60,000. The Accountant of X Limited booked the sale for ₹ 10,60,000.

Discuss the contention of the Accountant with reference to relevant Accounting Standard.

AS 10

(b) A company is in the process of setting up a production line for manufacturing a new product. Based on trial runs conducted by the company it was noticed that the production lines output was not of desired quality. However, company has taken a decision to manufacture and sell the sub-standard product over the next one year due to the huge investment involved.

Advise the company on the cut-off date for capitalization of the project cost.

AS 11

5. (a) Explain briefly the accounting treatment needed as per AS 11 as on 31.3.2015 when Sundry Debtors include amount receivable ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales i.e. transactions recorded at US $ 1 = ₹58.50. Long term loan taken from US Company, amounting to ₹ 60,00,000. It was recorded at US $ 1 = ₹ 55.60, taking exchange rate prevailing at the date of transaction. On 31.3.2015, US $ 1 was ₹ 61.20.

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AS 12

(b) On 1.4.2015, A Ltd. purchases an asset having fair market value of ₹ 10 lakhs in exchange of another asset which was bought on 1.10.2012 for a consideration of ₹ 15 lakhs. A Government subsidy of 20% was received on such asset. The company does not maintain any deferral income account. It has a policy of charging depreciation @ 10% p.a. on reducing balance method. On sale of this asset, it has to refund the subsidy received at the time of purchase. Compute cost at which new machine should be recorded in the books of accounts and also state treatment of the existing asset.

AS 15

6. (a) An employee Johar has joined a company ABC Ltd. in the year 2015. The annual emoluments of Johar as decided is ₹ 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of Johar is expected to grow @ 10% per annum.

The company has inducted Johar in the beginning of the year and it is expected that he will complete the minimum five year term before retiring.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.

(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)

AS 16

(b) Shan Builders Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2014-15 for its residential project at LIBOR + 3%. The interest is payable at the end of the Financial Year.

At the time of availment, exchange rate was ₹56 per US $ and the rate as on 31st March, 2015 was ₹ 62 per US $. If Shan Builders Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%. Compute Borrowing Cost and exchange difference for the year ending 31st March, 2015 as per applicable Accounting Standards. (Applicable LIBOR* is 1 %)

AS 17

7. (a) Calculate the segment results of a manufacturing organisation from the following information:

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* LIBOR – London Inter bank Offered Rate (LIBOR) is the world's most widely used benchmark for short-term interest rate.

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Segments	*A*	*B*	*C*	*Total*
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 : 4 : 2 basis)				1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	1,25,000
Other Income				
Revenue from extra-ordinary items	5,000	10,000	15,000	30,000
Dividend income	20,000	15,000	10,000	45,000
Interest earned on advances and loan	30,000	40,000	50,000	1,20,000
Gain on sale of investments	1,000	5,000	3,000	9,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 : 4 : 2 basis)				77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	
Transaction from C	6,000	40,000		
Transaction from A		18,000	82,000	
Other Expenses				
Expenses on extra-ordinary items	3,000	7,000	11,000	21,000
Interest on bank overdraft	30,000	28,000	12,000	50,000
Income tax	60,000	55,000	50,000	1,65,000

AS 19

(b) Aksat International Limited has given machinery on lease for 36 months and its useful life is 60 months. Cost & fair market value of the machinery is ₹ 5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is ₹ 50,000. IRR of investment is 10% and present value of annuity

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factor of ₹ 1 due at the end of 3 years at 10% IRR is 2.4868 and present value of ₹ 1 due at the end of 3 years at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income.

AS 20

8. What do you mean by "Weighted average number of equity shares outstanding during the period" and why is it required to be calculated? Compute weighted average number of equity shares (on month basis) in the following case:

		No. of shares
1st April,2014	Balance of Equity shares	5,00,000
30th June, 2014	Equity shares issued for cash	1,00,000
15th January, 215	Equity shares bought back	50,000
31st March, 2015	Balance of equity shares	5,50,000

AS 28

9. (a) On 1.4.2008, C Ltd. purchased an asset for ₹ 10 lakhs with an estimated useful life of 10 years. The machine is depreciated on straight line basis. On 1.4.2011, the asset was revalued to ₹ 8,40,000 and the surplus arising out of revaluation being credited to revaluation reserve. During the year ended 31.3.2014, the asset was reviewed for impairment and recoverable amount of the asset was ascertained to be only ₹ 4,30,000. Next year, there were some favourable changes in the market conditions and the recoverable amount of the asset was reassessed at ₹ 5,00,000. You are required to calculate the carrying amount of the asset as on 31.3.15 and show how changes in value of the asset is to be treated in the books of accounts, assuming C. Ltd. has the policy of writing down excess depreciation charged on revaluation to Revaluation Surplus.

AS 29

(b) Immediate Ltd. is a company engaged in the trading of spare parts used in the repair of automobiles. The company has been regular in depositing the tax, as such there is no liability of Income-tax etc. for the Financial Year 2012-13.

The figures for the year are as under:

Income chargeable to tax	₹ 211.64 lakhs
Total income after adjustments	₹ 228.48 lakhs
Tax thereon	₹ 74.13 lakhs
TDS deducted during the year	₹ 30.45 lakhs
Tax paid for the year	₹ 43.68 lakhs

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The company has prepared its Balance Sheet as per above figures. However, during the assessment proceeding held before the finalization of the Balance Sheet the Income Tax Officer has issued demand of ₹ 7.52 lakhs, insisting that this amount of TDS has not been uploaded online and thus is not acceptable as deduction.

The company has in reply to the same filed a rectification with the Assessing Officer. The company is trying to collect the TDS certificates, but ₹ 2.39 lakhs deducted by XY Ltd., is not traceable. The rectification is lying pending with the Assessing Officer.

Please suggest the treatment of ₹ 2.39 lakhs and ₹ 7.52 lakhs in Balance Sheet.

Ind AS – Differences *vis-a-vis* existing AS

10. (a) Write short note on some key differences between Ind AS 12 and Existing notified AS 22 with respect to Income Taxes.

Carve outs in Ind AS from IFRS

(b) Explain carve out in Ind AS 32 from IAS 32 with respect to "Financial Instruments: Presentation" alongwith the reason.

Corporate Financial Reporting – Schedule III to the Companies Act, 2013

11. Essential Ltd. is a group engaged in manufacture and sale of industrial and consumer products. One of its division deals with the real estate which is continuously engaged in leasing of real estate properties. The accountant showed the rent from leasing of real estate as 'other income' in the Statement of Profit and Loss. State, whether the classification of the rent income made by the accountant is correct or not in light of Schedule III to the Companies Act, 2013.

Accounting for Corporate Restructuring

12. Max Ltd. and Mini Ltd. decided to amalgamate their business with a view to a public share issue. A holding company, Maxima Ltd, is to be incorporated on 1st August, 2014 with all authorized capital of ₹ 75,00,000 in ₹ 10 ordinary shares.

The company will acquire the entire ordinary share capital of Max Ltd. and of Mini Ltd. in exchange for an issue of its own shares. The consideration for the acquisition is to be ascertained by multiplying the estimated profits available to the ordinary shareholders by agreed price earnings ratio.

The following relevant figures are given:

	Max Ltd. (₹)	Mini Ltd. (₹)
Issued Share Capital		
Ordinary shares of ₹ 10 each	50,00,000	15,00,000

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6% Cumulative Preference shares of ₹ 100 each	-	12,00,000
5% Debentures, redeemable in 2018-19		10,00,000
Estimated annual maintainable profits before deduction of debenture interest and tax	6,00,000	2,50,000
Price/earnings ratio	15	10

The shares in the Holding company are to be issued to members of the subsidiaries on 1st September, 2014, at a premium of ₹ 2.50 per share and thereafter these shares will be marketable on the Stock Exchange.

It is anticipated that the merger will achieve significant economics but will necessitate additional working capital. Accordingly, it is planned that on 31st March, 2015, Maxima Ltd. will make a further issue of 50,000 ordinary shares to the public for cash at premium of ₹ 3.75 per share. These shares will not rank for dividend until 31st March, 2015.

In the period ending 31st March, 2015, bank overdraft facilities will provide funds for the payment of management expenses etc. estimated at ₹ 6,000.

It is further assumed that interim dividends on ordinary shares relating to the period from 1st September, 2014 to 31st March, 2015 will be paid on 31st March, 2015 by Maxima Ltd. at 3½%, by Max Ltd. at 5% and by Mini Ltd. at 2%.

You are required to project, as on 31st March, 2015 for Maxima Ltd.

(a) the Balance Sheet as it would appear immediately after fully subscribed share issue, and

(b) the Statement of Profit and Loss for the period ending 31st March, 2015.

Assume the rate of corporation tax to be 35%. You may make any other assumption if consider relevant.

Consolidated Financial Statements

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

	As on 31st March, 2015 (₹ in lakhs)		
	R Ltd.	S Ltd.	T Ltd.
Equity and Liabilities			
Shareholder's Funds			
Equity Shares (₹ 10 each fully paid up)	300	250	200
10% Cumulative Preference Shares (₹ 100 each fully paid up)	75	60	50
Capital Reserve	600		

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General Reserve	125	75	50
Profit & Loss Account	480	170	110
Non-current Liabilities			
Secured Loan:			
12,500, 11% Mortgage Debenture Bonds of ₹ 1,000 each	125	-	-
Bank Loans	765	355	260
Unsecured Loan:			
From S Ltd.	-	-	60
From T Ltd.	75	-	-
Deposit from Public	90	60	15
Current Liabilities:			
Inter-company balances	45	-	-
Other Liabilities & Provision	1,570	625	355
	4,250	1,595	1,100
Assets			
Non-Current Assets			
Fixed Assets : Tangible Assets	1,695	625	320
Investment (At Cost):			
15,00,000 shares of S Ltd.	150		
4,00,000 Equity Shares of T Ltd.	40		
8,00,000 Equity Shares of T Ltd.		120	
50,000 Cumulative Preference Shares of R Ltd.			50
7,500 Mortgage Debentures of R Ltd.			70
Current Assets	2,365	850	660
	4,250	1,595	1,100

Additional Information:

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

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

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

Prepare the consolidated balance sheet of the group as on 31st March, 2015.

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Financial Instruments

14. A Company invested in Equity shares of another entity on 15th March, 2015 for ₹ 2,50,000. Transaction Cost = ₹ 2,500 (not included in ₹ 2,50,000). Fair Value on Balance Sheet date i.e. 31st March 2015 = ₹ 2,60,000. Pass necessary journal entries when Financial Asset is accounted as FVTOCI.

Share Based Payments

15. PQ Ltd. grants 100 stock options to each of its 1,000 employees on 1-4-2013, conditional upon the employee remaining in the company for 2 years. The fair value of the option is ₹ 18 on the grant date and the exercise price is ₹ 55 per share. The other information is given as under:

    (i) The no. of employees expected to satisfy service condition are 930 in the 1st year and 850 in the 2nd year.

    (ii) 40 employees left the company in the 1st year of service and 880 employees have actually completed 2 year vesting period.

    (iii) The profit of the enterprise before amortization of the compensation cost on account of ESOPs is as follows:

    (A) ₹ 18,50,000

    (B) ₹ 22,00,000

    (iv) The fair value of share for these years was ₹ 80 and ₹ 88 respectively.

    (v) The company has 6 lakhs shares of ₹ 10 each outstanding at the end of both years.

    Compute basic and diluted EPS for both the years (ignore the tax impacts).

Mutual Fund

16. (a) Calculate the year-end NAV of the Mutual Fund Scheme on the basis of the information given below:

    (i) UTI launched a new fund scheme for ₹ 1,800 crore.

    (ii) Underwriting commission is 1% of the fund shared equally by SBI, PNB, Syndicate Bank and UTI Bank.

    (iii) The fund was launched on 1.4.2014 with a face value of ₹100 per unit.

    (iv) Underwriting commission was paid in full.

    (v) Management expenses was allowed by SEBI @ 1% of the fund raised. However, during the year management expense was of ₹ 1,350 lakhs only. The management decided to defer the payment of ₹ 150 lakhs to the next financial year.

    (vi) On 1.5.2014, the total fund received was invested after deduction of underwriting commission and ₹ 30 crore to meet the day to day management

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expenses. The investment fund yielded 10% interest per annum. The interest was received for 3 quarters and the interest for last quarter is yet to receive. The interest realized in cash has been distributed to the unit holders @ 80%. The financial year runs from April to March. The quarter starts from the date of investment i.e. 1.5.2014.

NBFC

(b) While closing its books of account on 31st March, 2016 a Non-Banking Finance Company has its advances classified as follows:

	₹ in lakhs
Standard assets	33,600
Sub-standard assets	2,680
Secured portions of doubtful debts:	
– upto one year	640
– one year to three years	180
– more than three years	60
Unsecured portions of doubtful debts	194
Loss assets	96

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

Valuation of Shares

17. The following is the summarized Balance Sheet of Sun Ltd. as on 31st March, 2015:

Particulars			Amount (₹)	Amount (₹)
A.	Equity and Liabilities			
(1)		Shareholders' Fund		
	(a)	60,000 Equity Shares of ₹10 each, fully paid up	6,00,000	
		Less: Calls in arrear (on 10,000 Equity Shares)	(20,000)	
			5,80,000	
		40,000 Equity Shares of ₹ 10 each, ₹ 6 paid up	2,40,000	
		50,000 Equity Shares of ₹ 5 each, fully paid up	2,50,000	
		7% Preference Shares of ₹10 each, fully paid up	2,00,000	12,70,000
	(b)	Reserve & Surplus:		
		General reserve	1,40,000	
		Profit & Loss Account	1,95,000	3,35,000

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(2)		Non-Current Liabilities		
		Secured Loan:		
		10% Debentures of ₹10 each		5,00,000
(3)		Current Liabilities:		
	(a)	Trade Payables		1,50,000
	(b)	Provision for Tax		1,60,000
	(c)	Proposed Dividend:		
		Equity Shares	1,20,000	
		Preference Shares	14,000	1,34,000
		Total		25,49,000
B.	Assets			
(1)		Non-current Assets		
	(a)	Fixed Assets		
		Tangible Assets:		
		Land & Building	7,50,000	
		Plant & Machinery	7,10,000	
		Furniture & Fixtures	2,85,000	17,45,000
	(b)	Non-current Investment		2,00,000
(2)		Current Assets		
	(a)	Inventories		2,60,000
	(b)	Trade Receivables		1,90,000
	(c)	Cash & Cash Equivalents		1,54,000
		Total		25,49,000

Additional Information:

(1) Fixed Assets are worth 20% more than their book value. On 1-4-2013, a Plant & Machinery costing ₹ 30,000 was purchased but wrongly included in Furniture. The depreciation is provided @ 15% on Plant & Machinery and 10% on Furniture on reducing balance method. No rectification has yet been made for the same.

(2) Inventories are undervalued by ₹ 15,000 in 2011-2012. A provision for doubtful debt is to be made @ 5% in 2014-2015. Disputed bonus claim of ₹ 43,000 not yet provided in the accounts for 2014-2015 is settled at ₹ 27,000.

(3) Trade investments which constitute 10% of total investments were purchased on 1-4-2014. 30% of non-trade investments were also purchased on 1-4-2014 and rest on 1-4-2011. All investments yielded 10% return on cost.

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(4) Debentures are due for conversion into equity shares of ₹ 10 each on 1-4-2015.

(5) Expected increase in expenditure without commensurate increase in selling price is ₹ 25,000. Depreciation on appreciated value of fixed assets except machinery is not to be considered for valuation of goodwill.

(6) Profit (after tax) are as follows:

In 2011 - 2012 = ₹ 1,65,000

In 2012 - 2013 = ₹ 1,80,000

In 2013 - 2014 = ₹ 2,01,900

In 2014 - 2015 = ₹ 2,40,000

(7) Future maintainable profits (pre-tax) are likely to be higher by 20%.

(8) Sun Ltd. does not have a consistent trend in case of dividend payment, for which 1% risk premium may be added to the normal rate of return.

(9) Current Income Tax rate is 30% and the normal rate of return on average capital employed is 10%.

From the above, ascertain ex-dividend and cum-dividend intrinsic value for different categories of equity shares. For this purpose, goodwill may be taken as 4 years purchase of super profits.

Valuation of Brand

18. From the following information, determine the possible value of brand as per potential earning model:

	(₹ in lakhs)
Profits before tax	10,000
Income tax	2,500
Tangible fixed assets	30,000
Identifiable intangibles other than Brand	4,500
Weighted average cost of capital (%)	14%
Expected normal return on tangible assets (weighted average cost 14% + Normal spread 4%)	18%

Appropriate capitalization factor for intangibles is 25%.

Value Added Statement

19. On the basis of the following income statement pertaining to B Ltd., you are required to prepare:

(a) Gross value added statement; and

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(b) Statement showing reconciliation of gross value added with Profit Before Taxation.

Profit and Loss Account of B Ltd.

for the year ended 31st March, 2015

	(₹ in thousands)	(₹ in thousands)
Income		
Sales less returns		30,55,912
Dividends and interest		260
Miscellaneous income		948
(A)		30,57,120
Expenditure		
Production and operational expenses:		
Decreases in inventory of finished goods	52,108	
Consumption of raw materials	14,81,642	
Power and lighting	2,40,060	
Wages, salaries and bonus	7,63,520	
Staff welfare expenses	52,480	
Excise duty	29,080	
Other manufacturing expenses	65,130	26,84,020
Administrative expenses:		
Directors' remuneration	15,620	
Other administrative expenses	65,280	80,900
Interest on:		
9% Mortgage debentures	28,800	
Long-term loan from financial institution	20,000	
Bank overdraft	200	49,000
Depreciation on fixed assets		1,01,200
(B)		29,15,120
Profit before Taxation (A) — (B)		1,42,000
Provision for Income-tax		(50,940)
Profit after Taxation		91,060
Balance of account as per last Balance Sheet		12,600
		1,03,660

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Transferred to:		
General reserve 40% of ₹91,060	36,424	
Dividend @ 22%	44,000	
Tax on distributed profits @ 16.995%	7,478	(87,902)
Surplus carried to Balance Sheet		15,758

Economic Value Added

20. (a) The following information supplied to you by Able Ltd.:

	Amount (₹)
Equity Shares (Face value ₹ 10)	5,80,000
12% Preference Shares (Face value ₹ 10)	1,50,000
10% Debentures (Face value ₹ 10)	5,00,000
Term Debt (taken at 15%)	2,00,000
Financial leverage	1.2
Securities Premium A/c	50,000
General Reserve	20,000
Statutory Reserve	60,000
Income Tax Rate	30%

The industry to which Able Ltd. belongs has a practice of paying at least 15% dividend to its shareholders. The ordinary shares are quoted at a premium of 400%, preference shares at ₹ 25 and debentures at a discount of 20%.

You are required to calculate EVA and MVA of the company and also explain the reason for the difference, if any between the two.

Human Resource Accounting

(b) A company has a capital base of ₹ 1.5 crores and has earned profits of ₹ 11 lakhs. The Return on Investment (ROI) of the particular industry to which the company belongs is 12%. To expand its business, the company has decided to recruit a Vice-President for which it has received several applications. Out of which two executives were shortlisted whose proposals were as follows:

Mr. Ram demands a salary of ₹ 7.5 lakhs and proposes to achieve target profit.

Mr. Shyam demands ₹ 4.5 lakhs and proposes a 50% increase in current profits.

You are required to analyze whose proposal is more beneficial to the company.

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SUGGESTED ANSWERS / HINTS

1. (a) As per AS 1 "Disclosure of Accounting Policies", any change in an accounting policy which has a material effect should be disclosed in the financial statements. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. Thus Pioneer Ltd. should disclose the change in valuation method of inventory and its effect on financial statements. The company may disclose the change in accounting policy in the following manner:

'The company values its inventory at lower of cost and net realisable value. Since net realisable value of all items of inventory in the current year was greater than respective costs, the company valued its inventory at cost. In the present year i.e. 2014-15 the company has changed to weighted average method, which better reflects the consumption pattern of inventory, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced current profit and value of inventory by ₹ 16,000'.

(b) According to AS 2 'Valuation of Inventories', inventories should be valued at the lower of cost and net realizable value.

Product – A

Material cost	₹ 40 x 200 = 8,000	
Wages cost	₹ 30 x 200 = 6,000	
Overhead	₹ 20 x 200 = 4,000	
Total cost		₹ 18,000
Realizable value [200 x (110-11)]		₹ 19,800
Hence inventory value of Product -A		₹ 18,000

Product – B

Material cost	₹ 45 x 800 = 36,000	
Wages cost	₹ 35 x 800 = 28,000	
Total cost		₹ 64,000
Realizable value (800 x 70)		₹ 56,000
Hence inventory value of Product-B		₹ 56,000

Product – C

Material cost	₹ 50 x 1,000 = 50,000	
Wages cost	₹ 40 x 1,000 = 40,000	

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Overhead	₹ 30 x 1,000 = 30,000	
Total		₹ 1,20,000
Realisable value [(1,000 x 110) – 8,000]		₹ 1,02,000
Hence inventory value of Product –C		₹ 1,02,000
Total Value of closing inventory i.e. Product A + Product B + Product C (18,000+ 56,000 + 1,02,000)		₹ 1,76,000

2. (a) Balance Ltd.

Cash Flow Statement for the year ended 31st March, 2015

(By direct method)

Particulars	₹	₹
Cash flows from Operating Activities		
Cash sales (₹ 3,82,500/0.30)		12,75,000
Less: Cash payments for trade payables	(4,60,000)	
Wages paid	(4,92,500)	
Office and selling expenses	(75,000)	(10,27,500)
Cash generated from operations		2,47,500
Less: Income tax paid		(65,000)
Net cash generated from operating activities (A)		1,82,500
Cash flows from Investing Activities		
Sale of investment	7,20,000	
Payments for purchase of plant & machinery	(2,50,000)	
Net cash used in investing activities (B)		4,70,000
Cash flows from Financing Activities		
Bank loan repayment (including interest)	(2,15,000)	
Dividend paid (including dividend distribution tax)	(30,000)	
Net cash used in financing activities (C)		(2,45,000)
Net increase in cash (A+B+C)		4,07,500
Cash and cash equivalents at the beginning of the period		2,00,000
Cash and cash equivalents at the end of the period		6,07,500

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(b) For the information given, the following will be recommended treatment with reference to the provisions of AS 4 'Contingencies and Events Occurring After the Balance Sheet Date'.

(1) The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, the event appears to be of such significance as to require a disclosure in the report of the approving authority to enable users of the financial statements to make proper evaluation and decision, hence, such disclosure is recommended.

(2) The closure of one of the manufacturing units on 15th May, 2015 is assumed not to have been anticipated at the year-end on 31.03.2015, hence, it would be treated as a non-adjusting event. Appropriate disclosure would be required in the report of the approving authority as non-disclosure would affect users' understanding of the financial statements.

(3) AS 4 defines events occurring after the balance sheet date as those significant event- both favourable and unfavourable that occur between the balance sheet date and the date on which the financial statements are approved by the approving authority. Accordingly, negotiation for acquisition of two manufacturing units which started in April, 2015 should be disclosed in the Board's Report. No adjustments of assets and liabilities are required, as the negotiation (which has only started) does not affect the determination and the conditions of the amounts stated in the financial statements for the year ended 31st March, 2015.

(4) The declaration of dividend by the subsidiary company on 30th April, 2015 would be treated as a non-adjusting event. Further, it is to be noted that as per AS 9, the right to receive the dividend is established on 30th April 2015 only i.e. on the date of declaration.

(5) The foreign exchange loss due to changes in exchange rates during the period between 1st April 2015 and 1st June 2015, is a non-adjusting event since it does not relate to the conditions existing at the balance sheet date. The amount of loss appears material and may be of such significance that requires disclosure in the report of the approving authority.

3. (a) As per AS 6 "Depreciation Accounting", if the depreciable assets are revalued, the provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful lives of such assets. In case the revaluation has a material effect on the amount of depreciation, the same should be disclosed separately in the year in which revaluation is carried out.

As per the standard, when there is a revision of the estimated useful life of an asset, the unamortized depreciable amount should be charged over the revised remaining useful life. Accordingly revised depreciation shall be calculated prospectively.

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Therefore, the treatment done by the accountant regarding recalculating the revised depreciation historically i.e. retrospectively is incorrect.

Calculation of depreciation for the fourth year

Depreciation per year charged for three years

= (₹ 1,50,000 – 15,000) / 6 = ₹ 22,500 per year

WDV of the machine at the beginning of the fourth year

= ₹ 1,50,000 – (₹ 22,500× 3) = ₹ 82,500

Depreciable amount after reassessment of residual value

= ₹ 82,500 - ₹ 7,500 = ₹ 75,000

Remaining useful life as per revised estimate = 4 years

Depreciation from the fourth year onwards = ₹ 75,000 / 4 = ₹ 18,750

(b) Total expected loss to be provided for = Contract Price –Total Cost

= ₹ 50,00,000 – (21,00,000 + 31,50,000) = ₹ 2,50,000

Calculation for 2014-15 on 40% work

Contract Revenue = ₹ 21,00,000

Contract Cost = ₹ 21,00,000

Current loss on contract (2,50,000 x 40%) = ₹ 1,00,000

Total expected loss recognized as per AS 7 = ₹ 2,50,000

Further provision required in respect of Expected Loss = 2,50,000 -1,00,000
= ₹ 1,50,000

In the Books of Five Star Construction Limited
Profit & Loss A/c (Extract for the year ended 31st March 2015)

Particulars	*Amount*	*Particulars*	*Amount*
To Construction Costs (for 40% work)	21,00,000	By Contract Revenue	20,00,000
To Provision for Loss	1,50,000	By Net Loss	2,50,000
	22,50,000		22,50,000

Customer A/c

Particulars	*Amount*	*Particulars*	*Amount*
To Contract Revenue	20,00,000	By Bank	19,00,000
		By Balance c/d	1,00,000
	20,00,000		20,00,000

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4. (a) As per AS 9, “Revenue Recognition”, revenue is the gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise from the sale of goods. However, the above is subject to trade discount and volume rebates received in the course of carrying on business which shall be deducted in ascertaining revenue since they represent a reduction of cost.

Revenue is also subject to certain risks like damages on transfer of goods to the buyers’ end.

In the given case, trade discount is to be deducted from ₹ 13,00,000 and gross sale shall be recognized at (₹ 13,00,000 – ₹ 1,06,000) = ₹ 11,94,000 and goods returned for ₹ 1,34,000 are to be recorded in the form of sales return.

Alternatively, if a trade discount is not allowed in the ordinary course of carrying on the business, X Limited should recognize the sale at ₹ 13 lakhs only.

Discount of ₹ 1,06,000 and return of goods worth ₹ 1,34,000 are to be adjusted by suitable provisions.

In such a case, X limited shall send a credit note of ₹ 2,40,000 to Y to account for these adjustments.

However, in both the cases contention of the Accountant to book sale of ₹ 10,60,000 is not correct.

(b) As per AS 10 ‘Accounting for Fixed Assets’, expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, are usually capitalized as an indirect element of the construction cost. However, the expenditure incurred after the plant has begun commercial production i.e., production intended for sale or captive consumption, is not capitalized and is treated as revenue expenditure even though the output from the plant is not of desired quality.

In the present case, the company did not stop production even when the output was not of the desired quality, and continued the sub-standard production due to huge investment involved in the project. Capitalisation should cease at the end of the trial run, since the cut-off date would be the date when the trial run was completed.

5. (a) As per AS 11 “The Effects of Changes in Foreign Exchange Rates”, exchange differences arising on the settlement of monetary items or on reporting an enterprise’s monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or as expense in the period in which they arise.

Accordingly, exchange difference on sundry debtors amounting ₹ 23,077 {₹ 5,23,077 (US $ 8547 x ₹ 61.20) less ₹ 5,00,000} and exchange difference on long term loan amounting ₹ 6,04,317 {66,04,317 (US $ 1,07,913.67 x ₹ 61.20) less ₹ 60,00,000} should be charged to profit & loss account.

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Alternatively, at the option of an entity, 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 non-depreciable capital asset can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset/ liability, by recognition as income or expense in each of such periods.

Thus exchange difference on long term loan amounting ₹ 6,04,317 may either be charged to profit & loss or to Foreign Currency Monetary Item Translation Difference Account.

(b) As per AS 10 "Accounting for Fixed Assets", when an asset is acquired in exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration. For the said purpose, fair market value may be determined by reference either to the asset given up or to the asset acquired, whichever is more clearly evident.

In the given case, fair market value of the asset acquired is ₹ 10 lakhs whereas net book value of asset given up in exchange is ₹ 12.234 lakhs (as per the working note). The fair market value of the asset given up is not available. Therefore, the cost of the new asset acquired is to be taken at its fair market value i.e. ₹ 10 lakhs.

The value of existing asset on the date of purchase is ₹ 12.234 lakhs. The difference of ₹ 2.234 lakhs (₹ 12.234 lakhs - ₹ 10 lakhs) should be charged to Profit & Loss account.

Working Note:

Calculation of cost of the asset exchanged:

	₹ in lakhs
Purchase price of the asset as on 1.10.2012	15.000
Less: Subsidy received (20% of ₹ 15 lakhs)	(3.000)
Cost of the asset (Net)	12.000
Depreciation for the year 2012-13	(0.600)
WDV of the asset as on 31.03.2013	11.400
Depreciation for the year 2013-14	(1.140)
WDV of the asset as on 31.03.2014	10.260
Depreciation for the year 2014-15	(1.026)
WDV of the asset as on 31.03.2015	9.234

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Add: Subsidy refunded on 1.4.2015	3.000
WDV of the asset as on 1.04.2015	12.234

6. (a) **Calculation of Defined Benefit Obligation**

Expected last drawn salary = ₹ 14,90,210 x 110% x 110% x 110% x 110% x 110%

= ₹ 24,00,000

Defined Benefit Obligation (DBO) = ₹ 24,00,000 x 25% x 5 = ₹ 30,00,000

Amount of ₹ 6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

Year	*Equal apportioned amount of DBO [i.e. ₹ 30,00,000/ 5 years]*	*Discounting @ 8% PV factor*	*Current service cost (Present Value)*
a	*b*	*c*	*d = b x c*
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	1 (0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	*Opening balance*	*Interest cost*	*Current service cost*	*Closing balance*
a	*b*	*c = b x 8%*	*d*	*e = b + c + d*
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

(b) (a) Interest for the period 2014-15

= US$ 10 lakhs x 4% × ₹ 62 per US$ = ₹ 24.80 lakhs

(b) Increase in the liability towards the principal amount

= US $ 10 lakhs × ₹ (62 - 56) = ₹ 60 lakhs

(c) Interest that would have resulted if the loan was taken in Indian currency

= US$ 10 lakhs × ₹ 56 x 10.5% = ₹ 58.80 lakhs

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(d) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

7. (a) Calculation of segment result

Segments	*A*	*B*	*C*	*Total*
	₹	₹	₹	₹
Directly attributed revenue	5,00,000	3,00,000	1,00,000	9,00,000
Enterprise revenue (allocated in 5 : 4 : 2 basis)	50,000	40,000	20,000	1,10,000
Revenue from transactions with other segments				
Transaction from B	1,00,000		50,000	1,50,000
Transaction from C	10,000	50,000		60,000
Transaction from A		25,000	1,00,000	,25,000
Total segment revenue as per AS 17 (A)	6,60,000	4,15,000	2,70,000	13,45,000
Operating expenses	3,00,000	1,50,000	75,000	5,25,000
Enterprise expenses (allocated in 5 : 4 : 2 basis)	35,000	28,000	14,000	77,000
Expenses on transactions with other segments				
Transaction from B	75,000		30,000	1,05,000
Transaction from C	6,000	40,000		46,000
Transaction from A		18,000	82,000	1,00,000
Total segment expenses as per AS 17 (B)	4,16,000	2,36,000	2,01,000	8,53,000
Segment result (A-B)	2,44,000	1,79,000	69,000	4,92,000

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Note: As per para 5.5 and 5.6 of AS 17 "Segment Reporting", following revenues and expenses are not considered for calculation of segment revenue and segment expenses:

Other Income:

Revenue from extra-ordinary items

Dividend income

Interest earned on advances and loan

Gain on sale of investments

Other Expenses:

Expenses on extra-ordinary items

Interest on bank overdraft

Income-tax

(b) (i) Determination of Nature of Lease

It is assumed that the fair value of the leased equipment is equal to the present value of minimum lease payments.

Present value of unguaranteed residual value at the end of 3rd year

= ₹ 50,000 x 0.7513

= ₹ 37,565

Present value of lease payments = ₹ 5,00,000 – ₹ 37,565

= ₹ 4,62,435

The percentage of present value of lease payments to fair value of the equipment is (₹ 4,62,435 / ₹ 5,00,000) x 100 = 92.487%.

Since, it substantially covers the major portion of the lease payments, the lease constitutes a finance lease.

(ii) Calculation of Unearned Finance Income

Annual lease payment = ₹ 4,62,435/ 2.4868 =₹ 1,85,956 (approx.)

Gross investment in the lease = Total minimum lease payment + unguaranteed residual value

= (₹ 1,85,956 × 3) + ₹ 50,000 = ₹ 5,57,868 + ₹ 50,000 = ₹ 6,07,868

Unearned finance income = Gross investment - Present value of minimum lease payments and unguaranteed residual value

= ₹ 6,07,868 – ₹ 5,00,000 = ₹ 1,07,868.

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8. As per AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or lesser number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Computation of weighted average number of shares outstanding during the period

Date	*No. of equity shares*	*Period outstanding*	*Weights (months)*	*Weighted average number of shares*
(1)	*(2)*	*(3)*	*(4)*	*(5) = (2) x (4)*
1st April, 2014	5,00,000 (Opening)	12 months	12 /12	5,00,000
30th June 2014	1,00,000 (Additional issue)	9 months	9/12	75,000
15th Jan, 2015	50,000 (Buy back)	2.5 months	2.5/12	(10,417)
31st March, 2015	5,50,000 (Balance)	0 month	0/12	-
Total				5,64,583

9. (a) **Calculation of carrying amount as on 31.03.2015:**

	₹
Cost of the asset purchased on 01.04.2008	10,00,000
Less: Depreciation 3 years – upto 31.03.2011 (3/10)	(3,00,000)
Carrying amount as on 31.03.2011	7,00,000
Add: Upward revaluation as on 01.04.2011 credited to Revaluation Reserve	1,40,000
Carry amount as on 01.04.2011	8,40,000
Less: Depreciation 3 years – upto 31.03.2014 (3/7)	(3,60,000)
	4,80,000
Less: Impairment loss due to recoverable amount being ₹ 4,30,000	(50,000)
Carrying amount as on 01.04.2014	4,30,000
Less: Depreciation for 2014-15 (4,30,000/4)	(1,07,500)
	3,22,500
Add: Reversal of impairment (as per Working Note 2)	37,500
Carrying amount as on 31.03.2015	3,60,000

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Working Notes:

1. Statement showing balance of Revaluation Reserve

	₹
Revaluation Reserve credited on 01.04.2011	1,40,000
Less: Excess depreciation charges due to revaluation for 3 years upto 31.03.2014 [(1,40,000/7) x 3]	(60,000)
Revaluation Reserve balance on 31.03.2014	80,000
Less: Impairment loss on 31.03.2014	(50,000)
Revaluation Reserve balance on 01.04.2014	30,000
Less: Depreciation charge for 2014-15	(7,500)
	22,500
Add: Reversal of impairment on 31.03.2015	37,500
Revaluation Reserve balance on 01.04.2015	60,000

2. Treatment of Impairment loss: Reversal of impairment loss should not exceed the carrying amount that would have been determined (net of depreciation) has no impairment loss been recognized for the asset in prior accounting periods.

	₹
Carrying amount of the asset before impairment as on 31.03.2014	4,80,000
Less: Depreciation for the year 2014-15	(1,20,000)
Carrying amount of the asset as on 31.03.2015	3,60,000
Carrying amount as calculated after impairment	(3,22,500)
Reversal of impairment to be transferred to Revaluation surplus	37,500
Impairment gain to be ignored:	
Recoverable amount on 31.03.2015	5,00,000
Less: Carrying amount on 31.03.2015	(3,60,000)
	1,40,000

(b) As per para 10 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a contingent liability is: (a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or (b) a present obligation that arises from past events but is not recognised

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because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) a reliable estimate of the amount of the obligation cannot be made. An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

In the given case, TDS shall be allowed by the IT department on submission of duplicate TDS certificates. Since the company is making efforts and is hopeful for its ultimate collection, contingent liability will be made for ₹ 2.39 lakhs in the books of account.

Further as per para 15 of the standard, where it is more likely that no present obligation exists at the balance sheet date and the possibility of an outflow of resources embodying economic benefits is remote, no contingent liability is disclosed.

TDS certificates for ₹ 5.13 lakhs (₹ 7.52 lakhs less ₹ 2.39 lakhs) have been submitted and the company has filed a rectification with the Assessing Officer. Therefore, the possibility of an outflow of resources embodying economic benefits is remote; the company shall not disclose it as contingent liability. This amount should be disclosed by way of a note to the accounts.

An alternative view can also be considered on the basis of the paragraph 14 of the standard which states that a provision should be recognised in the books when (a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation.

Accordingly, in the given case, since there is a probability of outflow of resources and also the amount can be quantified on account of non-traceability of TDS certificates, a provision may be made for ₹ 2.39 lakhs in the books of account.

Regarding the balance amount of ₹ 5.13 lakhs (₹ 7.52 lakhs less ₹ 2.39 lakhs), since TDS certificated have been submitted, it is likely that the Income-tax Officer may accept the rectification filed by the assessee. However, since the TDS details have not been uploaded online because of which demand has been issued, there may be a possibility that the rectification may also not be accepted. Therefore, taking a conservative approach, ₹ 5.13 lakhs may be disclosed as a contingent liability.

10. (a) **Some key differences between Ind AS 12 and Existing AS 22 are**

(i) **Approach for creating Deferred Tax:** Ind AS 12 is based on balance sheet approach. It requires recognition of tax consequences of differences between the carrying amounts of assets and liabilities and their tax base. Existing AS 22 is based on income statement approach. It requires recognition of tax

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consequences of differences between taxable income and accounting income. For this purpose differences between taxable income and accounting income are classified into permanent and timing differences.

(ii) **Limited Exceptions for Recognition of Deferred Tax Asset:** As per Ind AS 12, subject to limited exceptions, deferred tax asset is recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. The criteria for recognising deferred tax assets arising from the carry forward of unused tax losses and tax credits are the same that for recognising deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity

(iii) **Recognition of Current and Deferred Tax:** As per the existing AS 22, deferred tax assets are recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised. Where deferred tax asset is recognised against unabsorbed depreciation or carry forward of losses under tax laws, it is recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.

As per Ind AS 12, current and deferred tax are recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from a transaction or event which is recognised outside profit or loss, either in other comprehensive income or directly in equity, in those cases tax is also recognised in other comprehensive income or in equity, as appropriate. Existing AS 22 does not specifically deal with this aspect.

(iv) **Disclosure of DTA and DTL in Balance Sheet:** Existing AS 22 deals with disclosure of deferred tax assets and deferred tax liabilities in the balance sheet. Ind AS 12 does not deal with this aspect except that it requires that income tax relating to each component of other comprehensive income shall be disclosed as current or non-current asset/liability in accordance with the requirements of Ind AS 1.

(v) **Disclosure Requirements:** Disclosure requirements given in the Ind AS 12 are more detailed as compared to existing AS 22.

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(vi) **DTA/DTL arising out of Revaluation of Assets:** Ind AS 12 requires that deferred tax asset/liability arising from revaluation of non-depreciable assets shall be measured on the basis of tax consequences from the sale of asset rather than through use. Existing AS 22 does not deal with this aspect.

(vii) **Changes in Entities Tax Status or that of its Shareholders:** Ind AS 12 provides guidance as to how an entity should account for the tax consequences of a change in its tax status or that of its shareholders. Existing AS 22 does not deal with this aspect.

(viii) **Virtual Certainty:** Existing AS 22 explains virtual certainty supported by convincing evidence. Since the concept of virtual certainty does not exist in Ind AS 12, this explanation is not included.

(ix) **Guidance for Recognition of Deferred Tax in a Tax Holiday Period:** Existing AS 22 specifically provides guidance regarding recognition of deferred tax in the situations of Tax Holiday under Sections 80-IA and 80-IB and Tax Holiday under Sections 10A and 10B of the Income Tax Act, 1961. Similarly, existing AS 22 provides guidance regarding recognition of deferred tax asset in case of loss under the head 'capital gains'. Ind AS 12 does not specifically deal with these situations.

(x) **Guidance on Certain Issues:** Existing AS 22 specifically provides guidance regarding tax rates to be applied in measuring deferred tax assets/liabilities in a situation where a company pays tax under section 115JB. Ind AS 12 does not specifically deal with this aspect.

(b) As per accounting treatment prescribed under IAS 32, equity conversion option in case of foreign currency denominated convertible bonds is considered a derivative liability which is embedded in the bond. Gains or losses arising on account of change in fair value of the derivative need to be recognised in the statement of profit and loss as per IAS 32.

Carve out: In Ind AS 32, an exception has been included to the definition of 'financial liability' in paragraph 11 (b) (ii), whereby conversion option in a convertible bond denominated in foreign currency to acquire a fixed number of entity's own equity instruments is classified as an equity instrument if the exercise price is fixed in any currency.

Reasons: This treatment as per IAS 32 is not appropriate in instruments, such as, FCCBs since the number of shares convertible on the exercise of the option remains fixed and the amount at which the option is to be exercised in terms of foreign currency is also fixed; merely the difference in the currency should not affect the nature of derivative, i.e., the option. Further, the fair value of the option is based on the fair value of the share prices of the company. If there is decrease in the share price, the fair value of derivative liability would also decrease which would

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result in recognition of gain in the statement of profit and loss. This would bring unintended volatility in the statement of profit and loss due to volatility in share prices. This will also not give a true and fair view of the liability as in this situation, when the share prices fall, the option will not be exercised. However, it has been considered that if such option is classified as equity, fair value changes would not be required to be recognised. Accordingly, the exception has been made in definition of financial liability in Ind AS 32.

11. As per the "General Instructions for Preparation of Statement of Profit and Loss" given in the Schedule III to the Companies Act, 2013, 'Other Income' does not include operating income'.

    In the given case, rent income arising from leasing of real estate properties is an operating income as real estate is one of the divisions of Essential Ltd.

    There is a separate head for operating income i.e. "Revenue from Operations". Therefore, classification of rent income as 'Other Income' in the 'Statement of Profit and Loss' will not be correct. It would, in fact, be shown under the heading 'Revenue from Operations' only.

12. **Projected Balance Sheet of Maxima Ltd.**
as on 31st March, 2015

	Particulars	*Note No.*	₹
I	Equity and liabilities		
	Shareholders' Funds		
	Share Capital	1	56,44,000
	Reserves & Surplus	2	15,67,460
	Total		72,11,460
II	Assets		
	Non-current assets		
	Non-current Investments	3	64,30,000
	Current Assets		
	Cash & Cash equivalents		7,81,460
	Total		72,11,460

Projected Statement of Profit and Loss

for the period ending on 31st March, 2015

	Particulars	*Note No.*	₹
I	Other Income	4	2,80,000
	Total Revenue		2,80,000

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II	Expenses		
	Management expenses		6,000
	Total Expenses		6,000
	Net Profit before tax (I-II)		2,74,000

Notes to Accounts

	Particulars	₹	₹
1.	Share Capital		
	Authorised: 7,50,000 Equity Shares of ₹ 10 each		75,00,000
	Issued: 5,64,400 Equity Shares of ₹ 10 each		56,44,000
2.	Reserves & Surplus		
	Securities Premium		14,73,500
	Profit & Loss Account	2,74,000	
	Less: Dividend	(1,80,040)	93,960
			15,67,460
3.	Non-current investments		
	Share in subsidiary companies		
	Max Ltd.	58,50,000	
	Mini Ltd.	5,80,000	64,30,000
4	Other Issues		
	Dividend income		
	From Max Ltd. (₹ 50,00,000 x 5%)	2,50,000	
	From Mini Ltd. (₹ 15,00,000 x 2%)	30,000	2,80,000

Note: Due to availability of sufficient bank balance, ₹ 6,000 has not been shown as 'Bank Overdraft'.

Working Notes:

1. **No. of shares to be issued to Max Ltd. and Mini Ltd.**

Particulars	*Max. Ltd. (₹)*	*Mini Ltd. (₹)*
Estimated annual profits before debenture interest & tax	6,00,000	2,50,000
Less: Debenture interest	-	(50,000)
	6,00,000	2,00,000
Less: Corporation tax @ 35%	(2,10,000)	(70,000)

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	3,90,000	1,30,000
Less: Preference Dividend	-	(72,000)
Profit for equity shareholders	3,90,000	58,000
Particulars	*Max. Ltd. (₹)*	*Mini Ltd. (₹)*
Profit for equity shareholders as above	3,90,000	58,000
Price earnings ratio	15	10
Total Consideration (Profit x PE Ratio)	58,50,000	5,80,000
Share Issue Price	12.50	12.50
No. of shares to be issued (Nos.)	4,68,000	46,400

2. **Share Capital & Securities Premium**

Total No. of shares to be issued to Max Ltd. and Mini Ltd. (4,68,000+46,400)	5,14,400
Shares issue to public	50,000
Total no. of shares that will stand issued by 31.3.2015	5,64,400
Share capital 31.3.2015	56,44,000
Securities Premium	
On shares issued to Max Ltd. and Mini Ltd. (5,14,400 x ₹2.50)	12,86,000
On shares issue to public (50,000 x ₹3.75)	1,87,500
Total	14,73,500

3. **Cash and Cash equivalents:**

Bank A/c

	₹		₹
To Shares issued to public (50,000 x ₹ 13.750)	6,87,500	By Management Expenses	6,000
To Dividend receipts		By Dividend payment	1,80,040
Max - 50 lakhs x 5%	2,50,000	By Balance c/d	7,81,460
Mini - 15 lakhs x 2%	30,000		
	9,67,500		9,67,500

4. **Dividend payment by Maxima Ltd.**

Total share capital on 31.3.2015	₹ 56,44,000
Less: Share capital not qualified for dividend	(₹ 5,00,000)
Share capital eligible for dividend	₹ 51,44,000
Dividend at 3.5% thereon	₹ 1,80,040

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13. It is assumed that preference shares given in question are non-convertible in nature.

Consolidated Balance Sheet of R Ltd. and its Subsidiaries
S Ltd. and T Ltd. as on 31st March 2015

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

Notes to Accounts:

	Particulars			*₹ in lakhs*
1.	Share Capital			
	30,00,000, Equity Shares of ₹ 10 each fully paid		300.00	
	25,000, 10% Cumulative Preference Shares of ₹ 100 each fully paid		25.00	325.00
2.	Reserve and Surplus			
	Capital Reserve		600.00	
	General Reserve		189.00	
	Profit & Loss A/c		627.80	1,416.80

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3.	Long Term Borrowings			
	Secured Loans: 5,000, 11% Mortgage Debenture Bonds of ₹ 1,000 each		50	
	Bank Loans:			
	R Ltd.	765		
	S Ltd.	355		
	T Ltd.	260	1,380	
			1430	
	Unsecured loans:			
	Deposits from public (90+60+15)		165	1,595
4.	Other Current liabilities			
	R Ltd.		1,570	
	S Ltd.		625	
	T Ltd.		355	2,550
5.	Tangible assets			
	R Ltd.		1,695	
	S Ltd.		625	
	T Ltd.		320	2,640
6.	Intangible Assets			
	Goodwill			27
7.	Current Assets			
	R Ltd.		2,365	
	S Ltd.		850	
	T Ltd.		660	
			3,875	
	Less: Mutual indebtedness:			
	Unsecured loans (75+60)	135		
	Inter-company balances	45	(180)	3,695

Working Notes:

1. **Shareholding Pattern**

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

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Held by S Ltd.		8,00,000 i.e. 40%
Minority Interest	10,00,000 i.e. 40%	8,00,000 i.e. 40%

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

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

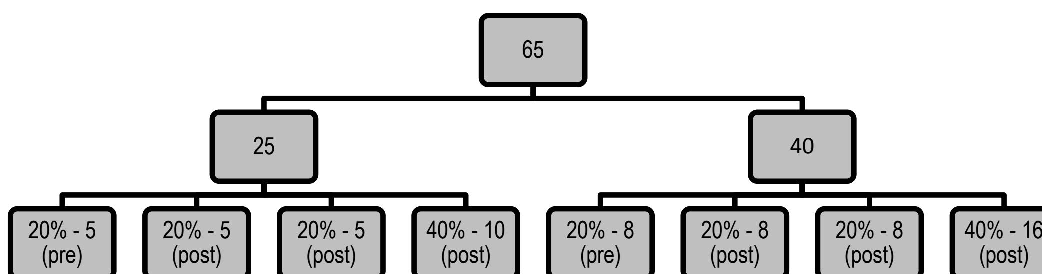
2. **Profit on Debentures of R Ltd. held T Ltd.**

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

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

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

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



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4. Analysis of profits of S Ltd.

	(₹ in lakhs)	
	Post-acquisition	
	General Reserve	*Profit & Loss A/c*
Balance on 31.3.2015	75	170
Add: Share in post-acquisition profits from T Ltd.	15	38
Total	90	208
Share of R Ltd. (60%)	54	124.80
Share of Minority (40%)	36	83.20
Total	90	208.00

5. Cost of Control

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

6. Minority Interest

	(₹ in lakhs)	
	S Ltd.	*T Ltd.*
Equity Share Capital	100.00	80.00
Capital profit		
General Reserves	36.00	20.00
Profit & loss Account	83.20	46.00
	219.20	146.00
Preference Share Capital	60.00	50.00
Total	279.20	196.00

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

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

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

14. Journal Entries

Date	*Particulars*		*(₹)*	*(₹)*
15/3/2015	Investment A/c	Dr.	2,52,500	
	To Bank			2,52,500
31/3/2015	Investment A/c	Dr.	7,500	
	To Fair Value Gain A/c			7,500
31/3/2015	Fair Value Gain A/c	Dr.	7,500	
	To OCI A/c			7,500
31/3/2015	OCI A/c	Dr.	7,500	
	To Fair Value Reserve A/c			7,500

15. Calculation of Basic & Diluted EPS

	2013-14	*2014-15*
Profit before amortization of ESOP cost	18,50,000	22,00,000
Less: ESOP cost amortised	(8,37,000)	(7,47,000)
Net profit for shareholders	10,13,000	14,53,000
No. of shares outstanding	6,00,000	6,00,000
Basic EPS	1.69	2.42
Potential equity	19,200	33,000
Total no. of equity shares	6,19,200	6,33,000
Diluted EPS	1.64	2.30

Working Notes:

1. Calculation of Potential Equity

		2013-2014	*2014-2015*
a.	Actual no. of employees	960	880

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b.	Options granted per employee	100	100
c.	No. of options outstanding	96,000	88,000
d.	Unamortised ESOP cost per option (₹)	(₹ 18-18/2)9	0
e.	Exercise price (₹)	55	55
f.	Expected exercise price to be received (c x e) (₹)	52,80,000	48,40,000
g.	Unamortised ESOP cost (c x d) (₹)	8,64,000	0
h.	Total proceeds (₹)	61,44,000	48,40,000
i.	Fair value per share	80	88
j.	No. of shares issued for consideration (h/i)	76,800	55,000
k.	Potential Equity (c-j)	19,200	33,000

2. **Calculation of ESOP cost to be amortised**

	2013-2014	*2014-15*
Fair value of options per share	₹ 18	₹ 18
No. of options expected to vest under the scheme	(930 x 100) 93,000	(880 x 100) 88,000
Fair value of options	16,74,000	₹ 15,84,000
Value of options recognized as expenses	(₹ 16,74,000 / 2) 8,37,000	(₹ 15,84,000 – ₹ 8,37,000) 7,47,000

16. (a) **Calculation of Net Asset Value of a Fund**

	₹ in crores	
Total Assets:		
Investment (1,800 -18-30)	1,752.00	
Add: Closing Cash Balance (Refer W.N)	44.28	
Add: Interest for 2 months due to be received (1,752 x 10% x 2/12)	29.20	1,825.48
Less: Outstanding Management Expenses		(1.50)
Total value of the fund		1,823.98

Number of units = ₹ 1,800 crore/100 = 18 crore units

NAV per unit = ₹ 1,823.98/18 = ₹ 101.33 per unit

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Working Note:

Calculation of year-end cash/bank balance of the fund

	₹ *in crores*	
Sale of units		1,800
Add: Interest for 3 quarters on investments (1,752 x 10% x 9/12)		131.40
		1931.40
Less: Underwriting Commission	18.00	
Management Expenses paid in cash (13.50 cr – 1.50 cr)	12.00	
Investment	1,752.00	
Dividend paid (131.40 x 80%)	105.12	(1,887.12)
Year-end cash/bank balance		44.28

(b) Calculation of provision required on advances as on 31st March, 2016:

	Amount ₹ in lakhs	*Percentage of provision*	*Provision ₹ in lakhs*
Standard assets	33,600	0.30	100.80
Sub-standard assets	2,680	10	268.00
Secured portions of doubtful debts			
–upto one year	640	20	128.00
–one year to three years	180	30	54.00
–more than three years	60	50	30.00
Unsecured portions of doubtful debts	194	100	194.00
Loss assets	96	100	96.00
			870.8

17. Computation of value per equity share

		Cum-Dividend (₹)	*Ex- Dividend (₹)*
a	Net assets available to Equity shareholders	19,32,366	18,12,366
	Add: Notional call (40,000 x ₹ 4)	1,60,000	1,60,000
	Calls in arrear	20,000	20,000

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b	Net assets available to deemed fully paid equity shareholders	21,12,366	19,92,366
c	No. of equity shares	1,25,000	1,25,000
d	Value of ₹ 10 fully paid equity shares (b/c)	16.90	15.94
e	Value of ₹ 8 paid up equity shares (d-₹ 2)	14.90	13.94
f	Value of ₹ 6 paid up equity shares (d-₹ 4)	12.90	11.94
g	Value of ₹ 5 fully paid up equity shares (dx 5/10)	8.45	7.97

Working Notes:

1. Calculation of Average Capital Employed

	₹	₹
Fixed Assets		
Land & Building	7,50,000	
Plant & Machinery (₹ 7,10,000 + ₹ 21,675)	7,31,675	
Furniture & Fixture (₹ 2,85,000 – ₹ 24,300)	2,60,700	
	17,42,375	
Add: Appreciation @ 20%	3,48,475	20,90,850
Trade Investment (₹ 2,00,000 x 10%)		20,000
Inventory		2,60,000
Trade Receivables	1,90,000	
Less: Provision for doubtful debts	(9,500)	1,80,500
Cash at Bank		1,54,000
		27,05,350
Less: Outside liabilities		
10% Debentures	5,00,000	
Trade Payables	1,50,000	
Provision for Tax	1,60,000	
Bonus claim	27,000	(8,37,000)
Capital employed at the end of the year i.e.Net assets		18,68,350
Less: ½ of current year's accounting profit after tax [(1/2 of {3,42,857-1,125 – 9,500 – 27,000)0.70}]		(1,06,831)
Average Capital Employed		17,61,519

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2. **Calculation of future maintainable profits**

	2011-2012	*2012-2013*	*2013-2014*	*2014-2015*
Profit after tax	1,65,000	1,80,000	2,01,900	2,40,000
Profit before tax (PATx 1/0.70)	2,35,714	2,57,143	2,88,429	3,42,857
Add: Difference of depreciation due to wrong treatment of assets (as per W.N.7)			(1,500)	(1,125)
Undervaluation of closing inventory	15,000			
Undervaluation of opening inventory		(15,000)		
Provision for doubtful debts				(9,500)
Bonus claim not recorded in books				(27,000)
Income from non-trade investment (as per W.N. 8)	(12,600)	(12,600)	(12,600)	(18,000)
Adjusted profits	2,38,114	2,29,543	2,74,329	2,87,232
Total adjusted profits of 4 years				10,29,218
Average profit				2,57,305
Add: 20% increase in expected future profits				51,461
				3,08,766
Less: Depreciation @ 15% on increased value of machinery (₹ 1,46,335 x 15%)			(21,950)	
Expected increase in expenses			(25,000)	
Add: Interest on Debentures			50,000	3,050
Future maintainable profit before tax				3,11,816
Less: Tax @ 30%				(93,545)
Future maintainable profit after tax				2,18,271

3. **Calculation of rate of return on capital employed:**

A nominal rate of 1% is to be added as risk premium to the normal rate of return for the uncertainty associated with dividend distribution.

Therefore rate of return for Sun Ltd. may be taken as 10% + 1% = 11%

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4. **Calculation of value of goodwill**

Future maintainable profit after Tax	=	₹ 2,18,271
Less: Normal profit (11% of ₹ 17,59,637)	=	(₹ 1,93,767)
Super profit	=	₹ 24,504
Goodwill (Super profit x 4 years)	=	₹ 98,016

5. **Computation of Net assets available to equity shareholders:**

	₹	₹
Value of Net assets (as computed for Goodwill)		18,68,350
Value of Goodwill (as per WN 4)		98,016
Non-trade Investment		1,80,000
		21,46,366
Less: Preference share capital	2,00,000	
Proposed dividend on preference shares	14,000	(2,14,000)
Net assets available to equity shareholders cum dividend		19,32,366
Less: Proposed dividend on equity shares		(1,20,000)
Net assets available to equity shareholders (ex-dividend)		18,12,366

6. **Computation of No. of equivalent shares**

		No. of equivalent shares
(60,000 + 40,000) Shares of ₹ 10 each	1,00,000x 10/10	1,00,000
50,000 Shares of ₹ 5 each	50,000 x 5/10	25,000
Total equivalent shares of ₹ 10 each		1,25,000

7.

	Furniture	*Plant and Machinery*	*Difference*
Machinery purchased on 1.4.13 wrongly charged to Furniture A/c	30,000	30,000	
Depreciation for the year 2013-14	(3,000)	(4,500)	(1,500)
WDV as on 31.3.14	27,000	25,500	
Depreciation for the year 2014-15	(2,700)	(3,825)	(1,125)
WDV as on 31.3.15	24,300	21,675	

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8. Total Investment as per Balance Sheet ₹ 2,00,000

   Trade Investment is 10% i.e. ₹ 20,000

   Non-trade Investment is ₹ 1,80,000

   Non-trade Investment purchased on 1.04.2014 is ₹ 54,000

   Non-trade Investment purchased on 1.04.2011 is ₹ 1,26,000

   Return on investment from 1.4.2011 to 31.3.2014 is ₹ 12,600

   Return on investment from 01.04.2014 is ₹ 18,000

18. Calculation of Possible Value of Brand

	(₹ in lakhs)
Profits after Tax (₹10,000 -2,500) lakhs	7,500
Less: Profit allocated to tangible assets (18% of ₹ 30,000 lakhs)	(5,400)
Profit allocated to intangible assets including brand	2,100
Capitalisation factor @ 25%	
Capitalised value of intangibles including brand (₹ 2,100 lakhs/25%)	8,400
Less: Identifiable intangibles other than Brand	(4,500)
Brand Value	3,900

19. B Ltd.

Value Added Statement for the year ended 31st March, 2015

	(₹ in thousands)	*(₹ in thousands)*
Sales less returns		30,55,912
Less: Cost of bought in materials and services, as per working note	18,68,020	
Administrative expenses	65,280	
Interest on bank overdraft	200	(19,33,500)
Value added by manufacturing and trading activities		11,22,412
Add: Dividends and interest		260
Miscellaneous income		948
Total value added		11,23,620

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Application of valued added

	(₹ in thousands)	(₹ in thousands)	%
To pay Employees:			
Wages, salaries and bonus	7,63,520		
Staff welfare expenses	52,480	8,16,000	72.62
To pay Directors:			
Directors' remuneration		15,620	1.39
To pay Government:			
Income tax	50,940		
Tax on distributed profits	7,478	58,418	5.20
To pay providers of capital:			
Interest on 9% debentures	28,800		
Interest on long-term loan from financial institution	20,000		
Dividend to shareholders	44,000	92,800	8.26
To provide for maintenance and expansion of the company:			
Depreciation on Fixed assets	1,01,200		
Transfer to General reserve	36,424		
Retained profit (15,758 – 12,600)	3,158	1,40,782	12.53
		11,23,620	100.00

Statement showing reconciliation of Total value added with Profit before taxation

	(₹ in thousands)	(₹ in thousands)
Profit Before Taxation		1,42,000
Add back:		
Wages, salaries and bonus	7,63,520	
Staff welfare expenses	52,480	
Directors' remuneration	15,620	
Interest on 9% mortgage debentures	28,800	
Interest on long-term loan from financial institution	20,000	
Depreciation on fixed assets	1,01,200	9,81,620
Total Value Added		11,23,620

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Working Note:

Calculation of cost of bought in materials and services:

	(₹ in thousands)
Decrease in inventory of finished goods	52,108
Consumption of raw materials	14,81,642
Excise duty	29,080
Power and lighting	2,40,060
Other manufacturing expenses	65,130
	18,68,020

20. (a) Cumulative of Economic Value Added (EVA)

	Amount (₹)
Profit after tax	2,80,000
Add: Interest (net of tax) (80,000 x 0.70)	56,000
Return to providers of fund	3,36,000
Less: Cost of capital (As per working note)	(1,71,450)
Economic value added	1,64,550

Computation of Market Value Added (MVA)

	Amount (₹)	Amount (₹)
Equity Share capital (Market Value) (58,000x10x 500%)		29,00,000
Preference share capital (15,000x25)		3,75,000
Debentures (50,000 x 10x 80%)		4,00,000
Current Market Value of firm		36,75,000
Less: Equity share capital	5,80,000	
Preference share capital	1,50,000	
Debentures	5,00,000	
Long term loan	2,00,000	
Securities Premium	50,000	
General Reserve	20,000	
Statutory Reserve	60,000	(15,60,000)
Market Value Added		21,15,000

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The MVA of ₹ 21.15 lakhs is the difference between the current market value of Able Ltd. and the capital contributed by the fund providers. While EVA measures current earning efficiency of the company, MVA takes into consideration the EVA from not only the assets in place but also from the future projects/activities of the company. The difference between MVA over EVA thus represents the value attributed to the future potential for the company and may change from time to time based on market sentiments. In short the MVA is the net present value of all future EVAs.

Working Notes:

1. **Calculation of net profit after interest and tax**

Interest on debentures (5,00,000 x 10%)	50,000
Interest on long term debt (2,00,000 x 15%)	30,000
Total interest	80,000

Financial leverage = Profit before interest and tax (PBIT)/(PBIT-Interest)

1.2 = PBIT/(PBIT- ₹80,000)

PBIT	=	₹ 4,80,000
Less: Interest	=	₹ (80,000)
Profit after interest before tax	=	₹ 4,00,000
Less: Tax @ 30%	=	₹ (1,20,000)
Profit after Interest and tax	=	₹ 2,80,000

2. **Calculation of weighted average cost of capital (WACC)**

	Amount (₹)	*Amount (₹)*	*Weights*	*Cost %*	*WACC %*
Equity Share holders fund					
Equity Shares	5,80,000				
Security premium	50,000				
General Reserve	20,000	6,50,000	0.43	15	6.45
Preference shareholders fund		1,50,000	0.10	12	1.20
Debenture holders fund		5,00,000	0.33	7*	2.31
Long term debt		2,00,000	0.14	10.5*	1.47
		15,00,000			11.43

* Rate of interest has been calculated net of tax.

Cost of capital = Capital employed x WACC %

= ₹ 15,00,000x 11.43% = ₹ 1,71,450

Note: It is assumed that Statutory Reserves is not a free Reserve. Therefore, it has not been taken in calculation of weighted average cost of capital.

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(b)

	₹ in lakhs	*Mr. Ram (₹ in lakhs)*	*Mr. Shyam (₹ in lakhs)*
Salary demanded		7.5	4.5
Current Profits (Given)	11		
Target profit (150 x 12%)	18		
Profits proposed by executives		18	16.5
Increase in profit		7	5.5
Rate of return on investment		12%	11%
Maximum Bid Price		58.33	50
Maximum Salary that can be offered		7	5.5

From the above, it is evident that Mr. Ram's salary demand exceeds the benefit (increase in profit) to the company. Whereas by hiring Mr. Shyam, the company stands to gain because the salary demanded by him is lower than the expected increase in profits to the company.

Therefore, proposal of Mr. Shyam is more beneficial to the company.

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PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

QUESTIONS

Risk Analysis in Capital Budgeting

1. L & R Limited wishes to develop new virus-cleaner software. The cost of the pilot project would be ₹ 2,40,000. Presently, the chances of the product being successfully launched on a commercial scale are rated at 50%. In case it does succeed L&R can further invest a sum of ₹ 20 lacs to market the product. Such an effort can generate perpetually, an annual net after tax cash income of ₹ 4 lacs. Even if the commercial launch fails, they can make an investment of a smaller amount of ₹ 12 lacs with the hope of gaining perpetually a sum of ₹ 1 lac. Evaluate the proposal, adopting decision tree approach. The applicable discount rate is 10%.

2. XYZ Ltd. requires ₹ 8,00,000 for a new project. Useful life of project - 4 years. Salvage value - Nil. Depreciation Charge ₹ 2,00,000 p.a. Expected revenues & costs (excluding depreciation) ignoring inflation.

Year	1	2	3	4
Revenues	₹ 6,00,000	₹ 7,00,000	₹ 8,00,000	₹ 8,00,000
Costs	₹ 3,00,000	₹ 4,00,000	₹ 4,00,000	₹ 4,00,000

If applicable Tax Rate is 60% and cost of capital is 10% then calculate NPV of the project, if inflation rates for revenues & costs are as follows:

Year	Revenues	Costs
1	10%	12%
2	9%	10%
3	8%	9%
4	7%	8%

3. IPL already in production of Fertilizer is considering a proposal of building a new plant to produce pesticides. Suppose, the PV of proposal is ₹ 100 crore without the abandonment option. However, it market conditions for pesticide turns out to be favourable the PV of proposal shall increase by 30%. On the other hand market conditions remain sluggish the PV of the proposal shall be reduced by 40%. In case company is not interested in continuation of the project it can be disposed off for ₹ 80 crore.

   If the risk free rate of interest is 8% than what will be value of abandonment option

Leasing

4. With the following data available compute the Break Even Lease Rental (BELR) that ABC Ltd. should charge from lessee.

Cost of Machine	₹ 150 Lakh
Expected Useful Life	5 year

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Salvage Value of Machine at the end of 5 years	₹ 10 lakh
Rate of Depreciation (WDV)	25%
K_o	14%
Applicable Tax Rate	35%

Machine will constitute a separate block for depreciation purpose.

Dividend Decisions

5. The following information pertains to M/s XY Ltd.

Earnings of the Company	₹ 5,00,000
Dividend Payout ratio	60%
No. of shares outstanding	1,00,000
Equity capitalization rate	12%
Rate of return on investment	15%

(i) What would be the market value per share as per Walter's model?

(ii) What is the optimum dividend payout ratio according to Walter's model and the market value of Company's share at that payout ratio?

Indian Capital Market

6. BSE 5000

Value of portfolio	₹ 10,10,000
Risk free interest rate	9% p.a.
Dividend yield on Index	6% p.a.
Beta of portfolio	1.5

We assume that a future contract on the BSE index with four months maturity is used to hedge the value of portfolio over next three months. One future contract is for delivery of 50 times the index.

Based on the above information calculate:

(i) Price of future contract.

(ii) The gain on short futures position if index turns out to be 4,500 in three months.

Security Analysis

7. Following Financial data are available for PQR Ltd. for the year 2008:

	(₹ in lakh)
8% debentures	125
10% bonds (2007)	50
Equity shares (₹ 10 each)	100

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Reserves and Surplus	300
Total Assets	600
Assets Turnovers ratio	1.1
Effective interest rate	8%
Effective tax rate	40%
Operating margin	10%
Dividend payout ratio	16.67%
Current market Price of Share	₹ 14
Required rate of return of investors	15%

You are required to:

(i) Draw income statement for the year

(ii) Calculate its sustainable growth rate

(iii) Calculate the fair price of the Company's share using dividend discount model, and

(iv) What is your opinion on investment in the company's share at current price?

8. The following data are available for a bond

Face value	₹ 1,000
Coupon Rate	16%
Years to Maturity	6
Redemption value	₹ 1,000
Yield to maturity	17%

Calculate the duration and volatility of this bond?

Portfolio Theory

9. Suppose if Treasury Bills give a return of 5% and Market Return is 13%, then determine

(i) The market risk premium

(ii) β Values and required returns for the following combination of investments.

Treasury Bill	100	70	30	0
Market	0	30	70	100

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10. The following information is available of Jay Kay Ltd. and of Market (Index)

Year	Jay Kay Limited		Market		Return on Govt. Bonds
	Average Share Price (₹)	DPS (₹)	Average Index	Dividend Yield (%)	
2002	242	20	1812	4	6
2003	279	25	1950	5	5
2004	305	30	2258	6	4
2005	322	35	2220	7	5

Compute Beta Value of the company at the end of the year 2005.

11. The following details are given for X and Y companies' stocks and the Bombay Sensex for a period of one year. Calculate the systematic and unsystematic risk for the companies' stocks. What would be the portfolio risk if equal amount of money is allocated among these stocks?

	X Stock	Y Stock	Sensex
Average return	0.15	0.25	0.06
Variance of return	6.30	5.86	2.25
β	0.71	0.685	
Correlation Co-efficient	0.424		
Co-efficient of determination (r^2)	0.18		

Financial Services

12. Mr. Stanley Joseph has secured from a housing bank, a six year housing loan of ₹ 12,00,000. The loan was structured as follows:

Loan Amount	---	₹ 12,00,000
Repayment	---	Six equated annual installments, payable in arrears.
Reference Base	---	Prime Lending Rate
Reference Rate	---	9% on the date of loan
Interest on Loan	---	1 percentage point over reference rate of 9%
Annual Installment	---	₹ 2,75,530

Two years after the loan was granted, the prime rate moves down to 8% and the effective rate on the loan automatically stood revised to 9%. Determine the revised amount of instalment.

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13. You have a housing loan with one of India's top housing finance companies. The amount outstanding is ₹ 1,89,540. You have now paid an installment. Your next installment falls due a year later. There are five more installments to go, each being ₹ 50,000. Another housing finance company has offered to take over this loan on a seven year repayment basis. You will be required to pay ₹ 36,408 p.a. with the first installment falling a year later. The processing fee is 3% of amount taken over. For swapping you will have to pay ₹ 12,000 to the first company. Should you swap the loan?

    [Given (PVAF 10%, 5) = 3.791 and (PVAF 8%, 7) = 5.206]

14. A company is considering engaging a factor, the following information is available:

    (i) The current average collection period for the Company's debtors is 80 days and ½% of debtors default. The factor has agreed to pay money due after 60 days and will take the responsibility of any loss on account of bad debts.

    (ii) The annual charge for the factoring is 2% of turnover payable annually in arrears. Administration cost saving is likely to be ₹ 1,00,000 per annum.

    (iii) Annual sales, all on credit, are ₹ 1,00,00,000. Variable cost is 80% of sales price. The Company's cost of borrowing is 15% per annum. Assume the year is consisting of 365 days.

    Should the Company enter into a factoring agreement?

Mutual Funds

15. Orange purchased 200 units of Oxygen Mutual Fund at ₹ 45 per unit on 31st December, 2009. In 2010, he received ₹ 1.00 as dividend per unit and a capital gains distribution of ₹ 2 per unit.

    Required:

    (i) Calculate the return for the period of one year assuming that the NAV as on 31st December 2010 was ₹ 48 per unit.

    (ii) Calculate the return for the period of one year assuming that the NAV as on 31st December 2010 was ₹ 48 per unit and all dividends and capital gains distributions have been reinvested at an average price of ₹ 46.00 per unit.

    Ignore taxation.

Money Market Instruments

16. Bank A enters into a Repo for 14 days with Bank B in 12% GOI Bonds 2017 at a rate of 5.25% for ₹ 5 Crore. Assuming that the clean price be 99.42, initial margin be 2% and days of accrued interest be 292, you are required to determine:

    (a) Dirty Price

    (b) Start Proceeds (First Leg)

    (c) Repayment at Maturity (Second Leg)

    Note: Assume number of days in a year as 360.

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International Financial Management

17. Opus Technologies Ltd., an Indian IT company is planning to make an investment through a wholly owned subsidiary in a software project in China with a shelf life of two years. The inflation in China is estimated as 8 percent. Operating cash flows are received at the year end.

    For the project an initial investment of Chinese Yuan (CN¥) 30,00,000 will be in a piece of land. The land will be sold after the completion of project at estimated value of CN¥ 35,00,000. The project also requires an office complex at cost of CN¥ 15,00,000 payable at the beginning of project. The complex will be depreciated on straight-line basis over two years to a zero salvage value. This complex is expected to fetch CN¥ 5,00,000 at the end of project.

    The company is planning to raise the required funds through GDR issue in Mauritius. Each GDR will have 5 common equity shares of the company as underlying security which are currently trading at ₹ 200 per share (Face Value = ₹ 10) in the domestic market. The company has currently paid a dividend of 25% which is expected to grow at 10% p.a. The total issue cost is estimated to be 1 percent of issue size.

    The annual sales is expected to be 10,000 units at the rate of CN¥ 500 per unit. The price of unit is expected to rise at the rate of inflation. Variable operating costs are 40 percent of sales. Current Fixed Operating costs is CN¥ 22,00,000 per year which is expected to rise at the rate of inflation.

    The tax rate applicable in China for business income and capital gain is 25 percent and as per GOI Policy no further tax shall be payable in India. The current spot rate of CN¥ 1 is ₹ 9.50. The nominal interest rate in India and China is 12% and 10% respectively and the international parity conditions hold.

    You are required to

    (a) Identify expected future cash flows in China and determine NPV of the project in CN¥.

    (b) Determine whether Opus Technologies should go for the project or not, assuming that there neither there is any restriction nor any charges/taxes payable on the transfer of funds from China to India.

Foreign Exchange Risk Management

18. Following are the rates quoted at Mumbai for British Pound (£):

Spot (£/₹)	52.60/70	Interest Rates	India	London
3 m Forward	20/70	3 months	8%	5%
6 m Forward	50/75	6 months	10%	8%

Verify whether there is any scope for covered interest arbitrage, if you can borrow in rupees.

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Mergers & Acquisitions

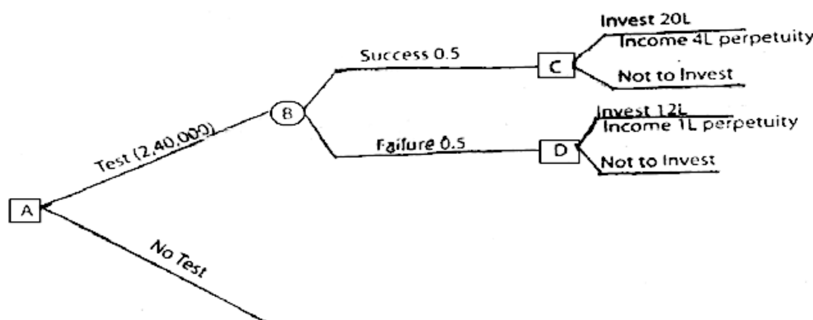
19. Simpson Ltd. is considering a merger with Wilson Ltd. The data below are in the hands of both Board of Directors. The issue at hand is how many shares of Simpson should be exchanged for Wilson Ltd. Both boards are considering three possibilities 20,000, 25,000 and 30,000 shares. You are required to construct a table demonstrating the potential impact of each scheme on each set of shareholders:

		Simpson Ltd.	Wilson Ltd.	Combined Post merger Firm 'A'
1.	Current earnings per year	2,00,000	1,00,000	3,50,000
2.	Shares outstanding	50,000	10,000	?
3.	Earnings per share (₹) (1÷ 2)	4	10	?
4.	Price per share (₹)	40	100	?
5.	Price-earning ratio [4 ÷ 3]	10	10	10
6.	Value of firm (₹)	20,00,000	10,00,000	35,00,000
7.	Expected Annual growth rate in earnings in foreseeable future	0	0	0

20. Write a short note on
    (a) Factors that affect Bond's Duration
    (b) Process of Portfolio Management
    (c) Benefits of International Portfolio Investment
    (d) Benefits of Debit Card
    (e) Factors affecting the selection of Mutual Funds

SUGGESTED ANSWERS/HINTS

1. Decision tree diagram is given below:



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Evaluation

At Decision Point C: The choice is between investing ₹ 20 lacs for a perpetual benefit of ₹ 4 lacs and not to invest. We shall determine the PV of Benefits in perpetuity (Capitalised Value) as follows:

$$= \frac{₹\ 4\,\text{lac}}{0.10} = ₹\ 40\ \text{lac}$$

Net Benefit = ₹ 40 lac - ₹ 20 lac = ₹ 20 lac

The preferred choice is to invest, since the capitalized value yields a net benefit of ₹ 20 lacs.

At Decision Point D: The choice is between investing ₹ 12 lacs, for a similar perpetual benefit of ₹ 1 lac, and not to invest shall be based on net benefit as computed above.

$$= \frac{₹1\ \text{lac}}{0.10} = ₹\ 10\ \text{lac}$$

Net Benefit = ₹ 10 lac - ₹ 12 lac = - ₹ 2 lac

Since, there is a negative benefit of ₹ 2 lacs. Therefore, it would not be prudent to invest at this point.

At Outcome Point B: Evaluation of EMV is as under (₹ in lacs).

Outcome	*Amount (₹)*	*Probability*	*Result (₹)*
Success	*20.00*	*0.50*	*10.00*
Failure	*0.00*	*0.50*	*00.00*
Net result			*10.00*

EMV at B is, therefore, ₹ 10 lacs.

At Decision Point A: Decision is to be taken based on preferences between two alternatives. The first is to test, by investing ₹ 2,40,000 and reap a benefit of ₹ 10 lacs. The second is not to test, and thereby losing the opportunity of a possible gain.

The preferred choice is, therefore, investing a sum of ₹ 2,40,000 and undertaking the test.

2. Computation of Annual Cash Flow

(i) Inflation adjusted Revenues

Year	*Revenues (₹)*	*Revenues (Inflation Adjusted) (₹)*
1	6,00,000	6,00,000(1.10) = 6,60,000
2	7,00,000	7,00,000(1.10)(1.09) = 8,39,300
3	8,00,000	8,00,000(1.10)(1.09)(1.08) = 10,35,936
4	8,00,000	8,00,000(1.10)(1.09)(1.08)(1.07) = 11,08,452

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(ii) Inflation adjusted Costs

Year	*Revenues (₹)*	*Revenues (Inflation Adjusted) (₹)*
1	3,00,000	3,00,000(1.12) = 3,36,000
2	4,00,000	4,00,000(1.12)(1.10) = 4,92,800
3	4,00,000	4,00,000(1.12)(1.10)(1.09) = 5,37,172
4	4,00,000	4,00,000(1.12)(1.10)(1.09)(1.08) = 5,80,124

(iii) Tax Benefit on Depreciation = ₹ 2,00,000 x 0.60 = ₹ 1,20,000

(iv) Net Profit after Tax

Year	*Revenues (Inflation Adjusted) (₹)(1)*	*Costs (Inflation Adjusted) (₹)(2)*	*Net Profit (₹) (3) = (1) - (2)*	*Tax (₹) (4) = 60% of (3)*	*Net after Profit (₹) (3) - (4)*
1	6,60,000	3,36,000	3,24,000	1,94,400	1,29,600
2	8,39,300	4,92,800	3,46,500	2,07,900	1,38,600
3	10,35,936	5,37,172	4,98,764	2,99,258	1,99,506
4	11,08,452	5,80,124	5,28,328	3,16,997	2,11,331

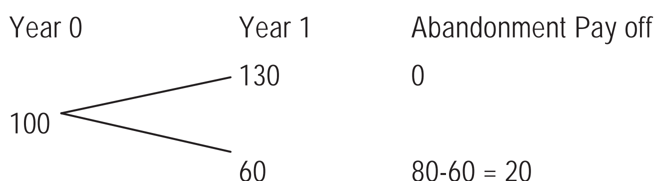
(iv) Present Value of Cash Inflows

Year	*Net after Profit (₹)*	*Tax Benefit on Depreciation (₹)*	*Cash Inflow (₹)*	*PVF@ 10%*	*PV (₹)*
1	1,29,600	1,20,000	2,49,600	0.909	2,26,886
2	1,38,600	1,20,000	2,58,600	0.826	2,13,604
3	1,99,506	1,20,000	3,19,506	0.751	2,39,949
4	2,11,331	1,20,000	3,31,331	0.683	2,26,299
					9,06,738

NPV = ₹ 9,06,738 – ₹ 8,00,000 = ₹ 1,06,738

3. Decision Tree showing pay off

Year 0 Year 1 Abandonment Pay off



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First of all we shall calculate probability of high demand (P) using risk neutral method as follows:

8% = p x 30% + (1-p) x (-40%)

0.08 = 0.30 p - 0.40 + 0.40p

$$p = \frac{0.48}{0.70} = 0.686$$

The value of abandonment option will be computed as follows:

Expected Payoff at Year 1

= p x 0 + [(1-p) x 20]

= 0.686 x 0 + [0.314 x 20]

= ₹ 6.28 crore

Since expected pay off at year 1 is 6.28 crore. Present value of expected pay off will be:

$$\frac{6.28}{1.08} = 5.81 \text{ crore.}$$

Thus the value of abandonment option (Put Option) is ₹ 5.80 crore.

4.

Cost of Machine	₹ 150,00,000
Less: - PV of Salvage Value (W1)	₹ 5,19,400
Less: PV of Tax benefit on Depreciation (W2)	₹ 27,34,184
Less: PV of Tax Saving on STCL at the end of 5 year (W3)	₹ 6,80,478
	₹ 110,65,938
PVIFA for 5 years @14%	3.433

$$\text{After tax Break Even Lease Rental} = \frac{1,10,65,938}{3.433} = 32,23,400$$

$$\text{Before Tax BELR} = \frac{32,23,400}{(1-0.35)} = ₹\ 49,59,100$$

Working Notes

<u>W1</u>

Salvage Value = ₹ 10,00,000

PVF @14% = 0.5194

PV of Salvage Value = ₹ 5,19,400

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W2

Table showing calculation of PV of Tax Benefit on Depreciation

Year	*Opening WDV (₹)*	*Depreciation @ 25% (₹)*	*Closing WDV (₹)*	*FVF @14%*	*PV (₹)*
1	150,00,000	37,50,000	11,250,000	0.877	32,88,750
2	112,50,000	28,12,500	84,37,500	0.769	21,62,813
3	84,37,500	21,09,375	63,28,125	0.675	14,23,828
4	63,28,125	15,82,031	47,46,094	0.592	9,36,562
					78,11,953

Tax Benefit on Depreciation = ₹ 78,11,953 X 0.35 = ₹ 27,34,184

W3

PV of Tax benefit on Short Term Capital Loss (STCL)

WDV at beginning of 5 year as per above table	47,46,094
Less: Salvage Value	10,00,000
STCL	37,46,094
Tax Benefit	13,11,133
PVF at 14%	0.519
PV of Tax Benefit on STCL	6,80,478

5. M/s XY Ltd.

(i) Walter's model is given by

$$P = \frac{D + (E - D)(r / k_e)}{K_e}$$

Where,

P = Market price per share.

E = Earnings per share = ₹ 5 (₹ 5,00,000/ 1,00,000)

D = Dividend per share = ₹ 3 (0.60 x ₹ 5)

r = Return earned on investment = 15%

K_e = Cost of equity capital = 12%

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$$P = \frac{3+(5-3)\times\frac{0.15}{0.12}}{0.12} = \frac{3+2\times\frac{0.15}{0.12}}{0.12} = ₹\ 45.83$$

(ii) According to Walter's model when the return on investment is more than the cost of equity capital, the price per share increases as the dividend pay-out ratio decreases. Hence, the optimum dividend pay-out ratio in this case is nil.

So, at a pay-out ratio of zero, the market value of the company's share will be:

$$\frac{0+(5-0)\frac{0.15}{0.12}}{0.12} = ₹\ 52.08$$

6. (i) Current future price of the index = 5000 + 5000 (0.09-0.06) $\frac{4}{12}$ = 5000+ 50= 5,050

$\therefore$ Price of the future contract = ₹ 50 x 5,050 = ₹ 2,52,500

(ii) Hedge ratio = $\frac{1010000}{252500}\times 1.5$ = 6 contracts

Index after there months turns out to be 4500

Future price will be = 4500 + 4500 (0.09-0.06) $\times\frac{1}{12}$ = 4,511.25

Therefore, Gain from the short futures position is = 6 x (5050 – 4511.25) x 50

= ₹ 1,61,625

Note: Alternatively we can also use daily compounding (exponential) formula.

7. Workings:

Asset turnover ratio	= 1.1
Total Assets	= ₹ 600
Turnover ₹ 600 lakhs × 11	= ₹ 660 lakhs
Effective interest rate	= $\frac{\text{Interest}}{\text{Libilities}} = 8\%$
Liabilities	= ₹ 125 lakhs + 50 lakhs = 175 lakh
Interest	= ₹ 175 lakhs × 0.08 = ₹ 14 lakh
Operating Margin	= 10%
Hence operating cost	= (1 - 0.10) ₹ 660 lakhs = ₹ 594 lakh
Dividend Payout	= 16.67%
Tax rate	= 40%

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(i) Income statement

	(₹ Lakhs)
Sale	660
Operating Exp	594
EBIT	66
Interest	14
EBT	52
Tax @ 40%	20.80
EAT	31.20
Dividend @ 16.67%	5.20
Retained Earnings	26.00

(ii) SGR = G = ROE (1-b)

$$\text{ROE} = \frac{\text{PAT}}{\text{NW}} \text{ and NW} = ₹\,100 \text{ lakh} + ₹\ 300 \text{ lakh} = 400 \text{ lakh}$$

$$\text{ROE} = \frac{₹\,31.2 \text{ lakhs}}{₹\,400 \text{ lakhs}} \times 100 = 7.8\%$$

SGR = 0.078(1 - 0.1667) = 6.5%

(iii) Calculation of fair price of share using dividend discount model

$$P_o = \frac{D_0(1+g)}{k_e - g}$$

$$\text{Dividends} = \frac{₹\,5.2 \text{ lakhs}}{₹\,10 \text{ lakhs}} = ₹\ 0.52$$

Growth Rate = 6.5%

$$\text{Hence } P_o = \frac{₹\,0.52(1+0.065)}{0.15\text{-}0.065} = \frac{₹\,0.5538}{0.085} = ₹\ 6.51$$

(iv) Since the current market price of share is ₹ 14, the share is overvalued. Hence the investor should not invest in the company.

8. To calculate the duration first the we shall calculate Market price of bond as follows:

160 (PVIFA 17%,6) + 1,000 (PVIF 17%,6)

= 160 (3.589) + 1,000 (0.390)

= 574.24 + 390

= 964.24

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1. **Duration**

Year	*Cash flow*	*P.V. @ 17%*		*Proportion of bond value*	*Proportion of bond value x time (years)*
1	160	0.855	136.80	0.142	0.142
2	160	0.731	116.96	0.121	0.242
3	160	0.624	99.84	0.103	0.309
4	160	0.534	85.44	0.089	0.356
5	160	0.456	72.96	0.076	0.38
6	1160	0.390	452.40	0.469	2.814
			964.40	1.000	4.243

Duration of the Bond is 4.243 years

2. **Volatility**

$$\text{Volatility of the bonds} = \frac{\text{Duration}}{(1 + \text{YTM})} = \frac{4.243}{1.17} = 3.63\%$$

9. (i) Market Risk Premium $R_m - R_f$ = 13% - 5% = 8%

(ii) β is the weighted average of investing in portfolios consisting of market (β = 1) and beta of treasury bills (β = 0)

Portfolio	Treasury Bills: Market Portfolio	β	$R_j = R_f + \beta \times (R_m - R_f)$
1	100:0	0	5% + 0(13%-5%)=5%
2	70:30	0.7(0)+0.3(1)=0.3	5%+0.3(13%-5%)=7.40%
3	30:70	0.3(0)+0.7(1)=0.7	5%+0.7(13%-5%)=10.60%
4	0:100	1	5%+1.0(13%-5%)=13%

10. **Computation of Beta Value**

Calculation of Returns

$$\text{Returns} = \frac{D_1 + (P_1 - P_0)}{P_0} \times 100$$

Year	*Returns*
2002 – 2003	$\frac{25 + (279 - 242)}{242} \times 100 = 25.62\%$
2003 – 2004	$\frac{30 + (305 - 279)}{279} \times 100 = 20.07\%$

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2004 – 2005 $\frac{35+(322-305)}{305}\times 100 = 17.05\%$

Calculation of Returns from market Index

Year	% of Index Appreciation Yield %	Dividend Return %	Total
2002 – 2003	$\frac{1950-1812}{1812}\times 100 = 7.62\%$	5%	12.62%
2003 – 2004	$\frac{2258-1950}{1950}\times 100 = 15.79\%$	6%	21.79%
2004 – 2005	$\frac{2220-2258}{2258}\times 100 = (-)1.68\%$	7%	5.32%

Computation of Beta

Year	X	Y	XY	Y^2
2002-2003	25.62	12.62	323.32	159.26
2003-2004	20.07	21.79	437.33	474.80
2004-2005	17.05	5.32	90.71	28.30
	62.74	39.73	851.36	662.36

$\bar{X} = \frac{62.74}{3} = 20.91,\ \bar{Y} = \frac{39.73}{3} = 13.24$

$$\beta = \frac{\sum XY - n\overline{XY}}{\sum Y^2 - n\bar{Y}^2}$$

$$= \frac{851.36 - 3(20.91)(13.24)}{662.36 - 3(13.24)^2}$$

$$= \frac{851.36 - 830.55}{662.36 - 525.89} = \frac{20.81}{136.47} = 0.15$$

11. The co-efficient of determination (r^2) gives the percentage of the variation in the security's return that is explained by the variation of the market index return. In the X company stock return, 18 per cent of variation is explained by the variation of the index and 82 per cent is not explained by the index.

According to Sharpe, the variance explained by the index is the systematic risk. The unexplained variance or the residual variance is the unsystematic risk.

Company X:

Systematic risk = $\beta_i^2 \times$ Variance of market index

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$= (0.71)^2 \times 2.25 = 1.134$

Unsystematic risk($\in_i^2$) = Total variance of security return - Systematic risk

= 6.3 – 1.134

= 5.166

or

= Variance of Security Return (1 - r^2)

= 6.3 X (1 - 0.18) = 6.3 X 0.82 = 5.166

Total risk $= \beta_i^2 \times \sigma_m^2 + \in_i^2$

= 1.134 + 5.166 = 6.3

Company Y:

Systematic risk $= \beta_i^2 \times \sigma_m^2$

$= (0.685)^2 \times 2.25 = 1.056$

Unsystematic risk = Total variance of the security return - systematic risk.

= 5.86 - 1.056 = 4.804

$$\sigma_p^2 = \left[\left(\sum_{i=1}^{N} X_i\beta_i\right)^2 \sigma_m^2\right] + \left[\left(\sum_{i=1}^{N} X_i^2 \in_i^2\right)\right]$$

$= [(0.5 \times 0.71 + 0.5 \times 0.685)^2\ 2.25] + [(0.5)^2(5.166)+(0.5)^2(4.804)]$

$= [(0.355 + 0.3425)^2\ 2.25] + [(1.292 + 1.201)] = 1.0946 + 2.493 = 3.5876$

12. Revision in equated Instalments

1. Determination of Unpaid principal
2. Re-Computation of EMI for revised period at revised rate

Determination of Remaining Principal

Year	*Opg. Bal* (₹)	*Interest @10%* (₹)	*Total* (₹)	*Repaid* (₹)	*Clg. Bal* (₹)
1	12,00,000	1,20,000	13,20,000	2,75,530	10,44,470
2	10,44,470	1,04,447	11,48,917	2,75,530	8,73,387

Determination of Revised Equated Monthly Installments

New Amount ₹ 8,73,387

New Period 4 years

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New Rate (8% + 1%)	9%	
PVAF	3.240	
Installment	₹ 8,73,387 / 3.240	= ₹ 2,69,564

Bank shall revise installment from ₹ 2,75,530 to ₹ 2,69,564.

13. **Present Interest Rate**

For a loan of ₹ 1,89,540 annuity being ₹ 50,000, PVAF = 3.791 (₹ 1,89,540 / ₹ 50,000). From PVAF table for 5 years, this corresponds to 10%.

New Interest Rate

For a similar loan, annuity being ₹ 36,408, PVAF = 5.206 (₹ 1,89,540 / ₹ 36,408). From PVAF table for 7 years, this corresponds to 8%.

Interest Rate is prima facie beneficial.

Additional Charges

(i)	Swap Charges	₹ 12,000
(ii)	Processing fee 3% on loan amount (3/100 × ₹ 1,89,540)	₹ 5,686

Let us compute the IRR as follows:

$$₹\ 1{,}89{,}540 - ₹\ 12{,}000 - ₹\ 5{,}686 = \frac{36{,}408}{(1+IRR)^1} \ldots\ldots\ldots\ldots \frac{36{,}408}{(1+IRR)^7}$$

IRR = 10.947%

Since interest rate on existing loan is 10% while proposed loan is 10.947% hence proposed loan is more expensive and it is advisable not to swap.

14. The annual change in cash flows through entering into a factoring agreement is:

Savings	*(Amount in₹)*	*(Amount in₹)*
Administration cost saved		1,00,000
Existing average debtors [₹ 1,00,00,000/365) x 80 days]	21,91,781	
Average New Debtors [(₹ 1,00,00,000/365) x 60 days]	16,43,836	
Reduction in debtors	5,47,945	
Cost there of @80%	4,38,356	
Add: Interest saving @15% p.a. on. ₹ 4,38,356		65,753

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Add: Bad Debts saved @.005 of ₹ 1,00,00,000		50,000
	Total	2,15,753
Less: Annual charges @2% of ₹ 1,00,00,000		2,00,000
Net annual benefits of factoring		15,753

Therefore, the factoring agreement is worthwhile and should be undertaken.

15. (i) **Returns for the year**

(All changes on a Per -Unit Basis)

Change in Price:	₹ 48 – ₹ 45 =	₹ 3.00
Dividends received:		₹ 1.00
Capital gains distribution		₹ 2.00
Total reward		₹ 6.00

Holding period reward: $\frac{₹ 6.00}{₹ 45} \times 100 = 13.33\%$

(ii) When all dividends and capital gains distributions are re-invested into additional units of the fund @ (₹ 46/unit)

Dividend + Capital Gains per unit = ₹ 1.00 + ₹ 2.00 = ₹ 3.00

Total received from 200 units = ₹ 3.00 x 200 = ₹ 600/-.

Additional Units Acquired = ₹ 600/₹ 46 = 13.04 Units.

Total No. of Units = 200 units + 13.04 units = 213.04 units.

Value of 213.04 units held at the end of the year

= 213.04 units x ₹ 48 = ₹ 10225.92

Price Paid for 200 Units at the beginning of the year = 200 units x ₹ 45 = ₹ 9000.00

Holding Period Reward ₹ (10225.92 – 9000.00) = ₹ 1225.92

Holding Period Reward = $\frac{₹1225.92}{₹ 9000} \times 100 = 13.62\%$

16. (a) **Dirty Price**

= Clean Price + Interest Accrued

$= 99.42 + 100 \times \frac{12}{100} \times \frac{292}{360}$

= 109.1533

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(b) First Leg (Start Proceed)

$$= \text{Nominal Value} \times \frac{\text{Dirty Price}}{100} \times \frac{100 - \text{Initial Margin}}{100}$$

$$= ₹\ 5,00,00,000 \times \frac{109.1533}{100} \times \frac{100-2}{100}$$

= ₹ 5,34,85,117 say ₹ 5,34,85,000

(c) Second Leg (Repayment at Maturity)

$$= \text{Start Proceed} \times \left(1 + \text{Repo rate} \times \frac{\text{No. of days}}{360}\right)$$

$$= ₹\ 5,34,85,000 \times \left(1 + 0.0525 \times \frac{14}{360}\right) = ₹\ 5,35,94,199$$

17. Working Notes:

1. Calculation of Cost of Capital (GDR)

Current Dividend (D_0)	2.50
Expected Dividend (D_1)	2.75
Net Proceeds (200 – 1% of 200)	198.00
Growth Rate	10.00%

$$k_e = \frac{2.75}{198} + 0.10 = 0.1139 \text{ i.e. } 11.39\%$$

2. Calculation of Expected Exchange Rate as per Interest Rate Parity

YEAR	*EXPECTED RATE*
1	$= 9.50 \times \frac{(1+0.12)}{(1+0.10)} = 9.67$
2	$= 9.50 \times \frac{(1+0.12)^2}{(1+0.10)^2} = 9.85$

3. Realization on the disposal of Land net of Tax

	CN¥
Sale value at the end of project	3500000.00
Cost of Land	3000000.00
Capital Gain	500000.00
Tax paid	125000.00
Amount realized net of tax	3375000.00

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4. Realization on the disposal of Office Complex

	(CN¥)
Sale value at the end of project	500000.00
WDV	0.00
Capital Gain	500000.00
Tax paid	125000.00
Amount realized net of tax (A)	375000.00

5. Computation of Annual Cash Inflows

Year	*1*	*2*
Annual Units	10000	10000
Price per bottle (CN¥)	540.00	583.20
Annual Revenue (CN¥)	5400000.00	5832000.00
Less: Expenses		
Variable operating cost (CN¥)	2160000.00	2332800.00
Depreciation (CN¥)	750000.00	750000.00
Fixed Cost per annum (CN¥)	2376000.00	2566080.00
PBT (CN¥)	114000.00	183120.00
Tax on Profit (CN¥)	28500.00	45780.00
Net Profit (CN¥)	85500.00	137340.00
Add: Depreciation (CN¥)	750000.00	750000.00
Cash Flow	835500.00	887340.00

(a) Computation of NPV of the project in CN¥ (CN¥)

Year	*0*	*1*	*2*
Initial Investment	-4500000.00		
Annual Cash Inflows		835500.00	887340.00
Realization on the disposal of Land net of Tax			3375000.00
Realization on the disposal of Office Complex			375000.00
Total	-4500000.00	835500.00	4637340.00
PVF @11.39%	1.000	0.898	0.806
PV of Cash Flows	-4500000.00	750279.00	3737696.00
NPV			-12,025

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(b) Evaluation of Project from Opus Point of View

(i) Assuming that inflow funds are transferred in the year in which same are generated i.e. first year and second year.

Year	*0*	*1*	*2*
Cash Flows (CN¥)	-4500000.00	835500.00	4637340.00
Exchange Rate (₹ / CN¥)	9.50	9.67	9.85
Cash Flows (₹)	-42750000.00	8079285.00	45677799.00
PVF @ 12%	1.00	0.893	0.797
	-42750000.00	7214802.00	36405206.00
NPV			870008.00

(ii) Assuming that inflow funds are transferred at the end of the project i.e. second year.

Year	*0*	*2*
Cash Flows (CN¥)	-4500000.00	5472840.00
Exchange Rate (₹/ CN¥)	9.50	9.85
Cash Flows (₹)	-42750000.00	53907474.00
PVF	1.00	0.797
	-42750000.00	42964257.00
NPV		214257.00

Though in terms of CN¥ the NPV of the project is negative but in ₹ it has positive NPV due to weakening of ₹ in comparison of CN¥. Thus Opus can accept the project.

18.

Particulars	*Option I (3 mths)*	*Option II (6 mths)*
Amount borrowed	100000	100000
Pounds (£) obtained by converting at spot rate	100000/52.70 = 1897.53	100000/52.70 = 1897.53
Invest pound for the period	1.25%	4%
Amount of pound received at the end Of the period	1897.53 × 1.0125 = 1,921.25	1897.53 × 1.04 = 1,973.43
Convert pounds to ₹ At forward rate	1,921.25 × 52.80 = 1,01,442	1,973.43 × 53.10 = 1,04,789
Amount of Re. Loan to be repaid	100000 × 1.02 = 102000	100000 × 1.05 = 105000

Since the amount of Indian Rupees to be Received is less than the amount repaid in both cases there is no scope for covered interest arbitrage by borrowing in Indian Rupees.

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19. The following table demonstrates the potential impact of the three possible schemes, on each set of shareholders:-

Number of Simpson Ltd.'s shares issued to shareholders of Wilson Ltd.	Exchange ratio [(1)/10,000 shares of Wilson Ltd.]	Number of Simpson Ltd.'s shares outstanding after merger [50,000+(1)]	Fraction of Simpson Ltd. (Post merger) owned by Wilson Ltd.'s shareholders [(1)/(3)]	Value of shares owned by Wilson Ltd.'s shareholders [(4)x 35,00,000]	Fraction of Simpson Ltd. (combined Post-merger owned by Simpson Ltd.'s share-holders [50,000/(3)]	Value of shares owned by Simpson Ltd.'s shareholder s [(6) x 35,00,000]
PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT (1)	(2)	(3)	(4)	(5)	(6)	(7)
20,000	2	70,000	2/7	10,00,000	5/7	25,00,000
25,000	2.5	75,000	1/3	11,66,667	2/3	23,33,333
30,000	3	80,000	3/8	13,12,500	5/8	21,87,500

Thus from above it is clear that except case of exchange ratio of 20000 shares, in remaining cases the value of shares will increase for both companies.

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20. (a) Following are some of factors that affect bond's duration:

(1) Time to maturity: Consider two bonds that each cost ₹ 1,000 and yield 7%. A bond that matures in one year would more quickly repay its true cost than a bond that matures in 10 years. As a result, the shorter-maturity bond would have a lower duration and less price risk. The longer the maturity, the higher the duration.

(2) Coupon rate: Coupon payment is a key factor in calculation of duration of bonds. If two identical bonds pay different coupons, the bond with the higher coupon will pay back its original cost quicker than the lower-yielding bond. The higher the coupon, the lower is the duration.

(b) Portfolio management is a process and broadly it involves following five phases and each phase is an integral part of the whole process and the success of portfolio management depends upon the efficiency in carrying out each of these phases.

(1) Security Analysis: Security analysis constitutes the initial phase of the portfolio formation process and consists in examining the risk-return characteristics of individual securities and also the correlation among them. A simple strategy in securities investment is to buy underpriced securities and sell overpriced securities. But the basic problem is how to identify underpriced and overpriced securities and this is what security analysis is all about. There are two alternative approaches to analyse any security viz. fundamental analysis and technical analysis. They are based on different premises and follow different techniques.

(2) Portfolio Analysis: Once the securities for investment have been identified, the next step is to combine these to form a suitable portfolio. Each such portfolio has its own specific risk and return characteristics which are not just the aggregates of the characteristics of the individual securities constituting it. The return and risk of each portfolio can be computed mathematically based on the risk-return profiles for the constituent securities and the pair-wise correlations among them.

(3) Portfolio Selection: The goal of a rational investor is to identify the Efficient Portfolios out of the whole set of Feasible Portfolios mentioned above and then to zero in on the Optimal Portfolio suiting his risk appetite. An Efficient Portfolio has the highest return among all Feasible Portfolios having identical Risk and has the lowest Risk among all Feasible Portfolios having identical Return.

(4) Portfolio Revision: Once an optimal portfolio has been constructed, it becomes necessary for the investor to constantly monitor the portfolio to ensure that it does not lose it optimality. In light of various developments in the market, the investor now has to revise his portfolio. This revision leads to addition (purchase) of some new securities and deletion (sale) of some of the

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existing securities from the portfolio. The nature of securities and their proportion in the portfolio changes as a result of the revision.

(5) **Portfolio Evaluation:** This process is concerned with assessing the performance of the portfolio over a selected period of time in terms of return and risk and it involves quantitative measurement of actual return realized and the risk borne by the portfolio over the period of investment. Various types of alternative measures of performance evaluation have been developed for use by investors and portfolio managers.

(c) Benefits of International Portfolio Investment are as follows:

(a) *Reduce Risk:* International investment aids to diversify risk as the gains from diversification within a country are therefore very much limited, because macro economic factors of different countries vary widely and do not follow the same phases of business cycles, different countries have securities of different industries in their market portfolio leading to correlation of expected returns from investment in different countries being lower than in a single country.

(b) *Raise Return through better Risk – Return Trade off* : International Investment aids to raise the return with a given risk and/or aids to lower the risk with a given rate of return. This is possible due to profitable investment opportunities being available in an enlarged situation and at the same time inter country dissimilarities reduce the quantum of risk.

(d) Benefits of Debit cards are as follows:

1) Obtaining a debit card is often easier than obtaining a credit card.

2) Using a debit card instead of writing cheques saves one from showing identification or giving his personal information at the time of the transaction.

3) Using a debit card frees him from carrying cash or a cheque book.

4) Using a debit card means he no longer has to stock up on traveller's cheques or cash when he travels

5) Debit cards may be more readily accepted by merchants than cheques, in other states or countries wherever the card brand is accepted.

6) The debit card is a quick, "pay now" product, giving one no grace period.

7) Using a debit card may mean one has less protection than with a credit card purchase for items which are never delivered, are defective, or misrepresented. But, as with credit cards, one may dispute unauthorized charges or other mistakes within 60 days. One should contact the card issuer if a problem cannot be resolved with the merchant.

8) Returning goods or canceling services purchased with a debit card is treated as if the purchase were made with cash or a cheque.

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(e) Factors affects the selection of Mutual Funds is as follows:

(1) *Past Performance* – The Net Asset Value is the yardstick for evaluating a Mutual Fund. The higher the NAV, the better it is. Performance is based on the growth of NAV during the referral period after taking into consideration Dividend paid.

$$\text{Growth} = (NAV_1 – NAV_0) + D_1 / NAV_0.$$

(2) *Timing* – The timing when the mutual fund is raising money from the market is vital. In a bullish market, investment in mutual fund falls significantly in value whereas in a bearish market, it is the other way round where it registers growth. The turns in the market need to be observed.

(3) *Size of Fund* – Managing a small sized fund and managing a large sized fund is not the same as it is not dependent on the product of numbers. Purchase through large sized fund may by itself push prices up while sale may push prices down, as large funds get squeezed both ways. So it is better to remain with medium sized funds.

(4) *Age of Fund* – Longevity of the fund in business needs to be determined and its performance in rising, falling and steady markets have to be checked. Pedigree does not always matter as also success strategies in foreign markets.

(5) *Largest Holding* – It is important to note where the largest holdings in mutual fund have been invested.

(6) *Fund Manager* – One should have an idea of the person handling the fund management. A person of repute gives confidence to the investors.

(7) *Expense Ratio* – SEBI has laid down the upper ceiling for Expense Ratio. A lower Expense Ratio will give a higher return which is better for an investor.

(8) *PE Ratio* – The ratio indicates the weighted average PE Ratio of the stocks that constitute the fund portfolio with weights being given to the market value of holdings. It helps to identify the risk levels in which the mutual fund operates.

(9) *Portfolio Turnover* – The fund manager decides as to when he should enter or quit the market. A very low portfolio turnover indicates that he is neither entering nor quitting the market very frequently. A high ratio, on the other hand, may suggest that too frequent moves have lead the fund manager to miss out on the next big wave of investments. A simple average of the portfolio turnover ratio of peer group updated by mutual fund tracking agencies may serve as a benchmark. The ratio is lower of annual purchase plus annual sale to average value of the portfolio.

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PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

PART – I : ACADEMIC UPDATE

(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority)

1. **Ceiling on Number of Company Audits:** As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies, other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.

2. **Guidance Note on Reporting under Section 143(3)(f) and (h) of the Companies Act, 2013:**

Introduction

1. Section 143 of the Companies Act, 2013 (hereinafter referred to as the "Act") deals with the powers and duties of the auditors of companies. Section 143(1) of the Act requires the auditor to make certain specific enquiries during the course of the audit. Section 143(2) of the Act requires the auditor to, *inter alia*, give his report to the members of company on the accounts examined by him, and on every financial statement which are laid before the company in a general meeting. Sub-section (3) of section 143 of the Act also lays down certain matters required to be reported upon by the auditor in his report. Sub-section (3) of section 143 of Act provides as follows:

"(3) The auditor's report shall also state -

(a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

(b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(c) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

(d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

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(e) whether, in his opinion, the financial statements comply with the accounting standards;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

(j) such other matters as may be prescribed.[1]

Scope of the Guidance Note

2. This Guidance Note is intended to assist the auditors in discharging their duties in respect of clauses (f) and (h) of sub-section (3) of section 143 of the Act. Clause (f) of the said sub-section creates a requirement for the auditor to consider observations or comments of the auditor on financial transactions or matters which have an adverse effect on the functioning of the company. Such observations or comments would ordinarily lead to the modification of or an emphasis of matter in the auditor's report on financial statements. It may be noted that the matters that lead to modification in the auditor's report on financial statements are matters that give rise to a qualified opinion, adverse opinion or a disclaimer of opinion[2]. Further, matters that lead to an emphasis of matter paragraphs are matters appropriately presented or disclosed in the financial statements that, in the auditor's judgement, are of such importance that they are fundamental to the users' understanding of the financial statements[3]. If the matter leading to the modification of the auditor's opinion or an emphasis of matter in the auditor's report on financial statements is likely to have an adverse effect on the functioning of the company, the auditor is required to report such matter. Under clause (h) of sub-section (3) of section 143 of the Act, the auditor is required to state whether any matter leading to a qualification, reservation or adverse remark, that is, effectively the modification of the auditor's report on financial statements, relates to the maintenance of accounts and other matters connected therewith.

[1] Refer Rule 11 of Companies (Audit and Auditors) Rules, 2014.

[2] Reference may be made to Standard on Auditing (SA) 705, "Modifications to the Opinion in the Independent Auditor's Report."

[3] Reference may be made to paragraphs 6 and 7 of Standard on Auditing (SA) 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report."

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Reporting under Section 143(3)(f) of the Act

3. The relevant extracts of section 143(3)(f) of the Act are reproduced below:

   "(3). *The auditor's report shall also state –*

   ………………………………….

   (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;"

4. Clause (f) requires the auditor to report "the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company". An auditor's report may contain matters leading to modifications to the auditor's opinion or emphasis of matter in the auditor's report on the financial statements. Such matters may be related to issues which may have an adverse effect on the functioning of the company. The words "observations" or "comments" as appearing in clause (f) of section 143(3) are construed to have the same meaning as referring to "emphasis of matter paragraphs, situations leading to modification in the auditor's report. Accordingly, the auditor should have made an "observation" or "comment" in the auditor's report in order to determine the need to report under clause (f) of section 143(3). Therefore, only such "observations" or "comments" of the auditors on financial transactions or matters that have been made by the auditor in the auditor's report which have an adverse effect on the functioning of the company are required to be reported under this clause. For the sake of clarity, it may be noted that neither the auditor's observations nor the comments made by him have any adverse effect on the functioning of a company. These observations or comments made by the auditor might contain matters which might have an adverse effect on the functioning of a company.

5. The Act does not specify the meaning of the phrase 'adverse effect on the functioning of the company'. The expression should not be interpreted to mean that any event affecting the functioning of the company, observed by the auditor, should be reported upon even though it does not affect the financial statements, e.g., revocation of a license to manufacture one out of the many products during the year to which the financial statements relate, where such product that does not have any material contribution to the revenues of the company, etc. Such an interpretation would not only be beyond the scope of the audit of financial statements of the company but would also not be in accordance with the objective and concept of audit stipulated under the Act. A more logical and harmonious interpretation is that this reporting requirement does not intend to change the basic objective and the concept of audit of financial statements of a company, which is to examine the financial statements with a view to express an opinion thereon.

6. The scope of the audit and auditor's role remains as contemplated under the Standards on Auditing (SAs) and other relevant pronouncements issued by the Institute of Chartered Accountants of India as well as laid down in the Act, i.e., to

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lend credibility to the financial statements by reporting whether they reflect a true and fair view. SA 200, *Objective of the Independent Auditor and the Conduct of an Audit in Accordance with Standards of Auditing*, specifies that the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form the opinion of the true and fair view of the financial position and operating result of an enterprise. The auditor's opinion, therefore, does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. SAs require auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. At this juncture, it may also be noted that SA 200 also clearly states that the concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.

7. There is no change in the objective and scope of an audit of financial statements because of inclusion of clause (f) in sub-section (3) of section 143 of the Act. The auditor expresses his opinion on the true and fair view presented by the financial statements through his report which may be modified in certain circumstances. However, the auditor would now have to evaluate the subject matters leading to modification of the audit report or emphasis of matter in the auditor's report to make judgement as to which of them has an adverse effect on the functioning of the company within the overall context of audit of financial statements of the company. Only such matters which, in the opinion of the auditor, have an adverse effect on the functioning of the company should be reported under this clause. Conversely, such qualifications or adverse opinions or disclaimer of opinion or emphasis of matters of the auditor, which do not deal with matters that have adverse effect on the functioning of the company, need not be reported under this clause.

8. As far as inquiries under section 143(1) are concerned, the auditor is not required to report on these matters unless he has any comments to make on any of the items referred to therein. If the auditor has any comments or observations on any of the matters stated in section 143(1), the auditor should consider such comments or

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observations when reporting under this clause if they contain matters that may have any adverse effect on the functioning of the company.

9. Auditor's will need to apply professional judgement in considering matters of emphasis that may have an adverse effect on the functioning of the company. Ordinarily matters that are pervasive in nature such as going concern or matters that will significantly impact the operations of the company due to its size and nature will need to be reported under clause (f) of sub-section (3) of section 143 of the Act. Examples of emphasis of matter which may have an adverse effect on the functioning of the company include situations where:

   - the going concern assumption is appropriate but there are several factors leading to a material uncertainty that may cast a significant doubt about the Company's ability to continue as a going concern; or
   - a material uncertainty regarding the outcome of a litigation wherein an unfavourable decision could result in a significant outflow of resources for the company, etc.

   Examples of emphasis of matter which may not have an adverse effect on the functioning of the company include a situation where there is an emphasis of matter:

   - on managerial remuneration which is subject to the approval of the Central Government;
   - relating to accrual of a contractually receivable claim based on management estimate where the ultimate realisation could be different from the amount accrued;
   - on frauds that have been dealt with in the financial statements of the company and would not have any continuing effect on the financial statements.

10. Another issue which arises is whether any observations or comments made by the auditor under clause (i) of section 143(3) in respect of the company's internal financial controls over financial reporting, which may have any adverse effect on the functioning of the company, should also be reported in terms of this clause. In this regard, it is noted that reporting under section 143(3)(i) is part of the auditor's report though it may be reported in an annexure to the auditor's report. Accordingly, if any observations or comments made by the auditor on the adequacy or operating effectiveness of internal financial controls over financial reporting contain such matters, which, in his opinion, may have any adverse effect on the functioning of the company, should also be reported under clause (f) of section 143(3) even if such observation did not result in a modification to the audit opinion on the financial statements of the company. An example in this regard may be where an auditor reports that the company did not have an appropriate internal control system for inventory with regard to receipts, issue for production and physical verification.

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Reporting under Section 143(3)(h) of the Act

11. The relevant extracts of section 143(3)(h) of the Act are reproduced below:

    "(3). *The auditor's report shall also state –*

    ……………………………………

    (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;"

12. Clause (h) requires the auditor to report "any qualification, reservation or adverse remark" relating to the maintenance of accounts and other matters connected therewith. An auditor's report may contain matters leading to modifications in the auditor's report on financial statements. The matters that cause such modification may have a consequential effects or possible effects on the books of account maintained by the company and other matters connected therewith.

13. Section 128 of the Act, *inter alia*, states that every company shall prepare and keep its books of account and other relevant books and papers and financial statements that give a true and fair view of the state of affairs of the company. Section 129(1) of the Act, *inter alia*, states that the financial statements shall comply with the accounting standards notified under section 133 of the Act. Section 2(13) of the Act defines "books of account" to include records maintained in respect of—

    (i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;

    (ii) all sales and purchases of goods and services by the company;

    (iii) the assets and liabilities of the company; and

    (iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section;

    Clause (b) of section 143(3) requires the auditor to, *inter alia,* state whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books.

14. Matters to be reported under clause (h) of section 143(3) needs to be evaluated based on the financial statements prepared under the Act. This is also consistent with the other reporting responsibilities of the auditor on books of account and compliance with notified/specified accounting standards that are reported by him under section 143(3). Accordingly, reporting under this clause is determined based on the financial statements prepared i.e., as at the balance sheet date.

15. The words "qualification", "adverse remark" and "reservation" used in clause (h) of section 143(3) should be considered to be similar to the terms "qualified opinion", "adverse opinion" and "disclaimer of opinion", respectively, referred to in SA 705 "Modifications to the Opinion in the Independent Auditor's Report".

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16. Accordingly, the auditor would need to report under clause (h) of section 143(3) any matter that causes a qualification, adverse remark or disclaimer of opinion on the financial statements since such matters will or possibly will have an effect on the books of account maintained by the company.
17. Further, reporting under clause (h) of section 143(3) will be required if the auditor makes any observation under clause (b) of section 143(3) relating to whether proper books of account as required by law have been kept by the company. For example, the auditor may have made an observation on maintenance of cost records under clause (b) of section 143(3) and this may not have had an effect on the financial statements of the company or the auditor's opinion on the financial statements.
18. As a corollary, reporting under clause (h) of section 143(3) will not be required if there are no modifications, i.e., no qualified, adverse or disclaimer of opinion, and there are no such observations under clause (b) of section 143(3) regarding books of account kept by the company.
19. Since clause (h) of section 143(3) requires the auditor to report under this clause only if the auditor has "any qualification, reservation or adverse remark", it is appropriate to conclude that a matter reported under emphasis of matter paragraph in the audit report need not be considered for reporting under this clause as an emphasis of matter is not in the nature of a qualification, reservation (disclaimer) or adverse remark.
20. Any material weakness in internal financial controls that is reported by the auditor under clause (i) of section 143(3) may not have an impact on the maintenance of books of account if such material weakness did not result in a modification to the opinion on the financial statements of the company. However, if the material weakness in internal financial controls resulted in a modification to the audit opinion on the financial statements, then such modification may be covered for reporting under clause (h) of section 143(3) as stated in paragraph 17 above.
21. The Appendix to this Guidance Note contains illustrations on matters that may give rise to reporting under section 143(3)(f) and/or section 143(3)(h) of the Companies Act, 2013.

APPENDIX

Illustrative Matters Forming Basis For Modified Opinion Or Emphasis Of Matter Paragraph in the Auditor's Report and Requiring Reporting Under Section 143(3)(f) and/or Section 143(3)(h) of the Companies Act, 2013

ILLUSTRATION 1

Basis for Qualified Opinion

The Company's inventories are carried in the Balance Sheet at ₹ XXX (*As at 31st March 20YY: ₹ YYY*). The Management has not stated the inventories at the lower of

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cost and net realisable value but has stated them solely at cost, which constitutes a departure from the Accounting Standard - 2 "Valuation of Inventories". The Company's records indicate that had the Management stated the inventories at the lower of cost and net realisable value, an amount of ₹ XXX (*As at 31st March 20YY: ₹ YYY*) would have been required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by ₹ XXX (*Previous year ended 31st March, 20YY: ₹ YYY*), and income tax, profit for the year and shareholders' funds would have been reduced by ₹ X, ₹ XX and ₹ XXX, respectively (*Previous year ended 31st March, 20YY: ₹ Y, ₹ YY and ₹ YYY, respectively*). This matter was also qualified in our report/ the report of the predecessor auditors on the financial statements for the year ended 31st March 20YY.[4]

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion paragraph above, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at 31st March, 20XX, and its profit/loss and its cash flows for the year ended on that date.

……………………..

……………………….

Report on Other Legal and Regulatory Requirements

As required by Section 143 (3) of the Act, we report that:

(a) We have sought and obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit;

....

……………………………………………….

(f) The matter described in the Basis for Qualified Opinion paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

……………………………

……………………………

(h) The qualification relating to the maintenance of accounts and other matters connected therewith are as stated in the Basis for Qualified Opinion paragraph above."

[4] Where applicable and only in such case, disclosure of previous year figures is required - Attention of the readers is drawn to the provisions of Standard on Auditing (SA) 710, *Comparative Information—Corresponding Figures And Comparative Financial Statements* .

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ILLUSTRATION 2[#]

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at 31st March, 20XX, and its profit/loss and its cash flows for the year ended on that date.

Emphasis of Matters

We draw attention to the following matters in the Notes to the financial statements:

(a) Note X to the financial statements which, describes the uncertainty related to the outcome of the lawsuit filed against the Company by XYZ Company.

(b) Note Y in the financial statements which indicates that the Company has accumulated losses and its net worth has been fully / substantially eroded, the Company has incurred a net loss/net cash loss during the current and previous year(s) and, the Company's current liabilities exceeded its current assets as at the balance sheet date. These conditions, along with other matters set forth in Note Y, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern. However, the financial statements of the Company have been prepared on a going concern basis for the reasons stated in the said Note.

Our opinion is not modified in respect of these matters.

……………

Report on Other Legal and Regulatory Requirements

As required by Section 143 (3) of the Act, we report that:

………

(f) The going concern matter described in sub-paragraph (b) under the Emphasis of Matters paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

ILLUSTRATION 3

Basis for Qualified Opinion

ABC Company Limited's investment in XYZ Company, a foreign associate whose net worth has been fully/substantially eroded, is carried at ₹ XXX in the Balance Sheet as at March 31, 20XX. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Company Limited's investment in XYZ Company as at

[#] In this case there is nothing reportable under sec 143(3)(h).

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March 31, 20XX because we were denied access to the financial information, management, and the auditors of XYZ Company. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the possible effects[5] of the matter described in the Basis for Qualified Opinion paragraph, the aforesaid standalone financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India of the state of affairs of the Company as at 31st March 20XX, and its profit/loss and its cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

As required by section 143 (3) of the Act, we report that:

……………………………….

………………………………..

(f) The matter described in the Basis for Qualified Opinion paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

……………………..

(h) The qualification relating to the maintenance of accounts and other matters connected therewith are as stated in the Basis for Qualified Opinion paragraph above.

ILLUSTRATION 4

Basis for Adverse Opinion

The Company's financing arrangements expired and the amount outstanding was payable on March 31, 20XX. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and, therefore, it may be unable to realise its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact.

Adverse Opinion

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion paragraph, the financial statements do not give the information required by the Companies Act, 2013 in the manner so required and also do not give a true and fair view in conformity with the accounting principles generally accepted in India of the

[5] Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

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state of affairs of the Company as at 31st March, 20XX, and its profit/loss and its cash flows for the year ended on that date.

………………………...

Report on Other Legal and Regulatory Requirements

As required by section 143 (3) of the Act, we report that:

………………….

(f) The matter described in the Basis for Adverse Opinion paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

………………

(h) The adverse remarks relating to the maintenance of accounts and other matters connected therewith are as stated in the Basis for Adverse Opinion paragraph above.

ILLUSTRATION 5

Basis for Disclaimer of Opinion

We were appointed as auditors of the Company after March 31, 20X1 and thus could not observe the counting of physical inventories at the beginning and end of the year. Accordingly, we were unable to satisfy ourselves by alternative means concerning the inventory quantities held at March 31, 20X0 and March 31, 20X1 which are stated in the Balance Sheet at ₹ XXX and ₹ XXX, respectively.

In addition, the introduction of a new computerised accounts receivable system in September 20X0 resulted in numerous errors in accounts receivable. As of the date of our audit report, Management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of ₹ XXX as at March 31, 20X1.

As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable in the Balance Sheet, and the corresponding elements making up the Statement of Profit and Loss and Cash Flow Statement.

Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements.

Report on Other Legal and Regulatory Requirements

As required by section 143 (3) of the Act, we report that:

…………………………

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……………………………..

(f) The matter described in the Basis for Disclaimer of Opinion paragraph above, in our opinion, may have an adverse effect on the functioning of the Company.

………………………

(h) The reservation relating to the maintenance of accounts and other matters connected therewith are as stated in the Basis for Disclaimer of Opinion paragraph above.

3. **Insurance Laws (Amendment) Act, 2015:** The Ministry of Law and Justice has amended the Insurance Act, 1938, the General Insurance Business (Nationalisation) Act, 1972 and the Insurance Regulatory and Development Authority Act, 1999 through the Insurance Laws (Amendment) Act, 2015 dated 20th March, 2015.

(i) According to section 2(9) of the Insurance Act, 1938, **'Insurer'** means-

(a) an Indian Insurance Company, or

(b) a statutory body established by an Act of Parliament to carry on insurance business, or

(c) an insurance co-operative society, or

(d) a foreign company engaged in re-insurance business through a branch established in India.

It may be noted that a "foreign company" shall mean a company or body established or incorporated under a law of any country outside India and includes Lloyd's established under the Lloyd's Act, 1871 (United Kingdom) or any of its Members.

(ii) According to section 2(7A) of the Insurance Act, 1938, **'Indian insurance company'** means any insurer, being a company which is limited by shares, and,-

(a) which is formed and registered under the Companies Act, 2013 as a public company or is converted into such a company within one year of the commencement of the Insurance Laws (Amendment) Act, 2015.

(b) in which the aggregate holdings of equity shares by foreign investors, including portfolio investors, does not exceed 49% of the paid up equity capital of such Indian Insurance company, which is Indian owned and controlled, in such manner as may be prescribed.

Here, the expression 'control' shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.

(c) whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business or health insurance business.

(iii) **Requirements as to the Minimum Paid-up Capital-** The minimum paid-up equity share capital of an Indian insurance company carrying on general insurance

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business should be ₹ 100 crores excluding preliminary expenses incurred in the formation and registration of company. The insurer may enhance the same in accordance with the provisions of the Companies Act, 2013, SEBI Act, 1992 and the rules, regulations or directions issued thereunder or any other law for the time being in force.

(iv) **Form and Contents of Financial Statements-** Section 11 of the Insurance Act, 1938 provides that every insurer, on or after the date of the commencement of the Insurance Laws (Amendment) Act, 2015, in respect of insurance business transacted by him and in respect of his shareholders' funds, shall, at the expiration of each financial year, prepare with reference to that year, balance sheet, a profit and loss account, a separate account of receipts and payments, a revenue account in accordance with the regulations as may be specified.

(v) **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. Many policies normally extend beyond this date into the following year during which risks continue. In other words, at the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year end.

As per section 64V of the Insurance Act, 1938 as amended by Insurance Laws (Amendment) Act, 2015, for the purpose of compliance with the provisions of maintaining control level of solvency margin, a proper value of every item of liability of the insurer shall be placed in the manner as may be specified by the regulations made in this behalf.

(vi) **Solvency Margin-** Section 64VA of the Insurance Act, 1938 as amended by Insurance Laws (Amendment) Act, 2015 requires every insurer and re-insurer to maintain an excess of the value of assets over the amount of liabilities at all times which shall not be less than 50% of the amount of minimum capital as stated under section 6 (requirement as to capital) of the Act and arrived at in the manner specified by the regulations.

The Authority, by way of regulation, shall specify a level of solvency margin known as ‘control level of solvency’. However, in certain special circumstances, the authority may direct application of this provision with some modifications provided this shall not result in the control level of solvency being less than what is stipulated in above para.

If, at any time, an insurer or re-insurer does not maintain the required control level of solvency margin, he is required to submit a financial plan to the Authority indicating the plan of action to correct the deficiency. If, on consideration of the plan, the Authority finds it inadequate, the insurer has to modify the financial plan.

Maintenance of solvency margin has a great importance for an insurance company considering their size and nature of business and also involvement of public money.

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Sub-section (2) of section 64VA states that if an insurer or re-insurer fails to comply with the prescribed requirement of maintaining excess of value of assets over amount of liabilities, it shall deemed to be insolvent and may be wound up by the Court on an application made by the authority.

4. **Income Computation and Disclosure Standards (ICDS):** Section 145 of the Income Tax Act, 1961 deals with the method of accounting.

Under section 145(1), income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee.

Section 145(2) empowers the Central Government to notify in the Official Gazette from time to time, income computation and disclosure standards to be followed by any class of assessees or in respect of any class of income.

Accordingly, the Central Government has, in exercise of the powers conferred under section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by all assessees, following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or " Income from other sources". This notification shall come into force with effect from 1st April, 2015, and shall accordingly apply to the Assessment Year 2016-17 and subsequent assessment years.

All the notified ICDSs are applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts. In the case of conflict between the provisions of the Income-tax Act, 1961 and the notified ICDSs, the provisions of the Act shall prevail to that extent.

The Central Government has prescribed 10 Income Computation and Disclosure Standards (ICDSs) as under:

A. ICDS I relating to Accounting Policies.

B. ICDS II relating to Valuation of Inventories.

C. ICDS III relating to Construction Contracts.

D. ICDS IV relating to Revenue Recognition.

E. ICDS V relating to Tangible Fixed Assets.

F. ICDS VI relating to the Effects of Changes in Foreign Exchange Rates.

G. ICDS VII relating to Government Grants.

H. ICDS VIII relating to Securities.

I. ICDS IX relating to Borrowing Costs.

J. ICDS X relating to Provisions, Contingent Liabilities and Contingent Assets.

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The above ICDSs are to be followed by all assessee following mercantile system of accounting. Therefore, it is clear that those assessees who are following cash system of accounting need not follow the ICDSs notified above.

5. **Reporting under Companies (Auditor's Report) Order, 2015 [CARO, 2015]:** The Central Government, after consultation with the Institute of Chartered Accountants of India, has issued the Companies (Auditor's Report) Order, 2015, (CARO, 2015) under section 143(11) of the Companies Act, 2013, dated 10th April, 2015. The requirements of the Order are supplemental to the existing provisions of section 143 of the Act regarding the auditor's report.

The Order is not intended to limit the duties and responsibilities of auditors but only requires a statement to be included in the audit report in respect of the matters specified therein. For example, examination of the system of internal control is one of the basic audit procedures employed by the auditor. The fact that the Order requires a statement regarding the internal control system applicable to purchases of inventory and fixed assets, and sale of goods and services only is no justification for the auditor to conclude that an examination of internal control regarding the other areas of a company's business is not important or not required.

Applicability of the Order: The CARO, 2015 is an additional reporting requirement Order. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2O13.

However, the Order specifically **exempts** the following class of companies-

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;

(ii) an insurance company as defined under the Insurance Act,1938;

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act;

(v) a small company as defined under clause (85) of section 2 of the Companies Act; and

(vi) a private limited company with a paid up capital and reserves not more than ₹ 50 lakh and which does not have loan outstanding exceeding ₹ 25 lakh from any bank or financial institution and does not have a turnover exceeding ₹ 5 crore at any point of time during the financial year.

Matters to be included in the Auditor's Report: Paragraph 3 of the Order requires the auditor to include a statement in the auditor's report on the following matters, namely-

(i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

(b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on

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such verification and if so, whether the same have been properly dealt with in the books of account.

(ii) (a) whether physical verification of inventory has been conducted at reasonable intervals by the management;

(b) are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;

(c) whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account.

(iii) whether the company has granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 189 of the Companies Act. If so,

(a) whether receipt of the principal amount and interest are also regular; and

(b) if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest.

(iv) is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system.

(v) in case the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules framed there under, where applicable, have been complied with? If not, the nature of contraventions should be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

(vi) where maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act, whether such accounts and records have been made and maintained.

(vii) (a) is the company regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, wealth tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

(b) in case dues of income tax or sales tax or wealth tax or service tax or duty of customs or duty of excise or value added tax or cess have not been deposited

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on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not constitute a dispute).

(c) whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956 and rules made thereunder has been transferred to such fund within time.

(viii) whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year.

(ix) whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported.

(x) whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company.

(xi) whether term loans were applied for the purpose for which the loans were obtained.

(xii) whether any fraud on or by the company has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.

Reasons to be Stated for Unfavourable or Qualified Answers: Where the answer to any of the questions referred to in paragraph 3 of the Order is unfavourable or qualified, in the auditor's report, the auditor shall also state the reasons for such unfavourable or qualified answer, as the case may be.

Further, where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

Consequential Amendment to the Format of the Auditor's Report of a Company: The Auditing and Assurance Standards Board has issued illustrative formats of the auditor's report on financial statements of a company under the Companies Act, 2013. While reporting on the requirements of CARO, 2015, a reference thereto also needs be added in the main audit report under the "Report on Legal and Other Regulatory Matters" paragraph as follows:

"Report on Other Legal and Regulatory Requirements

As required by the Companies (Auditor's Report) Order, 2015 ("the Order"), issued by the Central Government of India in terms of sub-section (11) of section 143 of the Companies Act, 2013, we give in the Annexure a statement on the matters specified in paragraphs 3 and 4 of the Order, to the extent applicable.

As required by Section 143(3) of the Act, we report that:

……………………….

………………………."

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6. <u>Companies (Cost Records and Audit) Rules, 2014:</u> The Central Government has amended the Companies (Cost Records and Audit) Rules, 2014 dated 31st December, 2014 which prescribes the classes of companies required to include cost records in their books of account, applicability of cost audit, maintenance of records etc.

   Maintenance of Cost Records: Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of ₹ 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of section 2 of the Act, but exclude a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006.

   The said rule has divided the list of companies into regulated sectors and non-regulated sectors. Some of the companies/industry/sector/product/service prescribed under the said rule are given below:

   (A) Regulated Sectors-

   (i) Telecommunication services made available to users by means of any transmission or reception of signs, signals, images etc. (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India.

   (ii) Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003, other than for captive generation.

   (iii) Petroleum products regulated by the Petroleum and Natural Gas Regulatory Board.

   (iv) Drugs and Pharmaceutical.

   (v) Fertilisers.

   (vi) Sugar and industrial alcohol.

   (B) Non-Regulated Sectors-

   (i) Machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items.

   (ii) Turbo jets and turbo propellers.

   (iii) Tyres and Tubes.

   (iv) Steel.

   (v) Cement.

   (vi) Production, import and supply or trading of following medical devices, such as heart valves; orthopaedic implants; pacemaker (temporary and permanent), etc. The rule excludes the foreign companies having only liaison offices.

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As per Rule 5 of the Companies (Cost Records and Audit) Rules, 2014, every company under these rules including all units and branches thereof, shall, in respect of each of its financial year, is required 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.

Additionally, as per clause (vi) to Paragraph 3 of the CARO, 2015, where maintenance of cost records has been specified by the Government under section 148(1) of the Companies Act, 2013, the auditor has to report whether such accounts and records have been made and maintained.

Applicability of Cost Audit: Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 states the provisions related to the applicability of cost audit depending on the turnover of the company as follows-

(i) Classes of companies specified under item (A) "Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 50 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 25 crore or more.

(ii) Classes of companies specified under item (B) "Non-Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 100 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 35 crore or more.

Casual Vacancy in the Office of a Cost Auditor: Any casual vacancy in the office of a Cost Auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within 30 days of occurrence of such vacancy and the company shall inform the central government in Form CRA-2 within 30 days of such appointment of cost auditor.

7. **General Features of Cost Records:** The following general features of the cost records to be maintained in the books of accounts as per Form CRA-1 pursuant to rule 5(1) of the Companies (Cost Records and Audit) Rules, 2014 have been amended by the Central Government *vide* notification dated 31st December, 2014-

(i) Material Costs- Proper records shall be maintained showing separately all receipts, issues and balances both in quantities and cost of each item of raw material required for the production of goods or rendering of services under reference.

The material receipt shall be valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited by the taxing authorities) that can be quantified with reasonable accuracy at the time of acquisition. Finance costs incurred in connection with the acquisition of Material shall not form part of material cost.

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Spares which are specific to an item of equipment shall not be taken to inventory, but shall be capitalized with the cost of the specific equipment. Cost of capital spares or insurance spares, whether procured with the equipment or subsequently, shall be amortised over a period, not exceeding the useful life of the equipment.

Normal loss or spoilage of material prior to reaching the factory or at places where the services are provided shall be absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal. Where materials are accounted at standard cost, the price variances related to materials shall be treated as part of material cost.

The material cost of normal scrap or defectives which are rejects shall be included in the material cost of goods manufactured. The material cost of actual scrap or defectives, not exceeding the normal shall be adjusted in the material cost of good production. Material Cost of abnormal scrap or objectives shall not be included in material cost but treated as loss after giving credit to the realisable value of such scrap or defectives.

Material costs shall be directly traced to a cost object to the extent it is economically feasible or shall be assigned to the cost object on the basis of material quantity consumed or similar identifiable measure and valued as per above principles. Where the material costs are not directly traceable to the cost object, the same shall be assigned on a suitable basis like technical estimates.

Where a material is processed or part manufactured by a third party according to specifications provided by the buyer, the processing or manufacturing charges payable to the third party shall be treated as part of the material cost.

(ii) Employee Cost- Proper records shall be maintained in respect of employee costs in whole such a manner as to enable the company to book these expenses cost centre wise or department wise with reference to goods or services under reference and to furnish necessary particulars. Where the employees work in such a manner that it is not possible to identify them with any specific cost centre or service centre or department, the employees cost shall be apportioned to the cost centre or service centres or departments on equitable and reasonable basis and applied consistently.

Employee cost shall be ascertained taking into account the gross pay including all allowances payable along with the cost to the employer of all the benefits.

Bonus whether payable as a statutory minimum or on a sharing of surplus shall be treated as part of employee cost. Ex-gratia payable in lieu of or in addition to bonus shall also be treated as part of the employee cost.

Remuneration payable to Managerial Personnel including Executive Directors on the Board and other officers of a corporate body under a statute shall be considered as part of the employee cost of the year under reference whether the whole or part of the remuneration is computed as a percentage of profits. Remuneration paid to non-executive directors shall not form part of employee cost but shall form part of administrative overheads.

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Where employee cost is accounted at standard cost, variances due to normal reasons related to employee cost shall be treated as part of employee cost. Variances due to abnormal reasons shall be treated as part of abnormal cost.

Any recovery from the employee towards any benefit provided, namely, housing shall be reduced from the employee cost. Any change in the cost accounting principles applied for the determination of the employee cost shall be made only if it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an enterprise.

Where the employee services are traceable to a cost object, such employees' cost shall be assigned to the cost object on the basis such as time consumed or number of employees engaged or other related basis or similar identifiable measure. While determining whether a particular employee cost is chargeable to a separate cost object, the principle of materiality shall be adhered to.

Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime. Idle time cost shall be assigned direct to the cost object or treated as overheads depending on the economic feasibility and the specific circumstances causing such idle time.

(iii) Utilities- Proper records shall be maintained showing the quantity and cost of each major utility such as power, water, steam, effluent treatment and other related utilities produced and consumed by the different cost centres in such detail as to have particulars for each utility separately.

Cost of utilities purchased shall be measured at cost of purchase including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified with reasonable accuracy at the time of acquisition.

Cost of self-generated utilities for own consumption shall comprise direct material cost, direct employee cost, direct expenses and factory overheads. In case of utilities generated for the purpose of inter unit transfers, the distribution cost incurred for such transfers shall be added to the cost of utilities determined as above. Cost of utilities generated for the intercompany transfers shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost and share of administrative overheads.

Where cost of utilities is accounted at standard cost, the price variances related to utilities shall be treated as part of cost of utilities and the portion of usage variances due to normal reasons shall be treated as part of cost of utilities. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.

Any subsidy or grant or incentive or any such payment received or receivable with respect to any cost of utilities shall be reduced for ascertainment of the cost to which such amounts are related.

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(iv) Direct Expenses- Proper records shall be maintained in respect of direct expenses in such a manner as to enable the company to book these expenses cost centre wise or cost object or department wise with reference to goods or services under reference and to furnish necessary particulars.

Direct expenses incurred for the use of bought out resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited. Other direct expenses shall be determined on the basis of amount incurred on connection therewith.

(v) Repairs and Maintenance- Proper records showing the expenditure incurred by the workshop, tool room and on repairs and maintenance in the various cost centres or departments shall be maintained under different heads.

Repairs and maintenance cost shall be the aggregate of direct and indirect cost relating to repairs and maintenance activity. Direct cost shall include the cost of materials, consumable stores, spares, manpower, equipment usage, utilities and other Identifiable resources consumed in such activity. Indirect cost shall include the cost of resources common to various repairs and maintenance activities such as manpower, equipment usage and other costs allocable to such activities.

Cost of in-house repairs and maintenance activity shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such activity.

Cost of repairs and maintenance activity carried out by outside contractors inside the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other costs incurred by the entity for such jobs.

Each type of repairs and maintenance shall be treated as a distinct activity, in material and identifiable. Cost of repairs and maintenance activity shall be measured for each major asset category separately.

Cost of spares replaced which do not enhance the future economic benefits from the existing asset beyond its previously assessed standard of performance shall be included under repairs and maintenance cost.

Where the repairs and maintenance cost is not directly traceable to cost object, it shall be assigned based on either of the following the principles of (1) Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost and (2) Benefits received - overheads are to be apportioned to the various cost objects in proportion to the benefits received by them. If the repairs and maintenance cost (including the share of the cost of reciprocal exchange of services) is shared by several cost objects, the related cost shall be measured as an aggregate and distributed among the cost objects.

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(vi) Fixed Assets and depreciation- Proper and adequate records shall be maintained for assets used for production of goods or rendering of services under reference n respect of which depreciation has to be provided for. These records shall, *inter-alia*, indicate grouping of assets under each good or service, the cost of acquisition of each item of asset including installation charges, date of acquisition and rate of depreciation.

The minimum amount of depreciation to be provided shall not be less than the amount calculated as per principles and methods as prescribed by any law or regulations applicable to the entity and followed by it.

Spares purchased specifically for a particular asset, or class of assets, and which would become redundant if that asset or class of asset was retired or use of that asset was discontinued, shall form part of that asset. The depreciable amount of such spares shall be allocated over the useful life of the asset.

Cost of small assets shall be written off in the period in which they were purchased as per the accounting policy of the entity.

(vii) Overheads- Overheads representing procurement of resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discounts), taxes and duties refundable or to be credited.

Overheads other than those referred to above shall be determined on the basis of cost incurred in connection therewith. Any abnormal cost where it is material and quantifiable shall not form part of the overheads.

Finance costs incurred in connection with procured or self-generated resources shall not form part of overheads. Marketing overheads that can be identified to a product or service shall be assigned to that product or service.

(viii) Administrative Overheads- Administrative overheads shall be the aggregate of cost of resources consumed in activities relating to general management and administration of an organisation.

In case of leased assets, if the lease is an operating lease, the entire rentals shall be included in the administrative overheads. If the lease is a financial lease, the finance cost portion shall be segregated and treated as part of finance costs.

The cost of software (developed in house, purchased, licensed or customised), including up-gradation cost shall be amortised over its estimated useful life.

The cost of administrative services procured from outside shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited.

Any subsidy or grant or incentive or any amount of similar nature received or receivable with respect to any administrative overheads shall be reduced for ascertainment of the cost of the cost object to which such amounts are related. Administrative overheads shall not include any abnormal administrative cost.

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Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the administrative overheads.

(ix) Transportation Cost- Proper records shall be maintained for recording the actual cost of transportation showing each element of cost such as freight, cartage, transit insurance and others after adjustment for recovery or transportation cost. Abnormal costs relating to transportation, if any, are to be identified and recorded for exclusion of computation of average transportation cost.

In case of a manufacturer having his own transport fleet, proper records shall be maintained to determine the actual operating cost of vehicles showing details of various elements of cost, such as salaries and wages of driver, cleaners and others, cost of fuel, lubricant grease, amortized cost of tyres and battery, repairs and maintenance, depreciation of the vehicles, distance covered and trips made, goods hauled and transported to the depot.

In case of hired transport charges incurred for despatch of goods, complete details shall be recorded as to date of despatch, type of transport used, description of the goods, destination of buyer, name of consignee, challan number, quantity of goods in terms of weight or volume, distance involved, amount paid and other related details.

(x) Royalty and Technical Know-how- Adequate records shall be maintained showing royalty or technical know-how fee including other recurring or non-recurring payments of similar nature, if any, made for the goods or services under reference to collaborators or technology suppliers in terms of agreements entered into with them.

Royalty and technical know-how fee paid or incurred in lump-sum or which are in the nature of 'one-time' payment, shall be amortised on the basis of the estimated output or benefit to be derived from the related asset. Amortisation of the amount of royalty or technical know-how fee paid for which the benefit is ensued in the current or future periods shall be determined based on the production or service volumes estimated for the period over which the asset is expected to benefit the entity.

Amount of the royalty and technical know-how fee shall not include finance costs and imputed costs. Any subsidy or grant or incentive or any such payment received or receivable with respect to amount of royalty and technical know-how fee shall be reduced to measure the amount of royalty and technical know-how fee.

(xi) Research and Development Expenses- Research and development costs shall include all the costs that are directly traceable to research or development activities or that can be assigned to research and development activities strictly on the basis of (a) cause and effect or (b) benefits received.

(xii) Quality control expenses- Adequate records shall be maintained to indicate the expenses incurred in respect of quality control department or cost centre or service centre for goods or services under reference. Where these services are also utilized for other goods or services of the company, the basis of apportionment to goods or services under reference and to other goods or services shall be on equitable and reasonable basis and applied consistently.

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(xiii) Pollution control expenses- Adequate records shall be maintained to indicate the expenses incurred in respect of pollution control. The basis of apportionment to goods or services under reference and to other goods or services shall be on equitable and reasonable basis and applied consistently.

Pollution control costs shall be the aggregate of direct and indirect cost relating to pollution control activity. Direct cost shall include the cost of materials, consumable stores, spares, manpower, equipment usage, utilities, resources for testing and certification and other identifiable resources consumed in activities such as waste processing, disposal, remediation and others. Indirect cost shall include the cost of resources common to various pollution control activities such as pollution control registration and such like expenses.

(xiv) Service department expenses- Proper records shall be maintained in respect of service departments, that is, cost centres which primarily provide auxiliary services across the enterprise, to indicate expenses incurred in respect of each such service cost centre like engineering, work shop, designing, laboratory, safety, transport, computer cell, welfare and other related centres.

Each identifiable service cost centre shall be treated as a distinct cost object for measurement of the cost of services subject to the principle of materiality.

Cost of service cost centre shall be the aggregate of direct and indirect cost attributable to services being rendered by such cost centre. Cost of in-house services shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such service. Cost of other resources shall include related overheads. Cost of services rendered by contractors within the facilities of the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources provided to the contractors for such services.

(xv) Packing expenses- Proper records shall be maintained separately for domestic and export packing showing the quantity and cost of various packing materials and other expenses incurred on primary or secondary packing indicating the basis of valuation.

The packing material receipts shall be valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified at the time of acquisition.

Finance costs directly incurred in connection with the acquisition of packing material shall not form part of packing material cost.

Self manufactured packing materials shall be valued including direct material cost, direct employee cost, direct expenses, job charges, factory overheads including share of administrative overheads comprising factory management and administration and share of research and development cost incurred for development and improvement of existing process or product.

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(xvi) Interest and financing charges- Interest and financing charges are costs incurred by an enterprise in connection with the borrowing of fund or other costs which in effect represent payment for the use of non-equity fund.

Interest and financing charges incurred shall be identified for-

(I) acquisition or construction or production of qualifying assets including fixed assets; and

(II) other finance costs for production of goods or operations or services rendered which cannot be classified as qualifying assets.

Interest and financing charges directly attributable to the acquisition or construction or production of a qualifying asset shall be included in the cost of the asset. The charges shall not include imputed costs.

Subsidy or grant or incentive or amount of similar nature received or receivable with respect to interest and financing Charges, if any, shall be reduced to ascertain the net interest and financing charges.

(xvii) Any other item of cost- Proper records shall be maintained for any other item of cost being indispensable and considered necessary for inclusion in cost records for calculating cost of production of goods or rendering of services, cost of sales, margin in total and per unit of the goods or services under reference.

(xviii) Capacity determination- Capacity shall be determined in terms of units of production or equivalent machine or man hours.

Installed capacity is determined based on-

(I) manufacturers' technical specifications;

(II) capacities of individual or interrelated production centres;

(III) operational constraints or capacity of critical machines; or

(IV) number of shifts.

In case manufacturers' technical specifications are not available, the estimates by technical experts on capacity under ideal conditions shall be considered for determination of installed capacity. In case any production facility is added or discarded the installed capacity shall be reassessed from the date of such addition or discard. In case the same is reassessed as per direction of the Government, it shall be in accordance with the principles laid down in the said directives. In case of improvement in the production process, the installed capacity shall be reassessed from the date of such improvement.

Normal capacity shall be determined *vis-a-vis* installed capacity after carrying out adjustments for-

(I) holidays, normal shut down days and normal idle time;

(II) normal time lost in batch change over;

(III) time lost due to preventive maintenance and normal break downs of equipments;

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(IV) losing efficiency due to ageing of the equipment; or

(V) number of shifts;

Capacity utilization is actual production measured as a percentage of installed capacity.

(xix) Work-in-progress and finished stock- The method followed for determining the cost of work-in-progress and finished stock of the goods and for services under delivery or in-process shall be appropriate and shall be indicated in the cost records so as to reveal the cost element that have been taken into account in such computation. All conversion costs incurred in bringing the inventories to their present location and condition shall be taken into account while computing the cost of work-in-progress and finished stock. The method adopted for determining the cost of work in progress and finished goods shall be followed consistently.

(xx) Captive consumption- If the goods or services under reference are used for captive consumption, proper records shall be maintained showing the quantity and cost of each such goods or services transferred to other departments or cost centres or units of the company for self-consumption and sold to outside parties separately.

(xxi) By-Products and Joint Products- Proper records shall be maintained for each item of by-product, if any, produced showing the receipt, issues and balances, both in quantity and value. The basis adopted for valuation of by-product for giving credit to the respective process shall be equitable and consistent and shall be indicated in cost records. Records showing the expenses incurred on further processing, if any, and actual sales realisation of by-product shall be maintained. The proper records shall be maintained in respect of credits or recoveries from the disposal of by-products.

Proper records shall be maintained the cost up to the point of separation of products or services shall be apportioned to joint products or services on reasonable and equitable basis and shall be applied consistently. The basis on which such joint costs are apportioned to different products or services arising from the process shall be indicated in the cost records. Proper records shall be maintained in respect credits or recoveries from the disposal of joint products or services.

(xxii) Adjustment of cost variances- Where the company maintains cost records on any basis other than actual such as standard costing, the records shall indicate the procedure followed by the company in working out the cost of the goods or services under such system. The cost variances shall be shown against separate heads and analyzed into material, labour, overheads and further segregated into quantity, price and efficiency variances. The method followed for adjusting the cost variances in determining the actual cost of the goods or services shall be indicated clearly in the cost records. The reasons for the variances shall be duly explained in the cost records and statements.

(xxiii) Reconciliation of cost and financial accounts- The cost statements shall be reconciled with the financial statements for the financial year specifically indicating the expenses or incomes not considered in the cost records or statements so as to ensure

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accuracy and to adjust the profit of the goods or services under reference with the overall profit of the Company. The variations, if any, shall be clearly indicated and explained.

(xxiv)Related party transactions- Related Party means related party as defined under clause (76) of section 2 of the Companies Act 2013.

'Normal' price means price charged for comparable and similar products in the ordinary course of trade and commerce where the price charged in the sole consideration of sale and such sale is not made to a related party. Normal price can be construed to be a price at which two unrelated and non-desperate parties would agree to a transaction and where such transaction is not clouded due to the proximity of the parties to the transaction and free from influence though the parties may have shared interest.

In respect of related party transactions or supplies made or services rendered by a company to a company termed 'related party relationship' and vice-a-versa, records shall be maintained showing contracts entered into, agreements or understanding reached in respect of-

(I) purchase and sale of raw materials, finished goods, rendering of services, process materials and rejected goods including scraps and other related materials;

(II) utilisation of plant facilities and technical know-how;

(III) supply of utilities and any other services;

(IV) administrative, technical, managerial or any other consultancy services;

(V) purchase and sale of capital goods including plant and machinery; and

(VI) any other payment related to the production of goods or rendering of services under reference.

(xxv) Expenses or incentives on exports- Proper records showing the expenses incurred on the export sales, if any, of the goods or services under reference shall be separately maintained so that the cost of export sales can be determined correctly. Separate cost statements shall be prepared for goods or services exported giving details of export expenses incurred or incentive earned.

Proper records shall be maintained giving the details of export commitments license-wise and the fulfillment of these commitments giving the reasons for non-compliance, if any. In case, duty free imports are made, the cost statements shall reflect this fact. If the duty free imports have been made after actual production, the statement shall reflect this fact also.

(xxvi)Production Records- Quantitative records of all finished goods (packed or unpacked) or services rendered showing production, issues for sales and balances of different type of the goods or services under reference, shall be maintained. The quantitative details of production of goods or services rendered shall be maintained separately for self-produced, third party on job work, loan license basis etc.

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(xxvii)Sales records- Separate details of sales shall be maintained for domestic sales at control price, domestic sales at market price, export sales under advance license, export sales under other obligations, export sales at market price, and sales to related party or inter unit transfer. In case of services details of domestic delivery or sales at control price, domestic delivery or sales at market price, export delivery or sales under advance license, export delivery or sales under other obligations, export delivery or sales at market price, and delivery or sales to related party or inter unit transfer. Such details shall be maintained separately for each plant or unit wise or service center wise for total as well as per unit sales realization.

(xxviii)Cost statements- Cost statements (monthly, quarterly and annually) showing quantitative information in respect of each good or service under reference shall be prepared showing details of available capacity, actual production, production as per excise records, capacity utilization (in-house), stock purchased for trading, stock and other adjustments, quantity available for sale, wastage and actual sale during current financial year and previous year.

Such statements shall also include details in respect of all major items of costs constituting cost of production of goods or services, cost of sales of goods or services and margin in total as well as per unit of the goods or services. The goods or services emerging from a process, which forms raw material or an input material or service for a subsequent process, shall be valued at the cost of production or cost of service up to the previous stage.

Cost Statements in respect of reconciliation of indirect taxes showing details of total clearances of goods or services, assessable value, duties or taxes paid, CENVAT or VAT or Service Tax credit utilized, duties or taxes recovered and interest or penalty paid.

If the company is operating more than one plant, factory or service centre, separate cost statements as specified above shall be prepared in respect of each plant, factory or service centre.

(xxix)Statistical Records- The records regarding available machine hours or direct labour hours in different production departments and actually utilized shall be maintained for production of goods or rendering of services under reference and shortfall suitably analyzed. Suitable records for computation of idle time of machines or labour shall also be maintained and analyzed.

Proper records shall be maintained to enable the company to identify the capital employed, net fixed assets and working capital separately for the production of goods or rendering of services under reference and other goods or services to the extent such elements are separately identifiable. Non-identifiable items shall be allocated on a suitable and reasonable basis to different goods or services. Fresh investments on fixed assets for production of goods or rendering of services under reference that have not contributed to the production of goods or rendering of services during the relevant period or year shall be indicated in the cost records. The records shall, in addition, show assets added as replacement and those added for increasing existing capacity.

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(xxx) Records of Physical Verification- Records of physical verification may be maintained in respect of all items held in the stock such as raw materials, process materials, packing materials, consumables stores, machinery spares, chemicals, fuels, finished goods and fixed assets etc. Reasons for shortages or surplus arising out of such verifications and the method followed for adjusting the same in the cost of the goods or services shall be indicated in the records.

8. **General Features of Cost Audit Report:**

1. (i) I/We have/have not obtained all the information and explanations, which to the best of my/ our knowledge and belief were necessary for the purpose of this audit.

   (ii) In my/our opinion, proper cost records, as per rule 5 of the Companies (Cost Records and Audit) Rules, 2014, have/have not been maintained by the company in respect of good(s)/service(s) under reference;

   (iii) In my/our opinion, proper returns adequate for the purpose of Cost Audit have/have not been received from the branches not visited by me/us.

   (iv) In my/our opinion and to the best of my/our information, the said books and records give/do not give the information required by the Companies Act, 2013, in the manner so required.

   (v) In my/our opinion, company has/does not have adequate system of internal audit of cost records which to my/our opinion is commensurate to its nature and size of its business.

   (vi) In my/our opinion, information, statements in the annexure to this cost audit report gives/does not give a true and fair view of the cost of production of good(s)/rendering of service(s), cost of sales, margin and other information relating to good(s)/service(s) under reference.

   (vii) Detailed unit-wise and product/service-wise cost statements and schedules thereto in respect of the product/service under reference of the company duly audited and certified by me/us are/are not kept in the company.

2. If as a result of the examination of the books of account, the cost auditor desires to point out any material deficiency or give a qualified report, he/she shall indicate the same against the relevant para (i) to (vii) in the prescribed form of the Cost Audit Report giving details of discrepancies he/she has come across.

3. The report, suggestions, observations and conclusions given by the cost auditor shall be based on verified data, reference to which shall be made here and shall, wherever practicable, be included after the company has been afforded an opportunity to comment on them.

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PART – II : QUESTIONS AND ANSWERS

QUESTIONS

Standards on Auditing, Statements and Guidance Notes

1. The directors of Chirag Ltd. are concerned about the reliability and usefulness of the monthly financial management information that they receive.

   As a result, the company's auditors have been engaged to review the system and the information it generates, and to report their conclusions.

   (a) What an ordinary procedure includes for the review of financial statements?

   (b) Contrast this assignment with the statutory audit of the company's financial statements with regard to the scope of the assignment and to the report issued.

2. (a) Gama Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of Gama Ltd. as to how he can obtain an understanding of how Gama Ltd. uses the services of the outsourced agency in its operations.

   (b) While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws. Comment.

   (c) Lakshya Ltd. has a branch office located outside India. Company is in the process of appointment of non-Chartered Accountant as an auditor but otherwise qualified person from country where the branch office is situated. Statutory auditor is of the opinion that non-Chartered Accountant cannot be appointed as branch auditor. Comment.

   You are also required to discuss the applicability of SA 600 using the work of another auditor by the head office auditor in regard to branch located outside India, if non-Chartered Accountant is appointed.

Audit Strategy, Planning and Programming

3. (a) As an internal auditor for a large manufacturing concern, you are asked to verify whether there are adequate records for identification and value of Plant and Machinery, tools and dies and whether any of these items have become obsolescent and not in use. Draft a suitable audit programme for the above.

   (b) M/s Abu & Co. was appointed as auditor of Grand Airways Ltd. As the audit partner, what factors shall be considered in the development of overall audit plan?

Risk Assessment and Internal Control

4. (a) Yex Ltd. has five entertainment centers to provide frivolous facilities for public especially for children and youngsters at 5 different locations in the peripheral of 200 kms. Collections are made in cash. Specify the adequate control system towards collection of money.

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(b) Briefly explain the corporate responsibility as envisaged under Sarbanes-Oxley Act of 2002.

Audit under CIS Environment

5. (a) Saras, a limited company having turnover of approximately ₹ 80 crores uses a tailor made accounting software package. In the said package, all transactions are recorded, processed and the final accounts generated from the system. The management tells you that in view of the voluminous nature of day books, there is no need to print them and that audit can be conducted on the computer itself. The management further assures you that any 'query based reports' as required can be generated and printed. As a statutory auditor of the company, enumerate the procedures you would adopt to conduct the audit.

   (b) "The auditor must evaluate major clauses of control used in a Computerised Information system to enhance its reliability" – Comment.

The Company Audit & Audit Report

6. M/s SSS & Co. is an audit firm having partners CA. Satyam, CA. Shivam and CA. Sundaram. CA. Satyam, CA. Shivam and CA. Sundaram are holding appointment as an auditor in 4, 6 and 10 companies respectively.

   (a) Provide the maximum number of audits remaining in the name of M/s SSS & Co.

   (b) Provide the maximum number of audits remaining in the name of individual partner i.e. CA. Satyam, CA. Shivam and CA. Sundaram.

   (c) Can M/s SSS & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than ₹ 100 crore, 2 small companies and 1 dormant company?

   (d) Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of ₹ 110 crore each?

7. CA. Rock is a partner in M/s Ajay & Associates and M/s Vijay & Associates simultaneously. M/s Ajay & Associates has completed its tenure of 10 years as an auditor in Sanjay Ltd. immediately preceding the current financial year. It may be noted that the provisions for applicability of rotation of auditors are applicable to Sanjay Ltd. Now, the company wants to appoint M/s Vijay & Associates as auditor for 5 years.

   (a) Whether M/s Vijay & Associates is allowed to accept the appointment as auditor of Sanjay Ltd.?

   (b) Would your answer be different from above if CA. Rock, being in-charge of M/s Ajay & Associates and certifying authority of financial statements of Sanjay Ltd., retires from the partnership in M/s Ajay & Associates and joins M/s Vijay & Associates?

8. (a) FX Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During the Financial Year 15-16, it incurred substantial amounts on external trade, business communication and branding expenses by participation in various corporate social responsibility initiatives. The

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company expects to benefits by this expenditure by attracting new customers over a period of time and accordingly it has capitalised the same under 'brand development expenses' and intends to amortise the same over the period in which it expects the benefits to flow. As the statutory auditor of the company, do you concur with this treatment? Give reasons.

(b) Dabloo Ltd. is facing financial crunch and has sold significant part of machinery to repay 25% amount of wages overdue. Many workers have also left the company due to non-payment of wages. Dabloo Ltd. is also considering filing for bankruptcy. The financial statements (and notes thereto) do not disclose the fact. As an Auditor, how would you deal with the situation? You are also required to identify the type of opinion you would issue and draft the same.

(c) OST Limited, a manufacturing company donated ₹ 45,000 and ₹ 55,000 to Charitable Societies namely 'Healthy World Charitable Foundation' and 'Learning Kids Foundation' respectively during the financial year 2015-16. The company has not taken any approval in general meeting for such donation. The average net profits of the company for the last three years were ₹ 15 lakhs. As an auditor, what will be your comment?

(d) As a Statutory Auditor, how would you report the following under CARO, 2015:

(i) A term loan was obtained from a bank for ₹ 110 lakh for acquiring R&D equipment, out of which ₹ 45 lakh was used to buy a car for use of the concerned director who was overlooking the R&D activities.

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

Liabilities of Auditor

9. (a) In assessment procedure of ABC Ltd., Income Tax Officer observed some irregularities. Therefore, he started investigation of books of accounts audited and signed by Mr. X, a practicing Chartered Accountant. While going through books he found that ABC Ltd. used to maintain two sets of books of accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the Institute of Chartered Accountants of India saying Mr. X had negligently performed his duties. Comment.

(b) Briefly explain the criminal liabilities of an auditor under the Companies Act, 2013.

Audit Committee and Corporate Governance

10. The audit committee has been granted several roles under Clause 49 of the Listing Agreement. Oversight of the company's financial reporting process; recommendation for appointment of auditors; approval of payment to statutory auditors etc. are some of the roles that an audit committee perform. State the role of Audit Committee as provided under Clause 49 of the Listing Agreement.

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Audit of Consolidated Financial Statements

11. (a) "Permanent Consolidation Adjustments are made only on the first occasion of the preparation and presentation of consolidated financial statements". What are the Permanent Consolidation Adjustments? Explain the role of auditor in this context.

    (b) While doing the audit of consolidated Financial Statements, which current period consolidation adjustments are to be taken into account?

Audit of Banks

12. (a) As a branch auditor of a Nationalised bank, how would you classify the following advances based on securities?

    (i) Advances covered by ECGC/DISGC guarantees.

    (ii) An account which is fully secured but the margin in which is lower than that stipulated by the bank.

    (iii) Advances covered against cheques purchased including self cheques.

    (iv) Advances against supply bill.

    (b) As the concurrent auditor of Nagpur Main Branch of XYZ Bank Ltd., state the issues which have to be considered in the audit of advances.

Audit of General Insurance Companies and Co-operative Societies

13. (a) "In an audit of an insurance company, the Receipts and Payments Account is also subjected to audit". Comment.

    (b) Mention the duties of Auditor of Co-operative Societies in regard to the following:

    (i) Over-due interest.

    (ii) Compliance with provisions of Co-operative Act and Rules thereunder.

    (iii) Special Report to Registrar of Co-operative Societies.

Audit under Fiscal Laws

14. (a) XYZ Pvt. Ltd., a company in which public are not substantially interested, issued 1,00,000 equity shares at a premium of ₹ 70 per share (face value ₹ 10 per share). The fair market value of the shares as on the date of issue was ₹ 60 per share.

    As the tax auditor of XYZ Pvt. Ltd., how would you report the same in your tax audit report?

    (b) X Ltd. has sold one of its buildings situated in Kolkata during the year for a consideration of ₹ 40 lakh. However, the stamp duty value assessed by the authority of Government of West Bengal is ₹ 48 lakh.

    As a Tax auditor, what will be your reporting requirement? Will it make any difference, if value adopted is more than that as assessable by any Authority of a State Government?

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(c) Draft an audit programme for conducting the audit of a Public Trust registered under section 12A of the Income-tax Act, 1961.

Cost Audit

15. (a) Expro Ltd. is engaged in the production of steel. A Chartered Accountant Firm 'M/s Manan & Co.' was appointed as the statutory auditor of Expro Ltd. for the current financial year. During the year, the management of the company realised that the company is required to maintain cost records in their books of account and get it audited. Therefore, in a general meeting, the members of the company appointed M/s Manan & Co. as the cost auditor of the company. You are required to examine the validity of appointment of M/s Manan & Co. as the cost auditor.

(b) "Like every other audit, a systematic planning for cost audit is also necessary". Indicate the matters to be included in a Cost Audit Programme.

Audit of Public Sector Undertakings

16. (a) Briefly explain performance audit? What are the considerations need to be taken care while performing such audit.

(b) Enumerate the right of C&AG of India to conduct a supplementary audit of the financial statement of a company, or comment upon or supplement audit report provided under section 143(6) of the Companies Act, 2013.

Internal Audit, Management and Operational Audit

17. (a) You have been appointed as management auditor of a large engineering company suffering from a working capital crunch. Enlist and discuss the related areas which you would probe into to overcome the company's problem.

(b) Amazekart, a manufacturing unit does not accept the recommendations for improvements made by the Operational Auditor. Suggest an alternative way to tackle the hostile management.

Investigation and Due Diligence

18. (a) Mr. Manan is above 80 years old and wishes to sell his proprietary business of manufacture of specialty chemicals. Preeto Ltd. wants to buy the business and appoints you to carry out a due diligence audit to decide whether it would be worthwhile to acquire the business. What procedures you would adopt before you could render any advice to Preeto Ltd.?

(b) Runri Ltd., a company engaged in manufacturing of chemicals is consistently recording higher sales turnover, but declining net profits since the last 5 years. As an investigator appointed to find out the reasons for the same, what are the points you would verify?

Professional Ethics

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

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(a) CA. Arjit registered his proprietorship firm last year and started practicing in the name of "M/s Arjit & Co.". He is of the view that a professional need to maintain books of accounts only if his earnings exceed the minimum prescribed limit as per section 44AA of the Income Tax Act, 1961. Therefore, he decided not to maintain his books of accounts as his earnings are below the prescribed limit given under section 44AA of the said Act.

(b) CA. Sufi is practicing since 2008 in the field of company auditing. Due to his good practical knowledge, he was offered editorship of a 'Company Audit' Journal which he accepted. However, he did not take any permission from the council regarding such editorship.

(c) As a Chartered Accountant in practice, Mr. Denis is offered to conduct a review of the "Profit Forecast" prepared by a company in connection with its application for a term loan from a financial institution.

(d) CA. Sonu and CA. Monu are two partners of the CA firm 'Sonu Monu and Associates'. Being very pious, CA. Sonu organised a religious ceremony at his home for which he instructed his printing agent to add his designation "Chartered Accountant" with his name in the invitation cards. Later on, the invitations were distributed to all the relatives, close friends and clients of both the partners.

Other Miscellaneous Chapters

20. Write short notes on the following:

(a) Haphazard Sampling.

(b) Key functions of an Energy Auditor.

(c) Collection of Evidence by Peer Reviewer.

(d) Compliance of Prudential Norms of RBI by NBFC.

(e) Circumstances in which Chartered Accountant in practice or firm of Chartered Accountants cannot conduct Tax Audit u/s 44 AB of the Income Tax Act, 1961 of the concern.

SUGGESTED ANSWERS/HINTS

1. **(a) Procedures for Review of Financial Statements:** As per SRE 2400 "Engagements to Review Financial Statements", procedures for the review of financial statements will ordinarily include-

(i) Discuss terms and scope of the engagement with the client and the engagement team.

(ii) Prepare an engagement letter setting forth the terms and scope of the engagement.

(iii) Obtain an understanding of the entity's business activities and the system for

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recording financial information and preparing financial statements.

(iv) Inquire whether all financial information is recorded:

(a) Completely;

(b) Promptly; and

(c) After the necessary authorisation.

(v) Obtain the trial balance and determine whether it agrees with the general ledger and the financial statements.

(vi) Consider the results of previous audits and review engagements, including accounting adjustments required.

(vii) Inquire whether there have been any significant changes in the entity from the previous year (e.g., changes in ownership or changes in capital structure).

(viii) Inquire about the accounting policies and consider whether:

(a) They comply with the applicable accounting standards;

(b) They have been applied appropriately; and

(c) They have been applied consistently and, if not, consider whether disclosure has been made of any changes in the accounting policies.

(ix) Read the minutes of meetings of shareholders, the board of directors and other appropriate committees in order to identify matters that could be important to the review.

(x) Inquire if actions taken at shareholder, board of directors or comparable meetings that affect the financial statements have been appropriately reflected therein.

(xi) Inquire about the existence of transactions with related parties, how such transactions have been accounted for and whether related parties have been properly disclosed.

(xii) Inquire about contingencies and commitments.

(xiii) Inquire about plans to dispose of major assets or business segments.

(xiv) Obtain the financial statements and discuss them with management.

(xv) Consider the adequacy of disclosure in the financial statements and their suitability as to classification and presentation.

(xvi) Compare the results shown in the current period financial statements with those shown in financial statements for comparable prior periods and, if available, with budgets and forecasts.

(xvii) Obtain explanations from management for any unusual fluctuations or inconsistencies in the financial statements.

(xviii) Consider the effect of any unadjusted errors – individually and in aggregate.

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Bring the errors to the attention of management and determine how the unadjusted errors will influence the report on the review.

(xix) Consider obtaining a representation letter from management.

(b) **Contrast of a Review Assignment with the Statutory Audit of the Company's Financial Statements with regard to the Scope of the Assignment and to the Report issued is hereunder:**

SCOPE	
Review assignment	**Statutory audit**
• Scope of Review assignments are generally falls in agreement between parties.	• Scope of Statutory audit should be in accordance with the Companies Act, 2013 or in accordance with other statute.
• Scope of Review assignments are restricted to instructions.	• Scope of Statutory audit should be in accordance with Audit Regulations and Norms.
• Review assignment should be done in accordance with SREs.	• Statutory audit should be conducted in accordance with Engagement and Quality Control Standards, Statements and Guidance Notes etc.
REPORT	
Review assignment	**Statutory audit**
• Report of Review assignment is addressed to the board.	• Statutory Audit Report is addressed to the members.
• Format of Report of Review assignment is wholly discretionary.	• Statutory Audit Report is on true and fair view and as per prescribed Format.
• Report of Review assignment is private report.	• Statutory Audit Reports are in public domain.

2. (a) **Understanding How User Entity Uses the Services of Service Organisation:** As per SA 402 on "Audit Considerations Relating to an Entity Using a Service Organisation", when obtaining an understanding of the user entity in accordance with SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment", the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:

(i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;

(ii) The nature and materiality of the transactions processed or accounts or

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financial reporting processes affected by the service organisation;

(iii) The degree of interaction between the activities of the service organisation and those of the user entity; and

(iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.

(b) **Compliance with Other Laws:** As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.

Further, non-compliance with other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for in the financial statements, but are not considered to have a direct effect on the financial statements.

If the auditor suspects there may be non-compliance, the auditor shall discuss the matter with management. If management does not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.

If the auditor is precluded by management from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope of the audit.

In the instant case, major portion of the labour employed in the company was child labour. While questioning by auditor, reply of the management that it was outside his scope of financial audit to look into the compliance with other laws is not acceptable as it may have a material effect on financial statements.

Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequences for the entity. In case, the auditor concludes that non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statement.

(c) **Non-Chartered Accountant as Branch Auditor:** As per section 143(8) of the Companies Act, 2013, where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company under this Act or by any other person qualified for appointment as an auditor of the company. Where the branch office is situated in a country outside India, the accounts of the

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branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed.

Thus, a non- Chartered Accountant can be appointed as an auditor of branch office located outside India provided he is qualified for appointment as an auditor in that country.

Using the Work of Another Auditor: When the accounts of the branch are audited by a person other than the company's auditors, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of accounts of the branch and the audit of the company as a whole. Also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in SA 600, "Using the Work of another auditor". It makes clear that in certain situations, the statute governing the entity may confer the right on the principal auditor to visit a component and examine the books of accounts and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it necessary for him to visit the component and/or to examine the books of accounts and other records of the said component. Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditors' purpose, in context of the specific assignment.

3. (a) **The Internal Audit Programme in connection with Plant and Machinery, Tools and Dies may be on the following lines:**

(i) **Internal Control Aspects -** The following may be incorporated in the audit programme to check the internal control aspects:

(a) Maintaining separate register for hired assets, leased asset and jointly owned assets.

(b) Maintaining register of fixed asset and reconciling to physical inspection of fixed asset and to nominal ledger.

(c) All movements of assets are accurately recorded.

(d) Authorisation be obtained for –

(i) a declaring a fixed asset scrapped.

(ii) selling a fixed asset.

(e) Check whether additions to fixed asset register are verified and checked by authorised person.

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(f) Proper recording of all additions and disposal.

(g) Examining procedure for the purchase of new fixed assets, including written authority, work order, voucher and other relevant evidence.

(h) Regular review of adequate security arrangements.

(i) Periodic inspection of assets is done or not.

(j) Regular review of insurance cover requirements over fixed assets.

(ii) **Assets Register:** To review the registers and records of plant, machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charged, etc.

(iii) **Cost Report and Journal Register:** To review the cost relating to each plant and machinery and to verify items which have been capitalised.

(iv) **Code Register:** To see that each item of plant and machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.

(v) **Physical Verification:** To see physical verification has been conducted at frequent intervals.

(vi) **Movement Register:** To verify (a) whether a Movement Register for movable equipments and (b) log books in case of vehicles, etc. are being maintained properly.

(vii) **Assets Disposal Register:** To review whether assets have been disposed off after proper technical and financial advice and sales/disposal/retirement, etc. of these assets are governed by authorisation, sales memos or other appropriate documents.

(viii) **Spare Parts Register:** To examine the maintenance of a separate register of tools, spare parts for each plant and machinery.

(ix) **Review of Maintenance:** To scrutinise the programme for an actual periodical servicing and overhauling of machines and to examine the extent of utilisation of maintenance department services.

(x) **Review of Obsolescence:** To scrutinise whether expert's opinion have been obtained from time to time to ensure purchase of technically most useful efficient and advanced machinery after a thorough study.

(xi) **Review of R&D:** To review R&D activity and ascertain the extent of its relevance to the operations of the organisation, maintenance of machinery efficiency and prevention of early obsolescence.

(b) Development of an Overall Plan: Overall plan is basically intended to provide direction for audit work programming and includes the determination of timing, manpower development and co-ordination of work with the client, other auditors and

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other experts. The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit-

(i) Terms of his engagement and any statutory responsibilities.

(ii) Nature and timing of reports or other communications.

(iii) Applicable Legal or Statutory requirements.

(iv) Accounting policies adopted by the clients and changes, if any, in those policies.

(v) The effects of new accounting and auditing pronouncement on the audit.

(vi) Identification of significant audit areas.

(vii) Setting of materiality levels for the audit purpose.

(viii) Conditions requiring special attention such as the possibility of material error or fraud or involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.

(ix) Degree of reliance to be placed on the accounting system and internal control.

(x) Possible rotation of emphasis on specific audit areas.

(xi) Nature and extent of audit evidence to be obtained.

(xii) Work of the internal auditors and the extent of reliance on their work, if any in the audit.

(xiii) Involvement of other auditors in the audit of subsidiaries or branches of the client and involvement of experts.

(xiv) Allocation of works to be undertaken between joint auditors and the procedures for its control and review.

(xv) Establishing and coordinating staffing requirements.

4. **(a)** **Control System over Selling and Collection of Tickets:** In order to achieve proper internal control over the sale of tickets and its collection by the Y Co. Ltd., following system should be adopted -

(i) **Printing of tickets:** Serially numbered pre-printed tickets should be used and designed in such a way that any type of ticket used cannot be duplicated by others in order to avoid forgery. Serial numbers should not be repeated during a reasonable period, say a month or year depending on the turnover. The separate series of the serial should be used for such denomination.

(ii) **Ticket sales:** The sale of tickets should take place from the Central ticket office at each of the 5 centres, preferably through machines. There should be proper control over the keys of the machines.

(iii) **Daily cash reconciliation:** Cash collection at each office and machine should be reconciled with the number of tickets sold. Serial number of tickets for each entertainment activity/denomination will facilitate the reconciliation.

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(iv) **Daily banking:** Each day's collection should be deposited in the bank on next working day of the bank. Till that time, the cash should be in the custody of properly authorized person preferably in joint custody for which the daily cash in hand report should be signed by the authorized persons.

(v) **Entrance ticket:** Entrance tickets should be cancelled at the entrance gate when public enters the centre.

(vi) **Advance booking:** If advance booking of facility is made available, the system should ensure that all advance booked tickets are paid for.

(vii) **Discounts and free pass:** The discount policy of the Y Co. Ltd. should be such that the concessional rates, say, for group booking should be properly authorized and signed forms for such authorization should be preserved.

(viii) **Surprise checks:** Internal audit system should carry out periodic surprise checks for cash counts, daily banking, reconciliation and stock of unsold tickets etc.

(b) **Corporate Responsibility under Sarbanes-Oxley Act of 2002:** The Sarbanes–Oxley Act of 2002, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 is a United States federal law passed in response to a number of major corporate and accounting scandals including those affecting Enron, Tyco International, and WorldCom. The act contains eleven titles and establishes corporate accountability and civil and criminal penalties for white – collar crimes. The title three deals with the Corporate Responsibility which is as follows-

(i) The audit committee to be more independent through enhancement of their over sight responsibilities and one of the Audit committee members to be financial expert.

(ii) Requires CEO& CFO to issue certification of the quarterly financial results and annual reports to SEC as part of compliance with Form 10K.

(iii) Provides rules of conduct for companies managerial and their officers regarding Pension matters.

(iv) To Comply with SEC rules requiring attorneys to report violation of securities to the company's CEO or Chief Legal Counsel and to Audit Committee if no action is taken.

5. **(a)** A key feature of the accounting software package used by the company definitely involves the absence of a clear audit trail. In other words, transactions cannot be easily traced or co-related from the individual supporting documents of those transactions. Moreover, the management does not wish to print the daybooks in view of the voluminous nature since it may involve extensive costs. This has naturally led to extensive dependence by management upon the "exception reporting" principle.

From the auditor's point of view, it must also be conceded, the exception reports in the form of 'query-based reports' which isolate the above data provide him with the

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very material that he requires for most of his verification work. The only problem which it raises, and it is a serious one, is that he cannot simply assume that the programmes which produce the exception reports are reliable in respect of the following factors:

(i) operating accurately;

(ii) printing out all the exceptions which exist; and

(iii) bound by programmed control parameters which meet the company's genuine internal control requirements.

In view of the above, whether management relies upon exception reports, it effectively eliminated the audit trail between input and output and the auditor is forced to test the invisible processes which purport to embody the controls, and produce the output such as it is. These tests, which invariably involve the use by the auditor of the computer itself, are known as tests through the machine. In the 'through the machine' approach, the auditor starts by proving the accuracy of the input data, and then thoroughly examines (by applying tests) the processing procedures with a view to establishing the following that:

(i) all input is actually entered into the computer.

(ii) neither the computer nor the operators can cause undetected irregularities in the final reports.

(iii) the programmes appear, on the evidence of rejection and exception routines, to be functioning correctly.

(iv) all operator intervention during processing is logged and scrutinised by the DP manager.

The auditor in such circumstances will have to first evaluate the existing controls. For the same, he has to do the following:

(i) Evaluate the internal control system especially the controls and checks existing for recording the transactions, i.e., he has to verify at what level transactions can be entered into the system and what checks are available to prevent any unauthorised data entry and for rectifying errors/omissions in the transactions entered.

(ii) Evaluate at what level there authority is given for modification of transactions already entered. Is there any authority given only to a senior employee to carry out modifications? Or is it that once transactions are entered and validated, no further modifications are possible thereto.

(iii) Whether there is a provision in the software for carrying out an on line audit of transactions, i.e. whether there a separate module in the package, where a separate password given to the auditor and once he has seen and approved a particular transaction/set of transactions, the same would be locked and no modifications would be possible by anyone (including the senior most

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employee) in the company.

(iv) Whether there are proper procedures for backup of data on a regular basis and whether the said procedures are being strictly followed.

(v) In case of any loss of data whether there is a clear defined recovery procedure to minimize the loss of data due to power failures or any human errors.

(vi) The auditor may introduce some dummy data into the system and see the results obtained.

After the auditor has evaluated the above procedures, he has to prepare an audit plan depending on the results obtained from his earlier evaluation. Since the daybooks are not being printed, the plan can contain procedures wherein data is verified directly on the computer from the vouchers/invoices, etc. The audit plan will also require a lot of analytical procedures to be performed. Depending on the importance of various expense heads and other important account heads, the auditor will also obtain various reports from the system depending on various queries that he would have to identify. Some illustrative reports can be:

(i) To check whether proper classification is done for revenue/capital - a report can be obtained of all purchases (not being raw materials or other routine purchases) exceeding ₹ 1 lakh.

(ii) To check whether all freight outward bills are accounted for a report containing a month-wise co-relation between goods despatched and freight amount paid. The same can be further co-related with the freight rates obtained from the bills.

Once the auditor has performed the above procedures, he would be able to form an opinion whether reliance can be placed on the accounting systems and the data recorded. If the auditor finds that reliance cannot be placed on the systems he can inform the management about the fact and also that the daybooks, etc., will need to printed to allow him to conduct the audit. The finalisation procedures to be followed even under this system would remain more or less similar to other accounting systems. The auditor can obtain reports of depreciation on fixed assets, inventory valuation and using the normal procedures find out whether reliance can be placed on them, e.g., if while valuing stocks the system is using the LIFO method, the same would not be acceptable and will need to be modified. Similarly depreciation calculations will have to verify on a random basis to find out its reliability.

(b) The reliability of a component is a function of control that acts on the component. In a computer system the following are the major types of controls and used to enhance component reliability which the auditor must evaluate:

(i) **Authenticity Control**: They are exercised to verify the identity of the individuals or process involved in a system. (Pass word, digital signature etc.)

(ii) **Accuracy Control**: These attempts to ensure the correctness of the data and processes in a system (Programme validation check).

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(iii) **Completeness Control**: This ensures that no data is missing and all processing is carried through to its proper conclusion.

(iv) **Privacy Control**: This ensures the protection of data from inadvertent or unauthorised disclosure.

(v) **Audit Trail Controls**: This ensures the traceability of all events occurred in a system.

(vi) **Redundancy Control**: It ensures that processing of data is done only once.

(vii) **Existence Control**: It attempts to ensure the on going availability of all system resources.

(viii) **Asset safeguarding controls**: It attempts to ensure that all resources within a system are protected from destruction or corruption.

(ix) **Effectiveness Control**: It attempts to ensure that the system achieves its goals.

(x) **Efficiency Control**: It attempts to ensure that a system uses minimum resources to achieve its goals.

6. **Ceiling on Number of Audit:** As per section 141(3)(g) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor if he is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.

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

In the given case, CA. Satyam is holding appointment in 4 companies, whereas CA. Shivam is having appointment in 6 Companies and CA. Sundaram is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.

(a) Therefore, M/s SSS & Co. can hold appointment as an auditor of 40 more companies:

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

(b) With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g) - already holding appointments as an auditor.

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Hence (1) CA. Satyam can hold: 20 - 4 = 16 more audits. (2) CA. Shivam can hold 20 - 6 = 14 more audits and (3) CA. Sundaram can hold 20 -10 = 10 more audits.

(c) In view of above disussed provisions M/s SSS & Co. can hold appointment as an auditor in all the 60 private companies having paid-up share capital less than ₹ 100 crore, 2 small companies and 1 dormant company as these are excluded from the ceiling limit of company audits given under section 141(3)(g) of the Companies Act, 2013.

(d) As per fact of the case, M/s SSS & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition, they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than ₹ 100 crores. In the given case, out of the 60 private companies, M/s SSS & Co. is offered 45 companies having paid-up share capital of ₹ 110 crore each.

Therefore, M/s SSS & Co. can also accept the appointment as an auditor for 2 small companies, 1 dormant company, 15 private companies having paid-up share capital less than ₹ 100 crore and 40 private companies having paid-up share capital of ₹ 110 crore each in addition to above 20 company audits already holding.

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

In the given case, CA. Rock is a common partner in M/s Ajay & Associates and M/s Vijay & Associates. The tenure of 10 years of M/s Ajay & Associates as an auditor has been expired in Sanjay Ltd. immediately preceding the current financial year i.e. the firm 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 Vijay & Associates will also be disqualified to be appointed as auditor of Sanjay Ltd. for next 5 financial years as CA. Rock was the common partner of M/s Vijay & Associates whose tenure in Sanjay Ltd. has expired.

(b) Retiring Partner being In-charge in Previous Audit Firm: As per 139(2) of the Companies Act, 2013 read with the explanation given under Companies (Audit and Auditors) Rules, 2014 for the purpose of rotation of auditors, if a partner, who is in-charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of 5 years.

In the given case, CA. Rock was in-charge of M/s Ajay & Associates and certifying authority of financial statements of Sanjay Ltd. who retires from the said firm and joins M/s Vijay & Associates. The tenure of 10 years of M/s Ajay & Associates as an auditor has been expired in Sanjay Ltd. immediately preceding the current financial year i.e. the firm shall not be eligible for re-appointment as auditor in the same

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company for 5 years from the completion of such term.

Therefore, M/s Vijay & Associates will also be disqualified to be appointed as auditor of Sanjay Ltd. for next 5 financial years as newly joined partner CA. Rock has retired from M/s Ajay & Associates immediately preceding the current financial year whose tenure in Sanjay Ltd. has expired.

8. (a) **Capitalisation of Expenses:** As per Accounting Standard 26 on "Intangible Assets", expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria.

In the given case, FX Ltd. incurred substantial amounts on external trade, business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefits by this expenditure by attracting new customers over a period of time and accordingly it has capitalised the same under brand development expenses. Here, no intangible assets or other asset is acquired or created that can be recognised.

Therefore, the accounting treatment by the company to amortise the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the Statement of Profit and Loss in the year of incurring.

(b) **Disclosure for Uncertainty about Going Concern:** As per SA 570 "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 whether there is a material uncertainty about the entity's ability to continue as a going concern.

In the given case, Dabloo Ltd. has sold significant part of machinery to repay its wages overdue and also considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the company's ability to continue as a going concern and, therefore, it would be unable to realize its assets and discharge its liabilities in the normal course of business.

Thus, 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. In view of circumstances mentioned in SA 705 "Modifications to the Opinion in the Independent Auditor's Report", the auditor should give adverse opinion in above case as follows -

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion paragraph, the financial statements do not give information required by the Companies Act, 2013 in the manner so required and also do not give a true and fair view in conformity with the accounting principles generally accepted in India:

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(i) In the case of the Balance sheet, of the state of affairs of the Company as at March 31,20xx;

(ii) In the case of the Profit & Loss account, of the profit/loss for the year ended on that date; and

(iii) In the case of the Cash flow statement, of the cash flow for the year ended on that date.

(c) **Donation to Charitable Institutions***:* Section 181 of the Companies Act, 2013 provides that the Board of Directors of a company may contribute to bona fide charitable and other funds with prior permission of the company in general meeting for such contribution in case any amount the aggregate of which, in any financial year, exceed 5 per cent of its average net profits for the three immediately preceding financial years.

In the instant case, OST Limited has given donation of ₹ 1,00,000/- (₹ 45,000/- + ₹ 55,000/-) to two charitable organisations. The average profit of the last 3 years is ₹ 15 lakhs and the 5% of this works out to ₹ 75,000. Hence the maximum of donation could be ₹ 75,000 only. For excess of ₹ 25,000 the company is required to take prior permission in general meeting which is not been taken.

Therefore, by paying donations of ₹ 1,00,000 which is more than ₹ 75,000, the Board has contravened the provisions of section 181 of the Companies Act, 2013. Hence, the auditor should qualify his report accordingly.

(d) **Reporting under CARO, 2015**

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

The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact.

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

Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report that out of the term loan taken for R&D equipment, ₹ 45 lakh was not utilised for the purpose of acquiring R&D equipment.

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

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cases. The auditor in order to satisfy himself about verification at reasonable intervals should examine the adequacy of evidence and record of verification.

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

9. (a) **Liability of Auditor:** It is the auditor's responsibility to audit the statement of accounts and prepare tax returns on the basis of books of accounts produced before him. Also if he is satisfied with the books and documents produced to him, he can give his opinion on the basis of those documents only by exercising requisite skill and care and observing the laid down audit procedure.

In the instant case, Income tax Officer observed some irregularities during the assessment proceeding of ABC Ltd. Therefore he started investigation of books of accounts audited and signed by Mr. X, a practicing Chartered Accountant. While going through the books, he found that ABC Ltd. used to maintain two sets of books of accounts, one is the official set and other is covering all the transactions. Income Tax Department filed a complaint with the ICAI saying Mr. X had negligently performed his duties.

Mr. X, the auditor was not under a duty to prepare books of accounts of assessee and he should, of course, neither suggest nor assist in the preparations of false accounts. He is responsible for the books produced before him for audit. He completed his audit work with official set of books only.

In this situation, as Mr. X, performed the auditing with due skill and diligence, therefore, no question of negligence arises. It is the duty of the Department to himself investigate the truth and correctness of the accounts of the assessee.

(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.

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,

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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. **Role of Audit Committee:** The role of the audit committee as provided under Clause 49 shall include the following -

(i) Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;

(ii) Recommendation for appointment, remuneration and terms of appointment of auditors of the company;

(iii) Approval of payment to statutory auditors for any other services rendered by the statutory auditors;

(iv) Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:

(a) Matters required to be included in the Director's Responsibility Statement to be

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included in the Board's report in terms of clause (c) of sub-section 3 of section 134 of the Companies Act, 2013.

(b) Changes, if any, in accounting policies and practices and reasons for the same.

(c) Major accounting entries involving estimates based on the exercise of judgment by management.

(d) Significant adjustments made in the financial statements arising out of audit findings.

(e) Compliance with listing and other legal requirements relating to financial statements.

(f) Disclosure of any related party transactions.

(g) Qualifications in the draft audit report.

(v) Reviewing, with the management, the quarterly financial statements before submission to the board for approval;

(vi) Reviewing, with the management, the statement of uses/application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter;

(vii) Review and monitor the auditor's independence and performance, and effectiveness of audit process;

(viii) Approval or any subsequent modification of transactions of the company with related parties;

(ix) Scrutiny of inter-corporate loans and investments;

(x) Valuation of undertakings or assets of the company, wherever it is necessary;

(xi) Evaluation of internal financial controls and risk management systems;

(xii) Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;

(xiii) Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit;

(xiv) Discussion with internal auditors of any significant findings and follow up there on;

(xv) Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board;

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(xvi) Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern;

(xvii) To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors;

(xviii) To review the functioning of the Whistle Blower mechanism;

(xix) Approval of appointment of CFO (i.e., the whole-time Finance Director or any other person heading the finance function or discharging that function) after assessing the qualifications, experience and background, etc. of the candidate;

(xx) Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

It is important to note that the term "related party transactions" shall have the same meaning as provided in Clause 49(VII) of the Listing Agreement.

If the company has set up an audit committee as per section 177 of the Companies Act, the company agrees that the said audit committee shall have such additional functions / features as is contained in the Listing Agreement.

11. (a) Permanent Consolidation Adjustments: Permanent consolidation adjustments are those adjustments that are made only on the first occasion of the preparation and presentation of consolidated financial statements. Permanent consolidation adjustments are-

(i) determination of excess or deficit of the cost to the parent of its investment in a subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made (determination of goodwill or capital reserve);

(ii) determination of the amount of equity attributable to minorities at the date on which investment in subsidiary is made; and

(iii) determination of goodwill or capital reserve arising on application of equity method to account for investments in associates in consolidated financial statements.

Role of Auditor – Verification Procedure:

(i) The auditor should verify that the above calculations have been made appropriately.

(ii) The auditor should pay particular attention to the determination of pre-acquisition reserves of the subsidiary and associates. Date(s) of investment in subsidiary and associates assumes importance in this regard.

(iii) The auditor should also examine whether the pre-acquisition reserves have been allocated appropriately between the parent and the minorities of the subsidiary.

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(iv) The auditor should also verify the changes that might have taken place in these permanent adjustments on account of subsequent acquisition of shares in the subsidiary/ associates, disposal of the subsidiary/associate in the subsequent years.

(v) The auditor should also examine the joint venture agreements, to establish whether any change has taken place in the interest of the parent in the joint venture.

(vi) It may happen that in the case of one subsidiary, goodwill arises and in the case of another subsidiary a capital reserve arises. The parent may choose to net off these amounts to disclose a single amount in the consolidated balance sheet. In such cases, the auditor should verify that the gross amounts of goodwill and capital reserves arising on acquisition of various subsidiaries have been disclosed in the notes to the consolidated financial statements to reflect the excess/shortage over the parents' portion of the subsidiary's equity.

(b) Following are the Current Period Consolidation Adjustments while making Consolidation of Financial Statements:

(i) Elimination of intra-group transactions relating to interest or management fees etc.

(ii) Elimination of unrealized intra-group profits on assets acquired from other subsidiaries.

(iii) Elimination of intra-group indebtedness.

(iv) Adjustments for harmonizing different accounting policies of parent unit and its subsidiaries.

(v) Adjustments for impairment loss that might exist for goodwill.

(vi) Adjustment for significant events that occur between date of financial statements of the parent and of its components when the date/s of financial statements of components are different from the reporting date.

(vii) Determination of movement in equity attributable to the minorities since the date of acquisition of the subsidiary.

(viii) Treatment of minority interests' share of the losses, if such losses exceed the minority interests' share in the equity.

12. (a) Classification of Advances of a Bank based on Security:

(i) Advances covered by ECGC/DICGC guarantee should be treated as covered by guarantee to the extent of guarantee cover available. The amount received from ECGC/DICGC and kept in sundry creditor account pending adjustment should be deducted from advances.

(ii) An account which is fully secured but the margin in which is lower than stipulated by the bank should nevertheless be treated as fully secured for the purpose of balance sheet presentation.

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(iii) Cheques purchased including self cheques should be treated as unsecured.

(iv) Advances against supply bill unless collaterally secured, should be classified as unsecured even if they have been accepted by the drawee.

(b) **Audit of Advances:** The items to be covered in the current audit of advances of a bank are as follows-

(i) Ensure that loans and advances are sanctioned properly.

(ii) Verify whether the sanctions are in accordance with the delegated authority.

(iii) Ensure that securities and documents have been received and properly charged/registered.

(iv) Ensure that post disbursement supervision and follow up is proper.

(v) Verify whether there is any misuse of loans and advances and whether there are instances indicative of diversion of funds.

(vi) Check whether letters of credit issued by the branch are within the delegated power and ensure that they are genuine trade transactions.

(vii) Check bank guarantees issued are properly worked and recorded.

(viii) Ensure proper follow up of overdue bills of exchange.

(ix) Verify the classifications of advances are as per RBI directions.

(x) Verify whether the submission of claims to DICGC and ECGC is in time.

(xi) Verify the instances of exceeding delegated powers have been promptly reported.

(xii) Verify the frequency and genuiness of such exercise of authority beyond to delegated powers of the concerned officials.

13. (a) **Audit of Receipts and Payments Account:** Every insurer, in respect of insurance business transacted by him and in respect of his shareholders' funds, should prepare at the end of each financial year, a Balance Sheet, a Profit and Loss Account, a separate account of receipts and payments and a Revenue Account in accordance with the Regulations made by the IRDA. Since receipts and payments account has been made a part of financial statements of an insurer, it is implied that the receipts and payments account is also required to be audited.

The IRDA (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations require that the auditor of an insurance company should:

(i) report whether the receipts and payments account of the insurer is in agreement with the books of account and returns;

(ii) express an opinion as to whether the receipts and payments account has been prepared in accordance with the provisions of the relevant statutes; and

(iii) express an opinion whether the receipts and payments account give a true and

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fair view of the receipts and payments of the insurer for the financial year/period under audit.

It may hence be said that auditor is required to audit the Receipts and Payments Account of the insurer and also express an opinion on the same.

(b) (i) **Overdue interest:** Overdue interest should be excluded from interest outstanding and accrued due while calculating profit. Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue. In practice an overdue interest reserve is created and the credit of overdue interest credited to interest account is reduced.

(ii) **Compliance with provisions of the Act and Rules:** An auditor of a co-operative society is required to point out the infringement with the provisions of the relevant Co-operative Act Rules and bye-laws. The auditor of a co-operative society is also required to point out various irregularities, improprieties, and departure from the provision of the Act, rules framed thereunder and the bye-laws of the society. The financial implications of such infringements should be properly assessed and quantified by the auditor and they should be reported. Some of the State laws contain restrictions on the payment of dividends, which should be noted by the auditor and if dividend is declared in excess of the prescribed percentage, the fact should be reported by the auditor. Auditor should also ensure that various provisions in the Co-operative Societies Act, such as, restriction on borrowings, investment of funds, contribution to education funds, restriction on loans, etc are also complied with.

(iii) **Special Report to the Registrar:** The auditors are required to report on number of matters as prescribed in various states. In addition to the main report, the auditors are also required to submit by way of schedules/audit memorandum information on the working of the company as well. During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society he may report these special matters to the Registrar, drawing his specific attention to the points. The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance a special report may become necessary:

(a) Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.

(b) Detection of fraud relating to expenses, purchases, property and stores of the society.

(c) Specific examples of mis-management. Decisions of management against co-operative principles.

(d) In the case of urban co-operative banks, disproportionate advances to vested interest groups, such as relatives of management, and deliberate negligence about the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.

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14. (a) **Reporting for Issue of Shares for Value Exceeding Fair Market Value**: In this case, XYZ Pvt. Ltd. is a company, other than a company in which the public are substantially interested. It has received consideration for issue of shares of ₹ 80 per share (Face value ₹ 10 per share + Premium ₹ 70 per share) which exceeds the face value of ₹ 10 per share and fair market value of the shares of ₹ 60 per share.

Provisions and Explanations: A tax auditor has to furnish the details of shares issued during the previous year, under clause 29 of Form 3CD, in case, the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in section 56(2)(viib) of the Income Tax Act, 1961.

Section 56(2)(viib) provides that where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income-tax under the head "Income from other sources".

Since section 56(2)(viib) is applicable to companies in which public is not substantially interested, reporting under this clause is to be done only for corporate assessees. The auditor should obtain from the auditee, a list containing the details of shares issued, if any, by him to any person being a resident and verify the same from the books of accounts and other relevant documents.

Conclusion: As per the facts of the case, provisions and explanations given above, the income generated by XYZ Pvt. Ltd., due to differences in consideration received and fair market value of shares issued, is chargeable to income-tax under the head "Income from other sources" as per section 56(2)(viib) of the Income Tax Act, 1961.

Therefore, the tax auditor of XYZ Pvt. Ltd. is required to furnish the details of shares issued under clause 29 of Form 3CD.

(b) **Reporting for Sale of Building for Value Less Than Adopted by Authority:** In this case, X Ltd. has sold one of its buildings situated in Kolkata for a consideration of ₹ 40 Lakh which is less than the value assessed by the Government of West Bengal i.e. Stamp Duty value of ₹ 48 Lakh.

Provisions and Explanations: As per Clause (17) of Form 3CD, the tax auditor is required to furnish detailed information in case if any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C of the Income-tax Act, 1961, as under:

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

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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 said 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 discussed in fact of the cases, X ltd. has sold a building for an amount which is less than the stamp duty value. Hence, the tax auditor is required to report the details of property, consideration received or accrued and valued adopted or assessed or assessable under Clause (17) of Form 3CD.

Further, if value adopted is more than that assessable by any authority of State Government, no reporting is required by Tax Auditor.

(c) **Audit Programme for Conducting Audit of Public Trust:** An auditor should conduct routine checking during the course of audit of a public trust, in the following manner -

(i) Check the books of account and other records having regard to the system of accounting and internal control;

(ii) Vouch the transactions of the trust to satisfy that:

(1) the transaction falls within the ambit of the trust

(2) the transaction is properly authorized by the trustees or other delegated authority as may be permissible in law;

(3) all incomes due to the trust have been properly accounted for on the basis of the system of accounting followed by the trust;

(4) all expenses and outgoings appertaining to the trust have been recorded on the basis of the system of accounting followed by the trust;

(5) amounts shown as applied towards the object of the trust are covered by the objects of trust as specified in the document governing the trust.

(iii) Obtain trial balance on the closing date certified by the trustees' duly certified by the trustee;

(iv) Obtain Balance Sheet and Profit & Loss Account of the trust authenticated by the trustees and check the same with the trial balance with which they should agree.

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15. (a) **Qualification and Appointment of Cost Auditor:** According to section 148(3) of the Companies Act, 2013 read with Companies (Audit & Auditors) Rules, 2014 -

(i) in the case of companies which are required to constitute an audit committee, the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee;

(ii) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor.

It is also provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records.

In the given case, the members of Expro Ltd. appointed M/s Manan & Co., a practicing Chartered Accountant Firm and the statutory auditor of the company, as the cost auditor.

Therefore, the appointment of the CA firm as cost auditor made by the company is not valid. The Board shall appoint a cost accountant in practice or a firm of cost accountants in practice to conduct such cost audit.

(b) **Matters to be included in Cost Audit Programme:** It is a true statement that like any other audit a systematic planning for cost audit is also necessary. Therefore, the cost audit programme should include all the usual broad steps that a financial auditor includes in his audit programme. This would require that the various aspects like what to be done, when to be done and by whom to be dome are adequately takes care of. However, looking to the basic difference in cost audit and financial audit as allocation and apportionment of expenses, statutory requirement etc. should require special consideration. Cost audit, in order to be effective, should be completed at one time as far as practicable. Based on above factors a set of procedures and instructions are evolved which may be termed the cost audit programme. Matters to be included in the Cost Audit Programme may be divided into following two stages-

(I) Review of Cost accounting record: This will include -

(i) Method of costing in use - batch, process or unit.

(ii) Method of accounting for raw materials; stores and spares, wastages, spoilage defectives, etc.

(iii) System of recording wages, salaries, overtime and spares, wastages, etc.

(iv) Basis of allocation of overheads to cost centres and of absorption by products and apportionment of service department's expenses.

(v) Treatment of interest, recording of royalties, research and development expenses, etc.

(vi) Method of accounting of depreciation.

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(vii) Method of stock-taking and its valuation including inventory policies.

(viii) System of budgetary control.

(ix) System of internal auditing.

(II) Verification of cost statement and other data: This will mainly cover-

(i) Licensed, installed and utilised capacities.

(ii) Financial ratios.

(iii) Production data.

(iv) Cost of raw material consumed, wages and salaries, stores, power and fuel, overheads provision for depreciation etc.

(v) Sales realisation.

(vi) Abnormal non-recurring and special costs.

(vii) Cost statements.

(viii) Reconciliation with financial books.

Some other factors which need to be brought into cost audit programme includes system of cost accounting, range of products, areas to be covered etc. indicating allocation of manpower and the time to be taken for computing the audit.

16. (a) **Performance Audit:** A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action. Performance audits include economy and efficiency; and program audits.

Economy and efficiency audits may, for example, consider whether the entity -

(i) is following sound procurement practices;

(ii) is acquiring the appropriate type, quality, and amount of resources at an appropriate cost;

(iii) is properly protecting and maintaining its resources;

(iv) is avoiding duplication of effort by employees and work that serves little or no purpose;

(v) is avoiding idleness and overstaffing;

(vi) is using efficient operating procedures;

(vii) is using the optimum amount of resources (staff, equipment, and facilities) in producing or delivering the appropriate quantity and quality of goods or services in a timely manner;

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(viii) is complying with requirements of laws and regulations that could significantly affect the acquisition, protection, and use of the entity's resources;

(ix) has an adequate management control system for measuring, reporting, and monitoring a program's economy and efficiency; and

(x) has reported measures of economy and efficiency that are valid and reliable.

Program audits may, for example -

(i) assess whether the objectives of a new, or ongoing program are proper, suitable, or relevant;

(ii) determine the extent to which a program achieves a desired level of program results;

(iii) assess the effectiveness of the program and/or of individual program components;

(iv) identify factors inhibiting satisfactory performance;

(v) determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost;

(vi) determine whether the program complements, duplicates, overlaps, or conflicts with other related programs;

(vii) identify ways of making programs work better;

(viii) assess compliance with laws and regulations applicable to the program;

(ix) assess the adequacy of the management control system for measuring, reporting, and monitoring program's effectiveness; and

(x) determine whether management has reported measures of program effectiveness that are valid and reliable.

(b) **Right of C&AG of India under section 143(6) of the Companies Act, 2013**: According to section 143(6) of the Companies Act, 2013, the Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report have a right to,

(i) conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and

(ii) comment upon or supplement such audit report.

It may be noted that 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

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section 136 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.

17. (a) **Action Plan to Overcome Working Capital Crunch**: Adequate working capital is required for liquidity and smooth operations of the company. To ensure an adequate flow of working capital to the manufacturing company, the following action plan may be considered -

(i) **Working Capital Estimation:** The company should start by preparing a statement of the projected working capital requirements. This should be based on the functional budgets in sales, production, expenses, capital expenditure and the Master Budget consisting of projected profit and loss and the Balance Sheet.

(ii) **Cash Flow Statement / Cash Budget:** Month-wise cash budgets showing inflows and outflows of cash heading-wise should be prepared to analyse the major inflows and outflows affecting the entity. At this stage any wasteful outflow can be traced and eliminated. Bank reconciliation should be undertaken periodically so that outstandings can be traced and acted upon. This is also necessary to reduce the float time.

(iii) **Inventory / Stock Management:** Raw materials and inventories should be classified properly to determine the level of stock of materials. The method of costing also needs to be looked at minutely. There is a need to establish linkage with the production pattern and work backwards accounting for time factor in receipt of material. This needs to be worked out carefully since at no cost, production schedule should be hampered. The caution also need to be exercised that there is not unused/obsolete inventory. The system of inventory management needs to be looked at so as to check the avoidable wastes/scraps generated during storage and handling. Just in time philosophy will enable the company to reduce processing time, stocks and related costs. The adoption of such a mechanism would bring down the cost to a considerable extent.

(iv) **Credit Management:** The company should lay down a proper policy for evaluating customers, determining the credit period and offering discounts for early payment. An age-wise analysis of debtors should also be prepared so as to avoid credit to defaulters. The sale department needs to be geared up so that realisation can be made in time. A careful analysis should be done of various customers according to pattern of sales so as to exercise control on their respective debit balances. The company should through its purchase department endeavour to avail the maximum credit period from its creditors. This would enhance the working capital of the company.

(v) **Funds Flow Analysis:** The company should prepare a funds flow analysis, distinguishing between long-term and short-term sources and applications.

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(vi) **Investment Management:** The idle funds of the company, if any, should be invested in short-term securities to augment the income.

(vii) **WIP Analysis:** Minimum WIP should be monitored and for the purpose it is necessary to ensure that no bottlenecks develop at any stage during the production process.

(b) **Alternative Way to Tackle the Hostile Management**: While conducting the operational audit, the auditor has to come across many irregularities and areas where improvement can be made and therefore he gives his suggestions and recommendations.

These suggestions and recommendations for improvements may not be accepted by the hostile managers and in effect there may be cold war between the operational auditor and the managers. This would defeat the very purpose of the operational audit.

The Participative Approach comes to the help of the auditor. In this approach the auditor discuses the ideas for improvements with those managers that have to implement them and make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes co-operative enterprise.

This participative approach encourages the auditee to develop a friendly attitude towards the auditors and look forward to their guidance in a more receptive fashion. When participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear and gives room for feelings of mutual trust. Team spirit is developed. The auditors and the auditee together try to achieve the common goal. The proposed recommendations are discussed with the auditee and modifications as may be agreed upon are incorporated in the operational audit report. With this attitude of the auditor it becomes absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing and the auditor do not have to force any change on the auditee.

Hence, Operational Auditor of Amazekart manufacturing unit should adopt above mentioned participative approach to tackle the hostile management of Amazekart.

18. (a) **Due Diligence:** A due diligence audit on behalf of Preeto Ltd. with a view to acquiring the business shall involve following steps -

(i) **Brief history of the target and background of its promoters -** The accountant should begin the financial due diligence review by looking into the history of the company and the background of the promoters. The details of how the company was set up and who were the original promoters have to be gone into, before verification of financial data in detail. An eye into the history of the target may reveal its turning points, survival strategies adopted by the target from time to time, the market share enjoyed by the target and changes therein, product life cycle and adequacy of resources. It could also help the accountant in determining whether, in the past, any regulatory requirements

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have had an impact on the business of the target. Broadly, the accountant should make relevant enquiries about the history of target's business products, markets, suppliers, expenses, operations.

(ii) **Accounting policies -** The accountant should study the accounting policies being followed by the target and ascertain whether any accounting policy is inappropriate. The accountant should also see the effects of the recent changes in the accounting policies. The target might have changed its accounting policies in the recent past keeping in view its intention of offering itself for sale. The overall scope has to be based on the accounting policies adopted by the management. The accountant has to look at the main effect of accounting policies on the overall profitability and their correctness. It is reiterated that the accountant should mainly look at all material changes in Accounting Policies in the period subjected to review very carefully.

The accountant's report should include a summary of significant accounting policies used by the target, that changes that have been made to the accounting policies in the recent past, the areas in which accounting policies followed by the target are different from those adopted by the acquiring enterprise, the effect of such differences.

(iii) **Review of Financial Statements -** Before commencing the review of each of the aspect covered by the financial statements, the accountant should examine whether the financial statements of the target have been prepared in accordance with the Statute governing the target, Framework for Preparation and Presentation of the Financial Statements and the relevant Accounting Standards. If not the accountant should record the deviations from the above and consider whether it warrant an inclusion in the final report on due diligence.

After having an overall view of the financial statements, as mentioned in the above paragraphs, the accountant should review the operating results of the target in great detail. It is important to make an evaluation of the profit reported by the target. The reason being the price of the target would be largely based upon its operating results. The accountant should consider the presence of an extraordinary item of income or expense that might have affected the operating results of the target. It is advisable to compare the actual figures with the budgeted figures for the period under review and those of the previous accounting period.

(iv) **Taxation -** Tax due diligence is a separate due diligence exercise but since it is an integral component of the financial status of a company, it is generally included in the financial due diligence. It is important to check if the company is regular in paying various taxes to the Government. Generally taxes are levied both by the Central Government as well as by the State Government. Further taxes may be direct or indirect. Most of the tax laws require the enterprise to register itself with the government and it is important to check if all necessary registrations have been made. The accountant has to also look at the tax effects of the merger or acquisition.

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(v) **Cash Flow -** A review of historical cash flows and their pattern would reflect the cash generating abilities of the target company and should highlight the major trends. It is important to know if the company is able to meet its cash requirements through internal accruals or does it have to seek external help from time to time. It is necessary to check if a) Is the company able to honour its commitments to its creditors, to the banks, to government and other stakeholders b) How well is the company able to turn its debtors and stocks c) How well does it deploy its funds d) Are there any funds lying idle or is the company able to reap maximum benefits out of the available funds?

(vi) **Financial Projections** - The accountant should obtain from the target company the projections for the next five years with detailed assumptions and workings. He should ask to give projections on optimistic, pessimistic and most likely bases.

Ordinarily, it would be desirable that the accountant evaluates the appropriateness of assumption used in the preparation and presentation of financial projections. If, the accountant is of the opinion that as assumption used by the target is unrealistic, the accountant should consider its impact on the overall valuation of the company. He should offer his comments on all the assumption, highlighting those which, in his opinion are not inappropriate. In case he feels the projections provided by the target are not achievable or aggressive he has to mention this in his report. He should thoroughly check the arithmetic of the calculations made for financial projections.

(vii) **Management and Employees -** In the Indian context, the status of work force, staff and employees and their demands is a complex problem. In most of the companies which are available for take over the problem of excess work force is often witnessed. It is important to work out how much of the labour force has to be retained. It is also important to judge the job profile of the administrative and managerial staff to gauge which of these match the requirements of the new incumbents. Due to complex set of labour laws applicable to them, companies often have to face protracted litigation from its workforce and it is important to gauge the likely impact of such litigation.

It is important to see if all employee benefits like Provident Fund (P.F.), Employees State Insurance (E.S.I), Gratuity, leave and Superannuation have been properly paid/ provided for/funded. In case of un-funded Gratuity, an actuarial valuation of the liability has to be obtained from a reputed actuary. The assumptions regarding increase in salaries, interest rate, retirement etc. have to be gone into to see if they are reasonable. It is also necessary to see if the basic salary /wage considered for the valuation is correct and includes all elements subject to payment of Gratuity. In the case of PF, ESI etc. the accountant has to see if all eligible employees have been covered.

It is very important to consider the pay packages of the key employees as this can be a crucial factor in future costs. One has to carefully look at Employees Stock Option Plans; deferred compensation plans; Economic Value Addition and other performance linked pay; sales incentives that have been promised etc. It is

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also important to identify the key employees who will not continue after the acquisition either because they are not willing to continue or because they are to be transferred to another company within the 'group' of the target company.

(viii) **Statutory Compliance -** During a due diligence this is one aspect that has to be investigated in detail. It is important therefore, to make a list of laws that are applicable to the entity as well as to make a checklist of compliance required from the company under those laws. If the company has not been regular in its legal compliance it could lead to punitive charges under the law. These may have to be quantified and factored into the financial results of the company.

In addition to the above steps, the following further points have to be seen:

(i) Reason for sale of business and the effect on turnover and profits due to the exist of the present proprietor.

(ii) The length of the lease under which business has been operating.

(iii) The unexpired period of patents if any held by the vendors.

(iv) The age of managerial staff and prospects of their continuing in service in the new environment; the effect of trained managerial staff learning the organisation in production/sales/administrative and the financial liability to pay terminal benefits/compensation, etc.

(v) If bulk sales are to a few limited customers, the profitability should be discounted greatly, because any substantial withdrawal of customers might cause business crashes.

(vi) A company with a sound financial structure can better withstand the stresses and strains of business. A low debt-equity ratio would indicate an ability to grow through debt financing without raising equity.

(vii) The cash generated from operations; the need for redeployment of resources and funds needed for repayment of loans become major factors in determining growth potential.

(viii) The valuation of goodwill if any should be on reasonable basis having regards to all factors mentioned above.

(b) **Investigation for Higher Sales Turnover:** As per the facts that there has been consistently high turnover but declining net profits is an anomalous situation. It may be attributed to one or more following reasons requiring further investigation -

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

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

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

(iv) **High Administrative and Selling Expenses -** Administrative and selling costs are generally period costs which are fixed in nature. Their increase is generally not proportional to sale increase. However, a reduction in profit could also be due to increase in administrative overheads and sales overheads at a rate higher than the rate of increase in sales.

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

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

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

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

(i) a Cash Book

(ii) a Ledger

Thus, a Chartered Accountant in practice is required to maintain books of accounts. In the instant case, CA. Arjit does not maintain books of accounts bearing in mind the provisions of section 44AA of the Income Tax Act, 1961.

Accordingly, it does not matter whether section 44AA of the Income Tax Act, 1961 applies or not. Hence, Mr. Arjit, being a practicing Chartered Accountant will be held guilty of professional misconduct for violation of Council General Guidelines, 2008.

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

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

In the instant case, CA. Sufi accepted editorship of a journal for which he did not take any permission from the Council. In this context, it may be noted that the editorship of professional journals is covered under the general permission.

Therefore, CA. Sufi shall not be held guilty of professional misconduct in terms of Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949.

(c) **Certification of Financial Forecast:** Under Clause (3) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a CA in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in manner which may lead to the belief that he vouches for the accuracy of the forecast.

Further, SAE 3400 "The Examination of Prospective Financial Information", provides that the management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes. Thus, while making report on projection, the auditor need to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same.

Hence, Mr. Denis may accept the offer if the above requirements are complied with.

(d) **Printing of Designation "Chartered Accountant" on Invitations for Religious Ceremony:** As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, the Council of the ICAI is of the view that the designation "Chartered Accountant" as well as the name of the firm may be used in greeting cards, invitations for marriages, religious ceremonies and any other specified matters, provided that such greeting cards or invitations etc. are sent only to clients, relatives and close friends of the members concerned.

In the given case, CA. Sonu has instructed to write designation "Chartered Accountant" on invitation cards for a religious ceremony and distributed the same to all the relatives, close friends and clients of both the partners.

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In this context, it may be noted that the Council has allowed using designation "Chartered Accountant" in invitations for religious ceremony, provided these are sent to clients, relatives and close friends of the members concerned only.

Therefore, CA. Sonu would be held guilty of professional misconduct under the said clause for sending such invitations to the relatives, close friends and clients of CA. Monu as well.

20. (a) **Haphazard Sampling:** In haphazard selection, the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

Haphazard selection of sample, may be an acceptable alternative to random selection of sample, provided the auditor attempts to draw a representative sample from the entire population with no intention to either include or exclude specific units.

When the auditor uses this method, care needs to be taken to guard against making a selection that is biased, for example, towards items which are easily located, as they may not be representative.

(b) **Key Functions of Energy Auditor:** Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. In that context, energy management involves the basis approaches reducing avoidable losses, improving the effectiveness of energy use, and increasing energy use efficiency. The function of an energy auditor could be compared with that of a financial auditor. The energy auditor is normally expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues. Generally, energy auditor for the industry is an external party. The following are some of the key functions of the energy auditor-

(i) Quantify energy costs and quantities.

(ii) Correlate trends of production or activity to energy costs.

(iii) Devise energy database formats to ensure they depict the correct picture – by product, department, consumer, etc.

(iv) Advise and check the compliance of the organisation for policy and regulation aspects.

(v) Highlight areas that need attention for detailed investigations.

(vi) Conduct preliminary and detailed energy audits which should include the following:

(a) Data collection and analysis.

(b) Measurements, mass and energy balances.

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(c) Reviewing energy procurement practices.

(d) Identification of energy efficiency projects and techno-economic evaluation.

(e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.

(f) Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organisation requirements, communications and public relations.

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

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

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

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

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

(d) **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/doubtfull/loss and that proper provision has been made in accordance with the directions.

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(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.

(e) **Circumstances in which CA in Practice or Firm of CAs Cannot Conduct Tax Audit u/s 44AB:** As per the Guidance Note on Tax Audit, a Chartered Accountant in practice or Firm of Chartered Accountants cannot conduct Tax Audit under section 44AB of the Income Tax Act, 1961 in the following circumstances -

(i) Internal Auditor whether working with the Assessee or independently practicing Chartered Accountant or firm of Chartered Accountants acting as Internal Auditor of the assessee, cannot be appointed as Tax Auditor.

(ii) A Chartered Accountant who is responsible for writing or maintenance of books of account of the assessee or any partner of such Chartered Accountant or the firm in which such Chartered Accountant is a partner cannot accept the appointment as the Tax Auditor.

(iii) A Chartered Accountant cannot accept the Tax Audit assignment in respect of a concern in which he or his relative has substantial interest.

(iv) A Chartered Accountant should not accept the tax audit of a person to whom he is indebted for more than ₹ 10,000.

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PAPER – 4: CORPORATE AND ALLIED LAWS

PART – I: RELEVANT AMENDMENTS APPLICABLE FOR MAY 2016

(A) Applicability of Relevant Amendments/ Circulars/ Notifications/ Regulations etc.

The Study material (January 2015 edition) of Corporate and Allied Laws is relevant for May 2016 examinations. It contains all relevant amendments/ circulars/ Notifications etc. in the Companies Act, 2013 and the Allied Laws made till 30th September, 2014. Below are the further amendments/ circulars/ Notifications etc. notified between 1st October, 2014 to 31st October, 2015 which are also applicable for the said examinations:

SL.No.	Heading of Amendments	Gist
Section –A: Company Law		
1.	The Companies (Audit and Auditors) Amendment Rules, 2014	**Vide Notification G.S.R. 722(E) dated 14th October 2014**, the Central Government amended the Companies (Audit and Auditors) Rules, 2014. According to it, in the Companies (Audit and Auditors) Rules, 2014, after rule 10, the new section 10A has been inserted. "10A. For the purposes of clause (i) of sub-section (3) of section 143, for the financial years commencing on or after 1st April, 2015, the report of the auditor shall state about existence of adequate internal financial controls system and its operating effectiveness."
2.	The Companies (Accounts) Amendment Rules, 2014.	**Vide Notification G.S.R. 723(E), dated 14th October, 2014**, the Central Government amended the Companies (Accounts) Rules, 2014. In the Companies (Accounts) Rules, 2014, in rule 6, after the existing proviso, the following provisos have been inserted- "Provided further that nothing in this rule shall apply in respect of preparation of consolidated financial statement by an intermediate wholly-owned subsidiary, other than a wholly-owned subsidiary whose immediate parent is a company incorporated outside India: Provided also that nothing contained in this rule shall, subject to any other law or regulation, apply for the financial year commencing from the 1st day

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		of April, 2014 and ending on the 31st March, 2015, in case of a company which does not have a subsidiary or subsidiaries but has one or more associate companies or joint ventures or both, for the consolidation of financial statement in respect of associate companies or joint ventures or both, as the case may be."
3.	Clarification on matters relating to Consolidated Financial statements	**Vide General Circular No, 39/2014, dated 14th October, 2014**, clarifications has been issued on the manner of presentation of notes in Consolidated Financial Statement (CFS) to be prepared .Circular clarified 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 consolidated. In the CFS, the company would need to give all disclosures relevant for CFS only.
4.	Right of persons other than retiring director to stand for directorship - Refund of deposit under section 160 of the Companies Act, 2013 in certain cases.	**Vide General Circular 38/2014, dated 14th October 2014**, clarity has been bought by companies registered under section 8 of the Companies Act, 2013 about the manner in which the amount of deposit of rupees one lakh received by them under section 160(1) of the Companies Act, 2013 is to be handled if the depositor fails to secure more than twenty five have per cent of the total valid votes. It has been clarified that in such cases, the Board of directors of a section 8 company 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.
5.	Amendments to Schedule VII	**Vide Notification G.S.R. 741(E) dated 24th October, 2014**, the Central Government hereby made further amendments to Schedule VII of the Companies Act, 2013. (a) In item (i), after the words "and sanitation", the words "including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation" shall be inserted; (b) In item (iv), after the words "and water", the

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		words "including contribution to the Clean Ganga Fund setup by the Central Government for rejuvenation of river Ganga;" shall be inserted.
6.	The Companies (Accounts) Amendment Rules, 2015.	**Vide Notification G.S.R. 37(E) dated 16th January 2015** the Central Government amended the Companies (Accounts) Rules, 2014. In the Companies (Accounts) Rules, 2014,- **(i)** after rule 2, new rule 2A dealing with "Notice of address at which books of account are to be maintained" has been inserted. **(ii)** in rule 6, after the third proviso, the following proviso has been inserted- "Provided also that nothing in this rule (rule 6)shall apply in respect of consolidation of financial statement by a company having subsidiary or subsidiaries incorporated outside India only for the financial year commencing on or after 1st April,2014. **(iii)** the Annexure, after Form AOC-4, the Form no. AOC-5 (Notice of address at which books of account are to be maintained have been inserted.
7.	The Companies (Appointment and Qualification of Directors)Amendment Rules, 2015	**Vide Notification G.S.R. 42(E) dated 19th January 2015** the Central Government further amended the Companies (Appointment and Qualification of Directors) Rules, 2014. In the Companies (Appointment and Qualification of Directors) Rules, 2014, in rule 16, following proviso has been inserted- "Provided that in case a company has already filed Form DIR-12 with the Registrar under rule 15,a foreign director of such company resigning from his office may authorise in writing a practicing chartered accountant or cost accountant in practice or company secretary in practice or any other resident director of the company to sign Form DIR-11 and file the same on his behalf intimating the reasons for the resignation."
8.	The Companies (Corporate Social Responsibility Policy) Amendment Rules,	**Vide Notification G.S.R. 43 (E) dated 19th January 2015**, Central Government amended the Companies (Corporate Social Responsibility Policy) Rules, 2014.

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	2015	In the Companies (Corporate Social Responsibility Policy) Rules, 2014, in rule 4, in sub-rule (2),— (i) for the words "established by the company or its holding or subsidiary or associate company under section 8 of the Act or otherwise", the words "established under section 8 of the Act by the company, either singly or along with its holding or subsidiary or associate company, or along with any other company or holding or subsidiary or associate company of such other company, or otherwise" shall be substituted; (ii) in the proviso, in clause (i), for the words "not established by the company or its holding or subsidiary or associate company, it", the words "not established by the company, either singly or along with its holding or subsidiary or associate company, or along with any other company or holding or subsidiary or associate company of such other company" shall be substituted.
9.	The Companies (Removal of Difficulties) Order, 2015	**Vide Order S.O. 504(E) dated 13 February 2015,** the Central Government issued an order to remove the difficulties having arisen in giving effect to the provisions contained under sections 2(85) and 186(11)(b) of the Companies Act, 2013. In the Companies Act, 2013- (a) in section 2, in clause (85), in sub-clause (i), for the word "or" occurring at the end, the word "and" shall be substituted; and (b) in section 186 sub-section (11), in clause (b), after item (iii), the following item shall be inserted, namely :— "(iv) made by a banking company or an insurance company or a housing finance company, making acquisition of securities in the ordinary course of its business."
10.	Clarification with regard to section 185 and 186 of the Companies Act 2013 - loans and advances to employees.	**Vide General Circular No, 04/2015, dated 10/3/2015** clarification has been issued on the applicability of provisions of section 186 of the Companies Act, 2013 relating to grant of loans and advances by Companies to their employees. It has been clarified that loans and/or advances

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		made by the companies to their employees, other than the managing or whole time directors (which is governed by section 185) are not governed by the requirements of section 186 of the Companies Act, 2013. This clarification will, however, be applicable if such loans/advances to employees are in accordance with the conditions of service applicable to employees and are also in accordance with the remuneration policy, in cases where such policy is required to be formulated.
11.	The Companies (Meetings of Board and its Powers) Amendment Rules, 20l5.	**Vide Notification G.S.R. 206 (E) dated 18th March, 2015,** the Central Government hereby makes the following rules further to amend the Companies (Meetings of Board and its Powers) Rules, 2014. Item no. 3, 5, 6, 7, 8, and 9 of Rule 8 prescribing powers of Board which shall be exercised by the Board of Directors only by means of resolutions passed at meetings of the Board shall be omitted.
12.	Clarification under section 186(7) of the Companies Act, 2013	**Vide General Circular No. 06/2015 dated 9th April, 2015** Ministry has clarified that in cases where effective yield (effective rate of return) on tax free bonds is greater than the prevailing yield of one year, three year, five year or ten year, Government Security closest to the tenor of the loan, there is no violation of section 186(7) of the Companies Act, 2013.
13.	Remuneration to managerial person under Schedule XIII of the Companies Act, 1956 - Clarification with regard to payment for period	**Vide General Circular 07/2015 dated 10th April, 2015,** it has been clarified that a managerial person who has been appointed in accordance with provisions of Schedule XIII of the Companies Act, 1956, may continue to receive remuneration for his remaining term in accordance with terms and conditions approved by company as per relevant provisions of Schedule XIII of 1956 Act even if the part of his/her tenure falls after 1st April, 2014.
14.	The Companies (Auditor's Report) Order, 2015.	**Vide Order S.O. 990(E) dated 10th April 2015,** the Central Government, after consultation with the Institute of Chartered Accountants of India, issued the Companies (Auditor's Report) Order, 2015 in exercise of the powers conferred by section 143(11)

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		of the Companies Act, 2013 and in supersession of the Companies (Auditor's Report) Order, 2003.
15.	The Companies (Amendment) Act, 2015	**Vide Notification dated 29th May 2015**, Central Government declared the date of enforcement of provisions of sections 1 to 12 and 15 to 23 of the Companies (Amendment) Act, 2015.
16.	The Companies (Declaration and Payment of Dividend) Second Amendment Rules, 2015	**Vide Notification G.S.R. 441(E) dated 29th May 2015**, the Central Government through the issue of the Companies (Declaration and Payment of Dividend) Second Amendment Rules, 2015, omitted sub-rule (5) of Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014.
17.	The Companies (Registration Offices and Fees) Second Amendment Rules, 2015	**Notification G.S.R. 438(E) dated 29 May 2015**, the Central Government further amends the Companies (Registration Offices and Fees) Rules, 2014, through the issue of notification the Companies (Registration Offices and Fees) Second Amendment Rules, 2015. According to which in rule 15, the following proviso shall be inserted: "Provided that no person shall be entitled under section 399 to inspect or obtain copies of resolutions referred to in clause (g) of sub-section (3) of Section117of the Act."
18.	Exemptions to private companies	**Vide Notification no. G.S.R. 464(E), dated 5th June 2015** the Central Government in the interest of public, hereby directs that certain provisions of the Companies Act, 2013, shall not apply or shall apply with certain exceptions, modifications and adaptations to a private company.
19.	Exemptions to companies covered under section 8	**Vide Notification G.S.R. 466(E) dated 5th June 2015**, the Central Government in the interest of public, hereby directs that certain provisions of the Companies Act, 2013, shall not apply or shall apply with certain exceptions, modifications and adaptations to a body to which a license is granted under the section 8 of the Act.

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20.	Exemptions to Nidhi companies	**Vide Notification G.S.R. 465(E) dated 5 June 2015** the Central Government hereby directs that certain provisions of the Companies Act, 2013, shall not apply or shall apply with such exceptions, modifications and adaptations to Nidhis.
21.	Exemptions to Government Companies	**Vide Notification dated G.S.R.463(E) dated 5 June 2015** the Central Government hereby directs that certain provisions of the Companies Act, 2013, shall not apply or shall apply with such exceptions, modifications and adaptations to a Government company.
22.	Clarification with regards to circulation and filing of financial statement.	**Vide General Circular No. 11/2015, dated 21st July 2015**, Ministry has clarified that a company holding general meeting after giving shorter notice as provided under section 101 of the Act may also circulate financial statements(to be laid/ considered in the same general meeting) at such shorter notice. It has also been clarified that in case of foreign company which is not required to get its accounts audited as per the legal requirements prevalent in the country of its incorporation and which does not get such accounts audited, the holding or parent Indian may place or file such unaudited accounts to comply with requirements of section 136(1) and 137(1) as applicable. Further, the format of accounts of foreign subsidiaries should be, as far as possible, in accordance with requirements under the Companies Act, 2013. In case this is not possible, a statement indicating the reasons for deviation may be placed/ filed along with such accounts.
23.	The Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015	**Vide Notification dated 9th Sep 2015,** Central Government hereby made the rules called the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015, in supersession of the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011.

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Section – B: Allied Laws		
24.	SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009	SEBI **Vide Notification dated 24th March, 2015** has issued SEBI (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2015. The amendments have been carried out in regulation 4 and 54 of SEBI (ICDR) Regulations, 2009. For detail see http://www.sebi.gov.in/cms/sebi_data/attachdocs/1427273950402.pdf
25.	The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Second Amendment) Regulations, 2015	The Board **Vide Notification dated 5th May 2015,** hereby issue the SEBI (Issue of Capital and Disclosure Requirements) (Second Amendment) Regulations, 2015, to further amend the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, with effect from the date of their publication in the Official Gazette. For detail see http://www.sebi.gov.in/cms/sebi_data/attachdocs/1430885855266.pdf
26.	The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Third Amendment) Regulations, 2015.	**Vide Notification dated 11th August, 2015** , the Board hereby issues the SEBI (Issue of Capital and Disclosure Requirements) (Third Amendment) Regulations, 2015 further to amend Regulation 10 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 with effect from the date of their publication in the Official Gazette. For detail see http://www.sebi.gov.in/cms/sebi_data/attachdocs/1439288946967.pdf
27.	The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Fourth Amendment) Regulations, 2015.	The Board hereby issues the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Fourth Amendment) Regulations, 2015 **vide Notification dated 14th August, 2015** to further amend Regulation 60 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 with effect from the date of their publication in the Official. Gazette. For detail see http://www.sebi.gov.in/cms/sebi_data/attachdocs/1439551592983.pdf

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28.	The SEBI (Issue of Capital and Disclosure Requirements) (Sixth Amendment) Regulations, 2015	**Vide Notification dated 10th September 2015**, the Board hereby issues the SEBI (Issue of Capital and Disclosure Requirements) (Sixth Amendment) Regulations, 2015 to further amend the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 with effect from the date of their publication in the Official Gazette. They shall be applicable to issuers filing offer documents with the Registrar of Companies on or after the date of commencement of these regulations. For detail see http://www.sebi.gov.in/cms/sebi_data/attachdocs/1441965949162.pdf
29.	The Securities Contracts (Regulation) Act, 1956 [As Amended by the Finance Act, 2015]	Various amendments have been inserted in the Securities Contracts (Regulation) Act, 1956 by Part II of Chapter VIII of the Finance Act 2015, w.e.f. 28.09.2015 vide Gazette Notification F. No. 1/9/SM/2015, Extraordinary, Pt. II, Sec. 3, Sub-section (ii) dated 28.08.2015. For detail see http://www.sebi.gov.in/cms/sebi_data/attachdocs/1444898310496.pdf
30.	Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India)(Amendment) Regulations, 2015	**Vide Notification No. FEMA. 335/2015-RB, dated 4th Feb, 2015,** the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) (Amendment) Regulations, 2015, substituted the existing regulation 7 of the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000 (Notification No. FEMA 21/2000-RB dated May 3, 2000) with the following from the date of their publication in the Official Gazette: "**7. Prohibition on acquisition or transfer of immovable property in India by citizens of certain countries** No person being a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Macau or Hong Kong without prior permission of the Reserve Bank shall acquire or transfer immovable property in India, other than lease, not exceeding five years." For detail see https://rbi.org.in/scripts/FS_Notification.aspx?Id=9582&fn=5&Mode=0

31.	Foreign Exchange Management (Permissible Capital Account Transactions) (Second Amendment) Regulations, 2015	**Vide Notification No. FEMA. 337/2015-RB dated 2nd March, 2015**, a new explanation have been added in Regulation 4, in sub- regulation (b) with effect from the date of their publication in the Official Gazette. According to which, the Registrar of Chits or an officer authorised by the state government in this behalf, may, in consultation with the State Government concerned, permit any chit fund to accept subscription from Non-resident Indians. Non- resident Indians shall be eligible to subscribe, through banking channel and on non- repatriation basis, to such chit funds, without limit subject to the conditions stipulated by the Reserve Bank of India from time to time". For detail see https://rbi.org.in/scripts/FS_Notification.aspx?Id=9763&fn=5&Mode=0
32.	The Foreign Exchange Management (Export of Goods and Services) (Amendment) Regulations, 2015	Vide **Notification No. FEMA.342/RB-2014, dated 23rd April, 2015**, Reserve Bank of India notified the Foreign Exchange Management (Export of Goods and Services) (Amendment) Regulations, 2015. According to which Regulation 3 sub-regulation (1) shall be substituted by the following :- i. "(1) In case of exports taking place through Customs manual ports, every exporter of goods or software in physical form or through any other form, either directly or indirectly, to any place outside India, other than Nepal and Bhutan, shall furnish to the specified authority, a declaration in one of the forms set out in the Schedule and supported by such evidence as may be specified, containing true and correct material particulars including the amount representing –" ii. In Regulation 6, the word "SDF", wherever appear, shall be deleted For detail see https://rbi.org.in/scripts/FS_Notification.aspx?Id=9764&fn=5&Mode=0
33.	Foreign Exchange Management (Permissible Capital Account Transactions) (Third Amendment)	The Foreign Exchange Management (Permissible Capital Account Transactions) (Third Amendment) Regulations, 2015 **vide Notification No. FEMA. 341/2015-RB dated May 26, 2015** substituted the existing proviso contained in Regulation 4 sub-

	Regulations, 2015	regulation (a) of the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 with the following- (a) subject to the provisions of the Act or the rules or regulations or directions or orders made or issued thereunder, a resident individual may, draw from an authorized person foreign exchange not exceeding USD 250,000 per financial year or such amount as decided by Reserve Bank from time to time for a capital account transaction specified in Schedule I. *Explanation*: Drawal of foreign exchange as per item number 1 of Schedule III to Foreign Exchange Management (Current Account Transactions) Rules, 2000 dated 3rd May 2000 as amended from time to time, shall be subsumed within the limit under proviso (a) above. (b) Where the drawal of foreign exchange by a resident individual for any capital account transaction specified in Schedule I exceeds USD 250,000 per financial year, or as decided by Reserve Bank from time to time as the case may be, the limit specified in the regulations relevant to the transaction shall apply with respect to such drawal. PROVIDED FURTHER that no part of the foreign exchange of USD 250,000, drawn under proviso (a) shall be used for remittance directly or indirectly to countries notified as non-co-operative countries and territories by Financial Action Task Force (FATF) from time to time and communicated by the Reserve Bank of India to all concerned." For detail see https://rbi.org.in/scripts/FS_Notification.aspx?Id=9757&fn=5&Mode=0
34.	The Foreign Exchange Management (Current Account Transactions) Amendment Rules, 2015	Vide **Notification No. G.S.R. 426(E) dated 26th May 2015** in exercise of the powers conferred by section 5 and sub-section (1) and clause (a) of sub-section (2) of section 46 of the Foreign Exchange Management Act, 1999 (42 of 1999), and in consultation with Reserve Bank, the Central Government having considered it necessary in the public interest, makes the following amendment to the Foreign Exchange Management (Current Account Transactions) Rules, 2000, by issuing the rules called as the Foreign

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		Exchange Management (Current Account Transactions) Amendment Rules, 2015, with effect from the date of their publication in the Official Gazette. As per the amendment rules, with respect to the requirement of Prior approval of Reserve Bank.— Every drawal of foreign exchange for transactions included in Schedule III shall be governed as provided therein: Provided that this rule shall not apply where the payment is made out of funds held in Resident Foreign Currency (RFC) Account of the remitter. Also Schedule III of the Foreign Exchange Management (Current Account Transactions) Rules, 2000 has been substituted with the Schedule III provided therein. For detail see https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9756&Mode=0
35.	The Foreign Exchange Management (Export of Goods & Services) (Second Amendment) Regulations, 2015	Vide Notification **FEMA. 347/2015-RB, dated 24th July 2015**, Reserve Bank of India amended the Foreign Exchange Management (Export of Goods and Services) Regulations, 2000 through passing of the Regulations called as the Foreign Exchange Management (Export of Goods and Services) (Second Amendment) Regulations, 2015. As per the amendment clause (h) of the regulation 4 of the principal regulations, stands deleted which deal with the export of goods /services that may be made without furnishing the declaration to Myanmar under the Barter Trade Agreement. For detail see https://rbi.org.in/scripts/FS_Notification.aspx?Id=10060&fn=5&Mode=0
36.	The Insurance Act, 1938 and the Insurance Regulatory and Development Authority Act, 1999	**Vide Notification dated 23rd March, 2015,** Ministry of Law and Justice further amended the Insurance Act, 1938 and the Insurance Regulatory and Development Authority Act, 1999 by enacting the Insurance Laws (Amendment) Act, 2015. It shall be deemed to have come into force on the 26th day of December, 2014. **Note: The reading material in relation to the Insurance Act, 1938 as amended by the Insurance (Amendment) Act, 2015 is given in annexure at the**

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		end of this RTP. Students may also refer the same from the website at http://resource.cdn.icai.org/41015bos30829.pdf

(B) Non-Applicability of the following chapters for the said examinations:

S. No.	Subject Matter
(i)	Chapter 9 of the study material (January 2015 edition) covering provisions relating to Revival and Rehabilitation of Sick-Industrial Companies.
(ii)	Chapter 15 of the study material (January 2015 edition) covering provisions relating to the National Company Law Tribunal and Appellate Tribunal.

PART – II: QUESTIONS AND ANSWERS

QUESTIONS

SECTION – A: COMPANY LAW

Dividend

1. (a) (i) XYZ, a Government Company (100% paid up capital is held by a State Government) has been declaring dividend at the rate of 20% during the last 3 years. The Company has not made adequate profits during the year ended 31st March, 2015, but it has got adequate reserves which can be utilized for maintaining the rate of dividend at 20%. State in the light of the Companies Act, 2013 whether the XYZ company can declare dividend for the year 2014-15.

(ii) R Limited did not have sufficient profits during the preceding financial year. The Board of Directors of the company propose to declare dividend out of the accumulated profits earned during the previous years which were transferred to some other reserves other than free reserves. Examine the validity of the above act referring to the provisions of the Companies Act, 2013.

(b) Mr. Representative, had purchased shares from Mr. Owner on 30th November 2015. He applied to the company for the transfer of shares in his name but the company failed to register the shares in his name. On 20th January 2016, the company declared dividend. Referring to the provisions of the Companies Act, 2013, comment whether Mr. Representative is entitled to receive the dividends?

Accounts and Audit

2. (a) Rajasthan Textiles Limited (RTL) is a company in India with a subsidiary company M and subsidiary company S in USA. Decide the liability of RTL with respect to the filing of the financial statements under the Companies Act, 2013.

(b) An audit firm, comprising of two partners, holds office as auditor of 40 private companies. Such audit firm wants to be further appointed as an auditor in XYZ Pvt. Ltd with a paid up capital of 110 crore . Decide whether this is in consonance with the applicable law.

3. (a) Mr. Zed, was appointed as an auditor of a company on 1st December, 2015. The company was incorporated on 1st November, 2015. Mr. K, a relative of Mr. Zed was holding securities of that company having face value of ` 1,10, 000. Mr. Murthy, a shareholder of the company raised an objection on the appointment of the auditor. Referring to the provisions of the Companies Act, 2013, comment whether the contention of Mr. Murthy is tenable.

(b) Mr. D, one of a Director in PQR Limited was not satisfied with the performance of its subsidiary company in financial matters. He authorised Mr. F, a financial expert, to inspect the books of accounts of the company on his behalf. Decide, under the provisions of the Companies Act, 2013 whether the said company can refuse to allow Mr. F to inspect the books of accounts of its subsidiary company?

Appointment and qualification of Directors

4. Explaining the regulatory provisions of the Companies Act, 2013 and the rules thereof regarding the appointment of independent directors on a company's Board, state whether BCD company Ltd. is required to appoint Independent directors in the following situations:

   (i) The company has a paid up share capital of ` 10 crore.

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

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

5. Examine the validity of the following appointments with reference to the provisions of the Companies Act, 2013:

   (i) Mr. Person together with one of his relatives holds 3% of the total voting power of XYZ Ltd. The Board of Directors of the company appointed him as an independent director.

   (ii) ABC Ltd., a listed company having 5,000 small shareholders, upon receiving notice from 400 of such small shareholders has refused to appoint a small shareholders' director under section 151 of the Companies Act, 2013.

   (iii) Mr. D, who fails to get appointed as a director in the general meeting of AJD Limited, subsequently was appointed as an additional director by the Board of Directors of the company.

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Appointment and Remuneration of Managerial Personnel

6. Mr. Raman is a Managing Director of X company. He resigns from his office as a result of amalgamation of the X company with the other body corporate. Further he is appointed as the Managing director of the body corporate resulting from the amalgamation. State in the light of the Companies Act, 2013 whether in this situation, is company liable towards Managing Director to compensate for the loss of office after his resignation?

7. (a) Mr. W have been appointed as a whole time director in a public company which is having a paid up share capital of 20 crores. He met with an accident which led the office of whole time KMP vacant. State the provisions of the Companies Act, 2013 with regards to filling of the casual vacancy of KMP. What will be the answer if Mr. W have been appointed as whole time director in a Government Company?

   (b) Global care Ltd. owns a Multi-specialty Hospital in Delhi. Dr. Dell, a practicing neuron surgeon, has been appointed by the company as its director and it wants to pay him fee, on case to case basis, for surgery performed on the patients at the hospital. Examine whether payment of such fee to him would amount to payment of managerial remuneration to a director subject to any restriction under the Companies Act, 2013.

Meetings of Board and its powers

8. XYZ Ltd. is a foreign collaborator in ABC Ltd incorporated in India under the Companies Act, 2013. The foreign collaborator holds 49% of the shareholding. The Board meetings of ABC Ltd are usually held in India and sometimes meetings of the Board are called at a very short notice for which there is a provision in the Articles of Association that during such situations notices of the meetings of the Board can be sent by e-mail. State in this connection whether such a provision in the Articles of Association of a foreign collaborated company is valid within the purview of the provisions of the Companies Act, 2013.

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

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

      (ii) If Mona Ltd. is a company formed for the promotion of the sports in a remote area of the Jharkhand State, what will be the quorum for the Board Meeting?

   (b) Mr. Kamal is a director of Y Pvt. company. The company entered into a contract with company Z with a paid-up capital of ` 20 lakhs. Mr. Kamal holds equity shares of the nominal value of ` 50,000 in Z company. He discloses his interest at the Board meeting under section 184 of the Companies Act, 2013. Examining the law given under the Companies Act, 2013, state whether Mr. Kamal can participate in the meeting?

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Inspection, Inquiry and Investigation

10. A notice was sent to Mr. Left by the registrar to furnish the information related to a business transacted during his tenure in the X company. Mr. Left ignored the notice considering that he is no more an employee of X company. Registrar issued the summon against Mr. Left. Explain in the light of the Companies Act, 2013 about the liability of the Mr. Left in the given case.

Compromise, Arrangements and Amalgamations

11. P Ltd. and Q Ltd. proposed in their respective meeting schemes for amalgamation of both the companies. The members of both P Limited and Q Limited approved the schemes of amalgamation by majority. A C.A firm was hired to fix the exchange ratio. The scheme of amalgamation was submitted for the sanction of the Court. In the mean time, a small group of members of one of the merging companies objected to the amalgamation on the ground that the exchange ratio was unfair.

    (i) Decide whether the said objection is likely to be sustained under the Companies Act, 1956.

    (ii) Would your answer be different if similar objection was raised by the Central Government?

Prevention of Oppression and Mismanagement

12. The profits of ABC Limited for the financial year 2014-2015 fell considerably due to recession. The Board of directors of the company, therefore, bonafide did not recommend any dividend for the year. At the Annual General Meeting of the company, a group of members objected to the Board's decision and wanted the Board to make recommendation for dividend.

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

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

    (i) Whether the members contention shall be tenable?

    (ii) Whether the act of Board of Directors not to recommend any dividend shall amount to oppression and mismanagement?

Winding Up

13. (a) X Ltd. had gone into liquidation and a liquidator was appointed to administer the assets and liabilities of the Company. The liquidator of the Company finds that the assets of the Company are not sufficient to meet out the liabilities. He therefore, calls on the contributories including the part members as per List B to contribute towards the assets. The past members object to the liquidator’s act on the ground that since there are no more members of the Company, they are not liable to

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contribute. Referring to the provisions of the Companies Act, 1956 decide:

(1) Whether the contention of the past member is tenable and can they be exempted from the liability to contribute?

(2) What would be your answer in case the members in question are the present members?

(b) The Management of Alpha Ltd. filed winding up petition for misappropriation of funds of the company. State the procedure that may be followed for scrutiny, inspection and investigation in winding up cases ?

Producer Companies

14. (a) (i) A Producer Company wants to issue bonus shares. You are required to state the relevant provisions of the Companies Act, 1956 in this regard.

(ii) What are the modes of investment, from and out of its general reserves, available to a Producer Company formed and registered under Section 581C of the Companies Act, 1956?

(b) Explain the provisions of the Companies Act, 1956, relating to the manner in which the meetings of the Board of Directors of a 'producer company' are required to be held. Also state the manner in which the directors of the company (Producer company) be paid sitting fees for attending the Board meetings and the committees thereof.

Companies Incorporated outside India

15. JKL Ltd. was incorporated in London. Mr. Y an Indian citizen holds 25% of the paid up capital. X Ltd. a company registered in India holds 30% of the paid up capital of JKL Ltd. JKL Ltd. has recently established a share transfer office at New Delhi. The company seeks your advice as to what formalities it should observe as a foreign company under Companies Act, 2013.

Offences and Penalties/E-Governance/Special Courts

16. What things should be taken care of while filling an application for allotment of DIN? What procedure has to be followed, if there is any change in particulars of Director?

17. P, a private company committed an offence related to issue of securities to a group of persons. A shareholder among the group, filed a complaint against the company and its officers. Examine the law related to the cognizance of an offence under the Companies Act, 2013. What if, the said company would have been a government company?

Miscellaneous provisions

18. The Board of Directors of Hi-tech company having its registered office at Chennai, decided to keep its books of accounts in Mumbai. Company failed to intimate the same and to file the relevant document to the registrar within the prescribed time. State the law

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with respect to submission of the document after the time specified in the relevant provision under the Companies Act, 2013.

19. Arihant Ltd. proposed in the Board to borrow money from the Company's bankers in the ordinary course of the business exceeding the aggregate of the paid up share capital and free reserves of the Company. Draft the special resolution as per the Companies Act, 2013 stating that the Board have been allowed to borrow money for the conduct of the Business.

SECTION – B: ALLIED LAWS

The Securities and Exchange Board of India (SEBI)

20. (i) What are the ways in which any person may be prohibited on the use of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control?

    (ii) How the price of the specified securities is determined by the issuer as per the SEBI (ICDR) Regulations, 2009?

The Securities Contracts (Regulation) Act, 1956

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

    (b) State the Special Provisions related to commodity derivatives inserted by the Finance Act, 2015, w.e.f. 28.09.2015 in the Securities Contracts (Regulation) Act, 1956.

The Foreign Exchange Management Act, 1999

22. (a) Miss Liza is an airhostess with the British Airways. She flies for 12 days in a month and thereafter takes a break for 18 days. During the break, she is accommodated of 'base', which is normally the city where the airways are headquartered. However, for security considerations, she was based in Mumbai. During the financial year, she was accommodated at Mumbai for more than 182 days. What would be her residential status under FEMA?

    (b) State which kind of approval is required for the following transactions under the Foreign Exchange Management Act, 1999:

    (1) X, a Film Star, wants to perform alongwith associates in New York on the occasion of Diwali for Indians residing at New York. Foreign Exchange drawal to the extent of US dollars 20,000 is required for this purpose.

    (2) R wants to get his heart surgery done at UK. Up to what limit Foreign Exchange can be drawn by him and what are the approvals required?

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(3) L wants to pursue a course in Fashion design in Paris. The Foreign Exchange drawal is US dollars 20,000 towards tuition fees and US dollars 30,000 for incidental and stay expenses for studying abroad.

The Competition Act, 2002

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

(b) Bombay Textiles Limited and Gujarat Textiles Limited marketing their products in India propose to be amalgamated. The enterprise created as a result of the said amalgamation will have assets of value of ` 300 crore and turnover of ` 1000 crore. Examine whether the proposed amalgamation attracts the provisions of the Competition Act, 2002?

The 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) X, a newly established insurance company started the business of health insurance. It decided to get itself registered with the paid up equity capital of ` 99 crore excluding the preliminary expenses incurred during formation and registration. Examine in the light of the Insurance Act, 1938, whether X can be registered and can conduct the insurance business.

(b) RST Ltd. is a securitization and reconstruction company under SARFAESI Act, 2002. The certificate of registration granted to it was cancelled. State the authority which can cancel the registration and the right of RST Ltd. against such cancellation.

The Prevention of Money Laundering Act, 2002 & Interpretation of Statutes, Deeds and Documents

25. (a) Mr. Fraudulent has been arrested for a cognizable and non-bailable offence punishable for a term of imprisonment for more than three years under the Prevention of Money Laundering Act, 2002. Advise, as to how can he be released on bail in this case?

(b) Explain the "Rule of Exceptional Construction" with regards to interpretation of Statutes .

SUGGESTED ANSWERS/HINTS

1. (a) (i) As per the second proviso to section 123(1) of the Companies Act, 2013, where a company, owing to inadequacy or absence of profits in any financial year, proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such

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declaration of dividend shall be made only in accordance with prescribed rule 3 of the *Companies (Declaration and Payment of Dividend) Rules, 2014*.

Vide Notification No. G.S.R. 463(E), dated 5th June 2015 Central Government directed that this proviso to section 123(1), shall not apply to a Government Company where the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments.

In the given case, therefore, the XYZ, a Government Company cannot declare dividend out of accumulated Reserves in the financial year 2014-15.

(ii) As per section 123(1) of the Companies Act, 2013, where a company, owing to inadequacy or absence of profits in any financial year, proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall be made only in accordance with prescribed rules of the *Companies (Declaration and Payment of Dividend) Rules, 2014*. Such dividend shall be declared or paid by a company only from its free reserves. No other reserve can be utilized for the purposes of declaration of such dividend.

Hence the decision of the Board of Directors of R Ltd. is not valid to declare dividend from any reserve other than free reserves.

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

Accordingly in the given situation, Mr. Representative is entitled to receive the dividend. The company shall transfer the dividend in relation to Mr. Representative's share to the Unpaid Dividend Account unless the company is authorized by Mr. Owner, the registered holder of such shares, in writing to pay such dividend to Mr. Representative, the transferee, specified in the instrument of transfer.

2. (a) Under section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, it shall, in addition to the financial statements provided under sub-section (2), prepare a consolidated financial statement (CFS) of the company and of all the subsidiaries in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub-section (2).

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Provided that the company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in such form as may be prescribed.

Section 129(2) provides that at every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year.

Accordingly as per the above provisions, CFS is prepared at the holding company level, so RTL (holding company of M & S) is required to prepare in addition to its own financial statements , a CFS of the company and of all the subsidiaries in the same form and manner as that of its own. So, the CFS prepared by RTL will include the financial statement of RTL and of its subsidiaries M and S in USA.

(b) As per section 141(3)(g) of the Companies Act, 2013, private companies shall also been included in the provisions with respect to ceiling on number of audits with the restriction inserted vide Notification No. G.S.R. 464(E), dated 5th June 2015, that the private companies having paid up share capital less than 100 crore rupees shall not be included for calculation of specified number of audits. As per the provision, a person shall not be eligible for appointment as an auditor of a company if such person or partner is at the date of such appointment or reappointment holding appointment as an auditor of more than twenty companies.

Since XYZ Pvt. Ltd. is with paid up share capital 110 crore and so will be included in the prescribed ceiling limit of audit, therefore, such audit firm cannot be appointed as an auditor of XYZ Pvt. Ltd as it will exceed the ceiling prescribed for number of audits.

Assumption: Here, it is assumed that all the 40 private companies in which the said audit firm holds the office of auditor are having the paid up capital of ` 100 crore or more.

3. (a) As per section 141(3)(d)(i) of the Companies Act, 2013, an auditor is disqualified to be appointed as an auditor if he or his relative or partner is holding any security of or interest in the company or its subsidiaries, or of its holding or associate company or a subsidiary of such holding company. Further as per proviso to this section the relative of the auditor may hold the securities or interest in the company of face value not exceeding ` 1,00,000.

Referring the above provisions to the given situation, Mr. K, the relative of Mr. Zed, an auditor, is holding securities of Face value of ` 1,10,000 in the company, which is in contravention to the provisions of Section 141(3)(d)(i). Therefore, Mr. Zed is not eligible for appointment as an auditor of the company. Hence, the contention of Mr. Murthey is tenable.

(b) Under section 128(3) of the Companies Act, 2013, the books of account and other books and papers maintained by the company within India shall be open for

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inspection at the registered office of the company or at such other place in India by any director during business hours, and in the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director subject to such conditions as prescribed under *Rule 4 of the Companies (Accounts) Rule, 2014*.

Provided that the inspection in respect of any subsidiary of the company shall be done only by the person authorized in this behalf by a resolution of the Board of Directors.

In the given case, Mr. D being the director in PQR Limited authorised Mr. F to inspect the books of accounts of its subsidiary company. As per the above provision, the inspection in respect of any subsidiary of the company shall be done only by the person authorized in this behalf by a resolution of the Board of Directors.

Since in the given problem, Mr. F was authorized by the Mr. D at its own without seeking approval of the Board of Directors to inspect the books of accounts of its subsidiary company. So, company can refuse to allow Mr. F to inspect the books of accounts of its subsidiary company.

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

According to the *Companies (Appointment and Qualification of Directors) Rules, 2014*, the following class or classes of companies shall have at least 2 directors as independent directors:

(1) the Public Companies having paid up share capital of 10 crore rupees or more; or

(2) the Public Companies having turnover of 100 crore rupees or more; or

(3) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding 50 crore rupees.

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

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

(i) Since, the company has a paid up share capital of ` 10 crore, it is mandatory to appoint atleast 2 directors as Independent Directors.

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(ii) Since, the paid up share capital is only ` 2 crore, it is not mandatory to appoint the Independent Directors.

(iii) As per the provisions a person who has been or is a one of the key Managerial Personnel cannot be appointed as an independent director in the given case.

5. **(i)** An independent director means a director who, neither himself nor any of his relatives holds together with his relatives 2% or more of the total voting power of the company [Section 149(6) of the Companies Act, 2013].

In the given problem, Mr. Person holds together with his relatives 3% of the total voting power of XYZ Ltd. Hence his appointment as an independent director is not valid.

(ii) According to section 151 of the Companies Act, 2013, a listed company may have one director elected by such small shareholders in such manner and on such terms and conditions as given in rule 7 of *the Companies (Appointment and Qualification of directors) Rules, 2014.*

As per the rule, a listed company, may upon notice of not less than-

(a) one thousand small shareholders; or

(b) one- tenth of the total number of such shareholders,

whichever is lower, have a small shareholders' director elected by the small shareholders.

Thus, according to the provisions stated above, since the number of small shareholders of ABC Ltd. who applied is less than 1000 and 500 (1/10th of the total 5000)small shareholders, ABC Ltd. can validly refuse to appoint such a director.

(iii) According to section 161(1) of the Companies Act, 2013, a person who fails to get appointed as a director in a General Meeting, cannot be appointed as an additional director.

Hence the appointment of Mr. D as an additional director in AJD Ltd. is not valid.

6. According to Section 202 of the Companies Act, 2013, a company may make payment to a managing or whole-time director or manager, but not to any other director, by way of compensation for loss of office, or as consideration for retirement from office or in connection with such loss or retirement.

However, in certain situations, no compensation shall be made by the company. As per the situation given in Section 202(2)(a) , where the director resigns from his office as a result of the reconstruction of the company, or of its amalgamation with any other body corporate or bodies corporate, and is appointed as the managing or whole-time director, manager or other officer of the reconstructed company or of the body corporate resulting from the amalgamation; no company shall make payment by way of compensation for loss of office to a managing or whole-time director or manager.

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As per the facts given in the question, Mr. Raman, a Managing Director of X company resigns from his office as a result of amalgamation of the said company with the other body corporate. He is appointed as Managing Director of the Body Corporate resulting from the amalgamation. So, accordingly, as per the above stated provision, company shall not make compensation to the Mr. Raman for the loss of office due to his resignation on the account of amalgamation of the company with other body corporate.

7. (a) As per section 203 of the Companies Act, 2013, every company belonging to such class or classes of companies as may be prescribed, shall have the whole time Key Managerial Personnel. According to Rule 8 of the *Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014* every listed company and every other public company having a paid-up share capital of ` 10 crore or more shall have whole-time key managerial personnel.

Further as per the Sub-section 4 to Section 203 of the Companies Act, 2013, if the office of any whole-time KMP is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

Vide Notification No. G.S.R. 463(E) dated 5th June, 2015, new sub-section 4A to Section 203 has been inserted. According to which the provisions of sub-section (1), (2), (3) and (4) of section 203 shall not apply to a managing director or Chief Executive Officer or manager and in their absence, to a whole-time director of the Government Company. So the law given above in section 203(4) shall not be attracted in the case of Government Company.

(b) In the given case, Dr. Dell has been appointed as a director. He has to be paid a fee for surgeries performed by him; it shall be fully possible under section 197(4) which states that the remuneration payable to the directors including managing or whole-time director or manager shall be inclusive of the remuneration payable for the services rendered by him in any other capacity except the following:

(i) the services rendered are of a professional nature; and

(ii) in the opinion of the Nomination and Remuneration Committee (if applicable) or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

The company can therefore, pay a remuneration to Dr. Dell a fee for surgeries performed by him as a professional fee which shall not be construed as a Managerial Remuneration under the Act.

8. In terms of the proviso to section 173(3) of the Companies Act, 2013 a meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting. No exception is made for any class or classes of companies.

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Further, under section 173(3) a meeting of the Board shall be called by giving not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

Hence, the sending of notice by e mail is an ordinary mode of sending notice of a board meeting under the Companies Act, 2013.

Therefore, in the given case the shorter notice is legally permitted with the only condition being the presence of the quorum and at least one independent director. The provision of the Articles in this regard is not relevant as the position is amply clear in the Act itself.

9. **(a)** **(i)** According to section 174(1) of the Companies Act, 2013, quorum is one third of the total strength of Board (any fraction contained in the said one third being rounded of as one) or two directors whichever is higher. The total strength is to be derived after 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. Being higher than 2, therefore 3 directors would constitute the quorum for the Board meetings.

   (ii) Any limited company formed with an object for the promotion of the sports, etc. shall be companies covered section 8 of the Companies Act, 2013. Vide Notification G.S.R.466(E) dated 5th June 2015 the companies covered under section 8 of the Companies Act, 2013 shall constitute quorum for the Board meeting, either eight members or 25% of its total strength whichever is less. Provided that quorum shall not be less than two members.

   (b) As per section 184 (2) of the Companies Act, 2013 the disclosure of interest by directors do apply to any contract or arrangement within two companies where any of the directors of one company or two or more of them together holds more than 2% of the paid up share capital in the other company and such an interested director/s shall not participate in such meeting in which such contract or arrangement is discussed. In the present case, the holding of the Mr. Kamal (director of Y Pvt. Company) in company Z is more than 2% [(50,000/20,00,000)*100% = 2.5%]. Vide Notification dated G.S.R. 464(E), dated 5th June 2015, section 184(2) of the Companies Act, 2013 shall apply on the private companies with the exception that the interested director may participate in such meeting after disclosure of his interest, at the meeting of the Board . So, Mr. Kamal, director of Y company can participate in the said meeting.

10. **Power of the Registrar to call for information, explanation or documents:** According to section 206(1) of the Companies Act, 2013, where on a scrutiny of any document filed by a company or on any information received by him, the Registrar is of the opinion that any further information or explanation or any further documents relating to the company is necessary, he may by a written notice require the company—

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(a) to furnish in writing such information or explanation; or

(b) to produce such documents,

within such reasonable time, as may be specified in the notice.

Further, proviso to sub-section (2) of section 206 provides that where such information or explanation relates to any past period, the officers who had been in the employment of the company for such period, if so called upon by the Registrar through a notice served on them in writing, shall also furnish such information or explanation to the best of their knowledge.

In the given instance, Mr. Left is a past member of the company. Registrar by serving notice asked Mr. Left to furnish the information related to the business transaction made during his tenure. So as per the above provision, where such information or explanation relates to any past period, the officers who had been in the employment of the company for such period, if so called upon by the Registrar through a notice served on him, he has a duty to give such information / Explanation to the best of his knowledge. Mr. Left is liable to provide such information.

11. **Amalgamation – Exchange Ratio:** In the matter given in the question, the court leaves the aspect of share valuation to expert valuers and shareholders. Unless the person who challenges the valuation satisfies the court that the valuation is grossly unfair, the court will not disturb the scheme of amalgamation. *(Piramal Spg. Vs. Weaving Mills Ltd.)*

    (i) In this case, the valuation is confirmed to be fair by firm of Chartered Accountants and is also confirmed by majority of members. The objection raised by some shareholders of a small group cannot be sustained. *(Hindustan Lever Employees Union Vs. Hindustan Lever Ltd.)*

    (ii) Section 394A of the Companies Act, 1956 requires the Court to give notice of every application made to it under sections 391 or 394 of the said Act, to the Central Government. The Court should take into consideration the representations, if any, made to it by the government before passing any order. The role played by the Central Government is that of impartial observer who acts in public interest and advises the court whether it is or it is not feasible for the two companies to amalgamate. Thus, in case of objection by the Central Government, the court will refuse to interfere unless the Government establishes that the exchange ratio was unfair and not in public interest. *(M.G. Investment & Industrial Co. Ltd. Vs. New Shorrock Spinning & Mfg. Coi. Ltd.)*

12. **Oppression & Mismanagement:** Under sections 397 and 398 of the Companies Act, 1956, members may apply to the Company Law Board in cases of oppression and mismanagement. However, bona fide decisions consistent with the company's memorandum and articles are not to be equated with mismanagement even if they turn out to be wrong in the circumstances or these cause temporary losses. The Court will not permit the machinery created by the sections to be used by the minority for compelling

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the majority to come to terms, where the company is honestly managed. Directors' bona fide decision not to declare dividend and to accumulate available profits into reserves is not mismanagement. *(Thomas Vettom (V.J.) vs. Kuttanad Rubber Co. Ltd. (1984) 56 Com. Cases 284 (Ker).*

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

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

(i) The contention of shareholders/members shall not be tenable.

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

13. (a) In accordance with the provisions of the Companies Act, 1956, as contained in Section 426, in the event of a Company being wound up every present and past member shall be liable to contribute to the assets of the Company to an amount sufficient -

(1) for payment of (i) its debts and liabilities, and (ii) costs, charges and expenses of the winding up, and

(2) for the adjustment of the rights of the contributories among themselves.

The liability of the present member i.e. as per List A shall be limited

(i) in case of a Company limited by shares , to the amount remaining unpaid on the shares; and

(ii) in case of a Company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the Company in the event of its being wound up.

However, in the winding up of a Company limited guarantee, which has a share capital, every member of the Company shall be liable, to contribute not only the amount undertaken to be contributed by him in the event of winding up but also to contribute to the extent of any sum unpaid on any shares held by him as if the company were a company limited by shares.

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Liability of Past Members: (List B)

A past member shall not be liable to contribute:

(i) if he has ceased to be a member for 1 year or more before the commencement of the winding up;

(ii) in respect of any debt or liability of the Company contracted after he ceased to be a member;

(iii) if it appears to the Court that the present members will be able to satisfy the contributions required to be made by them.

The past members can be called upon only after the Court has called upon the contributories in List A to pay and their contributions are found insufficient. In the case of a Company limited by shares a past member shall not be liable to contribute more than the amount unpaid on the shares in respect of which he is liable as such member:

Thus examining the above provisions, answer to the given questions shall be:

1. The past members' contention shall be tenable only:

   (i) When they have ceased to be a member for 1 year or more before the commencement of the winding up of the Company.

   (ii) If the liability of the Company was contracted after he ceased to be a member.

   (iii) If it appears to the court that the present members will be able to satisfy the contributions required to made by them.

2. In the second case, the present members shall be liable to the extent of the amount remaining unpaid on the shares in case of a Company limited by shares. In case of a Company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the Company.

(b) Following procedure may be followed for scrutiny, inspection and investigation in all winding up cases:-

(1) **Forwarding of copy of petition to Registrar:** The moment winding up petition is filed before the Court, Official Liquidator (OL) will obtain a copy of petition and forward the same to the Registrar of Companies (ROC) concerned.

(2) **Scrutiny by registrar:** ROC will have a scrutiny of the details/documents available in respect of the company in MCA21 registry and will submit a preliminary report to the Ministry within a week time for inspection or investigation, if so required, containing following information for the past five years of the date of filing of petition:-

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(i) History of the company, viz incorporation, maintenance of registered office, main object and present business activities;

(ii) Management pattern, including details of directors/nominee directors and their directorship in other companies;

(iii) Capital structure and shareholding pattern;

(iv) Financial position and working results;

(v) Comments on filing position and compliances of Schedule VI read with Accounting Standards;

(vi) Nature of complaints registered on MCA-21, their nature and any noticeable findings;

(vii) Whether any complaint was received alleging that the company is involved in fraudulent activities, siphoning of funds etc. If so, the details thereof.

(viii) Whether any scrutiny/inspection was carried out, if so, the details thereof;

(ix) Whether the company is having any holding or subsidiary company, if so, details thereof;

(x) Whether company has raised funds through IPO, if so, the utilization of amount collected, compliance of provisions of the Act for deviation from the object stated in Prospectus/Offer Document; transactions with related parties;

(xi) In case of public company, whether it has accepted public deposit. If so, whether the payment of matured amount including interest was made as per schedule. In case any amount is still pending, the details of amount and interest thereon.

(xii) The quantum of unsecured loan amount and related party transactions thereto.

(xiii) Secretarial reports and qualifications made by the auditors on accounts of the company;

(xiv) Whether company or its members/creditors have requested for investigation into the affairs of the company, if so, the details thereof.

(3) **Final view by MCA:** MCA will take a final view in the matter within a period of 15 days from the date of receipt of preliminary report from ROC. If any inspection under Section 209A and/or investigation under Section 235/237 of the Act are ordered, the same will be completed by the ROC and forwarded to the Official Liquidator within 30 days.

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(4) **Report presented to High Court:** The Official Liquidator will place the report before the Hon'ble High Courts for seeking appropriate order/action under Section 539 to 544 and other relevant provisions of the Act. Simultaneously, necessary action as per law will be initiated against the director, ex-director and key management of the company for any violation of law/ Companies Act, 1956.

(5) **Monitoring:** These cases will be monitored in the monthly staff meeting of Regional Directors.

14. (a) (i) As per provisions of section 581ZJ of the Companies act 1956, any Producer Company may, upon recommendation of the Board and passing of resolution in the general meeting, issue bonus shares by capitalisation of amounts from general reserves referred to in section 581ZI in proportion to the shares held by the Members on the date of the issue of such shares.

(ii) As per *Producer Companies (General Reserves) Rules, 2003* issued by the Ministry of Corporate Affairs, Ministry *of* Finance, Government of India on 7th August, 2003, a producer company formed and registered under section 581C of the Companies Act, 1956, shall make investments from and out of its general reserves in the following manner, namely:-

1. in approved securities, fixed deposits, units and bonds issued by the Central or State Governments or cooperative societies or scheduled bank; or
2. in a co-operative bank, state co-operative bank, co-operative land development bank or central co-operative bank; or
3. with any other scheduled bank; or
4. in any of the securities specified in section 20 *of* the Indian Trusts Act, 1882; or
5. in the shares or securities of any other multi-state co-operative society or any co-operative society; or
6. in the shares, securities or assets *of* a public financial institutions specified under section 4A of the Companies Act, 1956.

(b) Meetings of Board and quorum (Section 581V): A meeting of the Board shall be held not less than once in every three months and at least four such meetings shall be held in every year.

Notice of every meeting of the Board of directors shall be given in writing to every director for the time being in India, and at his usual address in India to every other director.

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The Chief Executive shall give notice as aforesaid not less than seven days prior to the date of the meeting of the Board and if he fails to do so, he shall be punishable with fine which may extend to one thousand rupees. However, a meeting of the Board may be called at shorter notice and the reasons thereof shall be recorded in writing by the Board.

The quorum for a meeting of the Board shall be one-third of the total strength of directors, subject to a minimum of three.

Subject to provisions in the articles, directors including the co-opted director, may be paid such fees and allowances for attendance at the meetings of the Board, as may be decided by the member in the general meeting.

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

(a) Has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) Conducts any business activity in India in any other manner.

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

Further, section 379 states that where not less than 50% of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company is held by one or more citizens of India or by one or more companies or bodies corporate incorporated in India, or by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with the provisions of this Chapter and such other provisions of this Act as may be prescribed with regard to the business carried on by it in India as if it were a company incorporated in India.

In the case given in the question, the following facts are given:

a. JKL Ltd. was incorporated in London and has a place of business (share transfer office) in India, hence, it is a foreign company.

b. Its shareholding comprises of 25% held by Y who is a citizen of India and 30% by X Ltd. which is a company registered in India. Together the two Indian shareholders hold 55% of the share capital of JKL Ltd.

Therefore, although JKL Ltd. is a foreign company, due to the holding of more than 50% of its share capital by two Indian entities, it will be covered under section 379 and will be treated as a company incorporated in India or as an Indian Company.

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However, it may be noted that under section 379, the application of the Companies Act, 2013 on JKL Ltd. will be only in respect of business carried by it in India and not in relation to its business anywhere outside India.

The Companies Act, 2013 under Chapter XXII does not require a foreign company to file any documents in relation to its global business.

Under section 380 of the Act, a foreign company is required to file for registration within 30 days of the establishment of a place of business in India the following documents with the Registrar:

(a) a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company. If the instrument is not in the English language, a certified translation thereof in the English language;

(b) the full address of the registered or principal office of the company;

(c) a list of the directors and secretary of the company containing such particulars as prescribed in the *Companies (Registration of Foreign Companies) Rules, 2014.*

(d) 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;

(e) the full address of the office of the company in India which is deemed to be its principal place of business in India;

(f) particulars of opening and closing of a place of business in India on earlier occasion or occasions;

(g) declaration that none of the directors of the company or the authorized representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and

(h) any other information as may be prescribed.

16. **Things should be taken care of while filling application for allotment of DIN through e-form DIR-3-** Income Tax PAN is mandatory in case of Indian applicants so the applicant details (name, father's name, date of birth) should be as per the PAN details. The particulars filled in form DIR-3 should match with the details given in the supporting documents to be submitted along with DIN application. Any mis-match will lead to rejection of DIN application.

Procedure to be followed, if there is any change in particulars of Director : Director is required to download and fill up eForm DIR-6 for such changes and follow the same process for uploading the same as mentioned for eForm DIR-3. The requested change is taken into the system on verification of the proof enclosed with the application for change request. In the case of change in applicant's name, gazette notification is must with form

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DIR-6. Married ladies, who are having Id proof with their maiden name, can submit marriage certificate along with application. Verification as per Form DIR-7 of Companies Act, 2013 also needs to be attached to Form DIR-6 as it is a mandatory attachment now.

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

    (a) The Registrar,

    (b) A shareholder of the company, or

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

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

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

    However, in case of government companies as per the Notification no. G.S.R. 463(E) dated 5th June 2015 , court shall take cognizance of any offences under this Act which is alleged to have been committed by any company or any officer thereof on the complaint in writing of a person authorized by the Central Government in that behalf.

18. According to the section 403 of the Companies Act, 2013, any documents required to be submitted, filed, registered or recorded, or any fact or information required or authorised to be registered under this Act, shall be submitted, filed, registered or recorded within the time specified in the relevant provision along with the specified fees .

    Submission after the time specified in relevant provision: Any document, fact or information may be submitted, filed, registered or recorded, after the time specified in relevant provision for such submission, filing, registering or recording, **within a period of 270 days from the date by which it should have been submitted, filed, registered or recorded**, as the case may be, on payment of such additional fee as may be prescribed as per the rule12 and 13 of *the Companies (Registration Offices and Fees) Rules, 2014.*

    Even after the expiration of above 270 days, submission of documents may also be done on payment of fee and additional fee specified under this section. Further contravention on submission of documents may lead to the company liable for the penalty or punishment provided under this Act for such failure or default.

19. **Section 180 of the Companies Act, 2013: Power of Board of directors to borrow money– Special resolution**

    "RESOLVED that pursuant to Section 180(1)(c) and any other applicable provisions of the Companies Act, 2013 and the rules made thereunder (including any statutory modification(s) or re-enactment thereof for the time being in force), the consent of the

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Company be and is hereby accorded to the Board of Directors to borrow moneys in excess of the aggregate of the paid up share capital and free reserves of the Company, provided that the total amount borrowed and outstanding at any point of time, apart from temporary loans obtained/to be obtained from the Company's Bankers in the ordinary course of business, shall not be in excess of ` ___Crores (Rupees ____ crores) over and above the aggregate of the paid up share capital and free reserves of the Company."

20. (i) **Prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control [Section 12A]:** No person shall directly or indirectly—

(a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognised stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;

(b) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognised stock exchange;

(c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognised stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder;

(d) engage in insider trading;

(e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;

(f) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognised stock exchange in contravention of the regulations made under this Act.

(ii) **Determination of Price and price band-** Regulation 30 of the SEBI (ICDR) Regulations, 2009 deals with the Price and price band.

(1) Reference of price/floor price in the prospectus- According to the regulation, the issuer may mention a price or price band in the draft prospectus (in case of a fixed price issue) and floor price or price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies: Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.

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(2) **Announcement of floor price/price band-** The issuer shall announce the floor price or price band at least five working days before the opening of the bid (in case of an initial public offer) and at least one working day before the opening of the bid (in case of a further public offer), in all the newspapers in which the pre issue advertisement was released.

(3) **Basis of issue price in the prospectus**- The announcement shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the prospectus.

(3A) **Above details disclosed on the websites**-The announcement and the relevant financial ratios, shall be disclosed on the websites of those stock exchanges where the securities are proposed to be listed and shall also be pre-filled in the application forms available on the websites of the stock exchanges.

(4) **Maximum Cap on price band-**The cap on the price band shall be less than or equal to one hundred and twenty per cent of the floor price.

(5) **Minimum Cap on Floor price-** The floor price or the final price shall not be less than the face value of the specified securities.

Explanation: For the purposes of sub-regulation (4), the "cap on the price band" includes cap on the coupon rate in case of convertible debt instruments.

21. (a) **Granting of Recognition (Section 4 of SCRA, 1956)-** Central Government may grant recognition to stock exchange subject to the following conditions that it may impose-

(i) qualification for membership of stock exchange.

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

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

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

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

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

(b) **Special Provisions related to commodity derivatives (Section 30A).** This provision in the Securities Contracts (Regulation) Act, 1956 has been inserted by Part II of Chapter VIII of the Finance Act 2015, w.e.f. 28.09.2015 vide Gazette Notification F. No. 1/9/SM/2015.

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(1) **According to the section** nothing contained in this Act shall apply to non-transferable specific delivery contracts:

Provided that no person shall organise or assist in organising or be a member of any association in any area to which the provisions of section 13 have been made applicable (other than a stock exchange) which provides facilities for the performance of any non-transferable specific delivery contract by any party thereto without having to make or receive actual delivery to or from the other party to the contract or to or from any other party named in the contract.

(2) Where in respect of any area, the provisions of section 13 have been made applicable in relation to **commodity derivatives for the sale or purchase of any goods or class of goods**, the Central Government may, by notification, declare that in the said area or any part thereof as may be specified in the notification all or any of the provisions of this Act shall not apply to transferable specific delivery contracts for the sale or purchase of the said goods or class of goods either generally, or to any class of such contracts in particular.

(3) Where, if the Central Government is of the opinion that in the interest of the trade or in the public interest **it is expedient to regulate and control non-transferable specific delivery contracts in any area**, it may, by notification in the Official Gazette, declare that all or any of the provisions of this Act shall apply to such class or classes of non-transferable specific delivery contracts in such area in respect of such goods or class of goods as may be specified in the notification, and may also specify the manner in which and the extent to which all or any of the said provisions shall so apply.

22 (a) Miss Liza stayed in India at Mumbai 'base' for more than 182 days in the preceding financial year. The issue here is whether staying can be considered 'residing'. FEMA emphasizes 'residing'. 'Stay' is a physical attribute, while 'residing' denotes permanency. Thus, while Miss Liza may have stayed in India for more than 182 days, it is doubtful whether she can be said to have 'resided' in India for more than 182 days.

Further under section 2(v)(a), she would become resident only if she has come to or stayed in India for employment. It would be doubtful and debatable, whether by staying at Mumbai base during the break, Miss Liza can be said to have come to stay in India for or on taking up employment. Hence Miss would continue to be non-resident.

(b) Approval to the following transactions under FEMA, 1999:

(1) Foreign Exchange drawals for cultural tours require prior permission/approval of the Government of India irrespective of the amount of foreign exchange required. Therefore, in the given case X, the Film Star is required to seek permission of the Government of India.

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(2) As per the Notification no G.S.R. 426(E) dated 26th May 2015 through the Foreign Exchange Management (Current Account Transactions) Amendment Rules, 2015, Individuals can avail of foreign exchange facility for the purposes given in schedule III (covers medical treatment abroad) within the limit of USD 2,50,000 only. Any additional remittance in excess of the said limit for the expenses in connection with medical treatment abroad, shall require prior approval of the Reserve Bank of India. Therefore, R can draw foreign exchange up to the USD 2,50,000 and for additional remittance in excess of this limit for bearing the expenses of medical treatment in UK, prior permission/approval of RBI will be required.

(3) As per the Notification no G.S.R. 426(E) dated 26th May 2015 through the Foreign Exchange Management (Current Account Transactions) Amendment Rules, 2015, Individuals can avail of foreign exchange facility for the purposes given in schedule III within the limit of USD 2,50,000 only. Any additional remittance in excess of the said limit, shall require prior approval of the Reserve Bank of India. Release of foreign exchange for education abroad is permitted up to US$ 2,50,000 on self declaration basis. Therefore, L can draw foreign exchange on self declaration basis for pursuing a course in fashion design in Paris.

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

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

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

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

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

(2) limits or restricts—

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

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

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

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

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

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

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

(b) Section 5 deals with combination of enterprises and persons. The amalgamation of enterprises shall be a combination of such enterprises if the enterprise created as a result of the amalgamation, as the case may be, have either in India, the assets of the value of more than ` 1,500 crores or turnover more than ` 4500 crores.

Hence, in the present case, the proposed amalgamation of Bombay Textiles Limited and Gujarat Textiles Limited will not attract the provisions of the Competition Act, 2002 as they have assets of value of ` 300 crore and turnover of ` 1000 crore which are less than specified under the provisions.

24. **(a)** **Requirements as to Capital**: As per the Insurance Laws (Amendment) Act, 2015, section 6 of the Insurance Act, 1938, has been amended. According to which the requirements as to capital for registration of the insurer has been modified. No insurer (not being an insurer as defined in sub-clause (d) of clause (9) of section 2) carrying on the business of life insurance, general insurance, health insurance or re-insurance in India or after the commencement of the Insurance Regulatory and Development Authority Act, 1999, shall be registered unless he has minimum paid up equity capital as prescribed below-

Type of Insurance Business	Minimum Paid-up equity capital required (with a provision for further enhancement & Paid-up equity excludes preliminary expenses incurred during formation and registration)
Life insurance or general insurance	` 100 crore
Health insurance (exclusively)	` 100 crore
Re-insurer (exclusively)	` 200 crore (besides re-insurer shall not be registered unless he has net owned funds of not less than ` 5,000 crore)

In the given case, X an insurance company is an insurer carrying business of health insurance. For registration as per the above provision, minimum paid-up equity capital required for conduct of business of health insurance is ` 100 crore. Since

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paid up equity capital of X insurance company is less than 100 crore, so it cannot be registered for carrying of the insurance business.

(b) Cancellation of Certificate of Registration under SARFAESI Act, 2002- The Reserve Bank of India may cancel a certificate of registration granted to a securitisation and reconstruction company for the reasons stated in Section 4 of SARFAESI Act, 2002.

RST Ltd., can prefer an appeal to the Central Government (Secretary, Ministry of Finance, Government of India) within a period of 30 days from the date on which order of cancellation was communicated to it. The Central Government must also give such company a reasonable opportunity of being heard before rejecting the appeal. If RST Ltd., is holding investments of qualified institutional buyers at the time of cancellation of certificate of registration, it shall be deemed to be a securitisation and reconstruction company until it repays the entire investments held by it, together with interest if any, within such period as may be specified by the Reserve Bank.

25. (a) Section 45 of the Prevention of Money Laundering Act, 2002, 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

(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 and that he is not likely to commit any offence while on bail.

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.

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

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

(ii) Conjunctive and Disjunctive Words 'or' 'and': The word **'or'** is normally disjunctive and **'and'** is normally conjunctive. However, at times they are read as *vice versa* to give effect to the manifest intention of the legislature as

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disclosed from the context. This would be so where the literal reading of the words produces an unintelligible or absurd result: in such a case 'and' may by read for 'or' and 'or' for 'and' even though the result of so modifying the words is less favourable to the subject, provided that the intention of the legislature is otherwise quite clear.

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

— the nature of the thing empowered to be done,

— the object for which it is done, and

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

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