PAPER – 1 : ADVANCED ACCOUNTING

Answer all questions.

Working notes should form part of the answer.

Question 1

The Balance Sheets of three companies Angle Ltd., Bolt Ltd., and Canopy Ltd., as at 31st December, 2007 are given below:

Liabilities	Angle Ltd.	Bolt Ltd.	Canopy Ltd.
	Rs.	Rs.	Rs.
Share capital			
(Equity shares of Rs.100 each)	15,00,000	10,00,000	6,00,000
Reserves	2,00,000	1,25,000	75,000
Profit and Loss A/c	5,00,000	2,75,000	2,50,000
Sundry creditors	2,00,000	2,50,000	1,00,000
Bills payable	-	-	50,000
Angle Ltd.	-	1,00,000	80,000
	24,00,000	17,50,000	11,55,000
Goodwill	2,50,000	5,80,000	4,50,000
Plant and Machinery	4,00,000	2,50,000	3,25,000
Furniture and Fittings	2,00,000	1,50,000	1,40,000
Shares in-			
Bolt Ltd. (7,500 shares)	9,00,000	-	-
Canopy Ltd. (1,000 shares)	1,50,000		
Canopy Ltd. (3,500 shares)	-	5,20,000	-
Stock in trade	1,00,000	1,50,000	1,60,000
Sundry debtors	1,40,000	70,000	70,000
Bills receivable	50,000	20,000	-
Due from-			
Bolt Ltd.	1,20,000	-	-
Canopy Ltd.	80,000	-	-
Cash in hand	10,000	10,000	10,000
Total	24,00,000	17,50,000	11,55,000

(a) All shares were acquired on 1st July, 2006.

(b) On 1st January, 2006, the balances were:

	Angle Ltd.	Bolt Ltd.	Canopy Ltd.
	Rs.	Rs.	Rs.
Reserves	1,00,000	1,00,000	50,000
Profit and Loss account	50,000	(50,000)Dr.	30,000
Profit during 2006 were earned evenly over the year	3,00,000	2,50,000	1,00,000

(c) Each company declared a dividend of 10% in the year 2007 on its shares out of Profits for the year 2006; Angle Ltd. and Bolt Ltd. have credited their Profit and Loss account with the dividends received.

(d) The increase in reserves in case of Angle Ltd., Bolt Ltd., and Canopy Ltd., was effected in the year 2006.

(e) All the bills payable appearing in Canopy Ltd.'s Balance Sheet were accepted in favour of Bolt Ltd., out of which bills amounting Rs.30,000 were endorsed by Bolt Ltd., in favour of Angle Ltd.

(f) Stock with Bolt Ltd. includes goods purchased from Angle Ltd., for Rs.18,000. Angle Ltd., invoiced the goods at cost plus 20%.

Prepare consolidated Balance Sheet of the group as at 31st December, 2007. Working should be part of the answer. Ignore taxation including dividend distribution tax, disclose minority interest as per AS 21. (20 Marks)

Answer

Consolidated Balance Sheet of Angle Ltd. and its subsidiaries

Bolt Ltd and Canopy Ltd

as at 31st December, 2007

Liabilities			Rs.	Assets			Rs.
Share Capital			15,00,000	Goodwill			
(Equity shares of Rs.100 each)				Angle Ltd.	2,50,000		
				Bolt Ltd.	5,80,000		
Minority Interest (W.N. 6)				Canopy Ltd.	4,50,000	12,80,000	
Bolt Ltd.		3,97,396		Add: Cost of control(W.N.7)		1,55,833	14,35,833
Canopy Ltd.		2,31,250	6,28,646				
Reserves (2,00,000+14,844+2,083)			2,16,927	Plant & Machinery			
				Angle Ltd.		4,00,000	
Profit and Loss Account (W.N.4)			7,62,260	Bolt Ltd.		2,50,000	
				Canopy Ltd.		3,25,000	9,75,000
Sundry Creditors				Furniture & Fittings			
Angle Ltd.	2,00,000		5,50,000	Angle Ltd.		2,00,000	
Bolt Ltd.	2,50,000			Bolt Ltd.		1,50,000	
Canopy Ltd.	1,00,000			Canopy Ltd.		1,40,000	4,90,000
Bills Payable		50,000		Stock-in-Trade			
Less: Mutually held		50,000	Nil	Angle Ltd.		1,00,000	
				Bolt Ltd.		1,50,000	
				Canopy Ltd.		1,60,000	

			4,10,000	
		Less: Provision for unrealised Profit	3,000	4,07,000
		Sundry Debtors		
		Angle Ltd.	1,40,000	
		Bolt Ltd.	70,000	
		Canopy Ltd.	70,000	2,80,000
		Bills Receivable		
		Angle Ltd.	50,000	
		Bolt Ltd.	20,000	
			70,000	
		Less: Mutually held	50,000	20,000
		Cash-in-hand		
		Angle Ltd.	10,000	
		Bolt Ltd.	10,000	
		Canopy Ltd.	10,000	30,000
		Cash-in-Transit / Dues from Bolt Ltd. (W.N. 8)		20,000
	36,57,833			36,57,833

Disclosure of Minority Interest in accordance with AS 21

Amount of Equity attributable to minorities on the date of Investment ie. 1.7.2006

	Bolt Ltd	Canopy Ltd.
Share capital	2,50,000	1,50,000
Share in Capital Reserve as on 1.1.06	25,000	12,500
Share in Capital Profits as on 1.1.06	(12,500)	7,500
Share in Capital Profits for the period1.1.06 to 30.6.06	31,250	12,500
	2,93,750	1,82,500
Total amount of Equity attributable to minorities	4,76,250	

Disclosure in accordance with AS 21

Minority Interest as on 31.12.2007

Amount of equity as on the date of Investment ie. 1.7.2006	4,76,250
Add: Movement in equity and proportionate share of Profit less dividend from the date of Investment upto 31.12.07	1,52,396
	6,28,646

Working Notes:

1. Ascertainment of Profits for the year 2007

	Angle Ltd.	Bolt Ltd.	Canopy Ltd.
	Rs.	Rs.	Rs.
Balance as on 1st January, 2006	50,000	(50,000)	30,000
Add: Profits earned during 2006	3,00,000	2,50,000	1,00,000
	3,50,000	2,00,000	1,30,000
Less: Dividend Declared	1,50,000	1,00,000	60,000
	2,00,000	1,00,000	70,000
Less: Transfer to Reserve	1,00,000	25,000	25,000
	1,00,000	75,000	45,000
Profit for the year 2007 (Balancing Figure)	4,00,000	2,00,000	2,05,000
Balance as on 31st December, 2007	5,00,000	2,75,000	2,50,000

2. Undistributed profits for the year 2006

	Bold Ltd.	Canopy Ltd.
	Rs.	Rs.
Profits for the year 2006	2,50,000	1,00,000
Less: Dividends declared	1,00,000	60,000
	1,50,000	40,000
Less: Transfer to Reserves	25,000	25,000
	1,25,000	15,000

3. Analysis of Profits

		Capital Profits	Revenue Reserve	Revenue Profits
		Rs.	Rs.	Rs.
Canopy Ltd.				
Reserves as on 1st January, 2006		50,000		
Transfer to Reserve in the year 2006 [(75,000-50,000)/2]		12,500	12,500	
Profit & Loss Account				
Balance as on 1st January, 2006		30,000		
Profit for 2006 remaining undistributed [(1,00,000-25,000-60,000)/2]		7,500		7,500
Profit for the year 2007 (2,50,000-30,000-15,000)				2,05,000
	(A)	1,00,000	12,500	2,12,500

Minority Interest [¼ th of (A)]		25,000	3,125	53,125
		75,000	9,375	1,59,375
Share of Angle Ltd. [$\frac{1}{6}$ th of (A)]		16,667	2,083	35,417
Share of Bolt Ltd.		58,333	7,292	1,23,958
Bolt Ltd.				
Reserves as on 1st January, 2006		1,00,000		
Transfer to Reserves 2006 [(1,25,000-1,00,000)/2]		12,500	12,500	
Profit & Loss Account - Balance (Dr.) as on 1st January, 2006		(50,000)		
Undistributed Profits for 2006 [(2,50,000-25,000-1,00,000)/2]		62,500		62,500
Share in profits of Canopy Ltd.		58,333	7,292	1,23,958
Profit for the year, 2007 (2,75,000+50,000-1,25,000)				2,00,000
	(B)	1,83,333	19,792	3,86,458
Less: Minority Interest [¼ th of (B)]		45,833	4,948	96,615
Share of Angle Ltd.		1,37,500	14,844	2,89,843

4. Consolidated Profit and Loss Account of Angle Ltd.

		Rs.
Profit & Loss Account balance as on 31.12.2007		5,00,000
Add: Share in revenue profits of Canopy Ltd.		35,417
Share in revenue profits of Bolt Ltd.		2,89,843
Less:Pre-acquisition dividend		8,25,260
Angle Ltd. ½ (Rs. 75,000 +Rs. 10,000)	42,500	
Bolt Ltd. (½ of Rs. 35,000)	17,500	60,000
		7,65,260
Less:Unrealised Profit in Closing Stock (20/120 × 18,000)		3,000
		7,62,260

5. Consolidated Reserves of Angle Ltd.

	Rs.
Reserves as on 31.12.2007	2,00,000
Add: Share in revenue reserves of Canopy Ltd.	2,083
Add: Share in revenue reserves of Bolt Ltd.	14,844
	2,16,927

6. Minority Interest

	Bolt Ltd.	Canopy Ltd.
	Rs.	Rs.
Share Capital	2,50,000	1,50,000
Share of Capital Profits	45,833	25,000

Share of Revenue Reserves	4,948	3,125
Share of Revenue Profits	96,615	53,125
Total	3,97,396	2,31,250
Grand total		6,28,646

7. Cost of Control/Goodwill

	Rs.	Rs.
Cost of investments (9,00,000+1,50,000+5,20,000)		15,70,000
Less: Dividend Attributable to Pre-Acquisition Profits for 6 months i.e. [(75,000+45,000)/2]		60,000
		15,10,000
Less:Face value of Shares		
Bolt Ltd.	7,50,000	
Canopy Ltd.	4,50,000	
Capital Profits		
Bolt Ltd.	1,37,500	
Canopy Ltd.	16,667	13,54,167
Goodwill		1,55,833

8 Cash in Transit /Dues from Bolt Ltd.

		Rs.	Rs.
(i)	Due to Angle Ltd.		
	From Bolt Ltd.	1,20,000	
	From Canopy Ltd.	80,000	2,00,000
(ii)	Due by Angle Ltd.		
	To Bolt Ltd.	1,00,000	
	To Canopy Ltd.	80,000	1,80,000
			20,000

Question 2

The following are the Balance Sheets of Andrew Ltd. and Barry Ltd., as at 31.12.2007:

Andrew Ltd.

(in Rs.'000s)

Liabilities		Assets	
Share capital		Fixed assets	3,400
3,00,000 Equity shares of Rs.10 each	3,000	Stock (pledged with secured loan creditors)	18,400

10,000 Preference shares of Rs.100 each	1,000	Other Current assets	3,600
		Profit and Loss account	16,600
General reserve	400		
Secured loans (secured against pledge of stocks)	16,000		
Unsecured loans	8,600		
Current liabilities	13,000		
	42,000		42,000

Barry Ltd.

(in Rs.'000s)

Liabilities		Assets	
Share capital		Fixed assets	6,800
1,00,000 Equity shares of Rs.10 each	1,000	Current assets	9,600
General reserve	2,800		
Secured loans	8,000		
Current liabilities	4,600		
	16,400		16,400

Both the companies go into liquidation and Charlie Ltd., is formed to take over their businesses. The following information is given:

(a) All Current assets of two companies, except pledged stock are taken over by Charlie Ltd. The realisable value of all Current assets are 80% of book values in case of Andrew Ltd. and 70% for Barry Ltd. Fixed assets are taken over at book value.

(b) The break up of Current liabilities is as follows:

	Andrew Ltd.	Barry Ltd.
	Rs.	Rs.
Statutory liabilities (including Rs.22 lakh in case of Andrew Ltd. in case of a claim not having been admitted shown as contingent liability)	72,00,000	10,00,000
Liability to employees	30,00,000	18,00,000

The balance of Current liability is miscellaneous creditors.

(c) Secured loans include Rs.16,00,000 accrued interest in case of Barry Ltd.

(d) 2,00,000 equity shares of Rs.10 each are allotted by Charlie Ltd. at par against cash payment of entire face value to the shareholders of Andrew Ltd. and Barry Ltd. in the ratio of shares held by them in Andrew Ltd. and Barry Ltd.

(e) Preference shareholders are issued Equity shares worth Rs.2,00,000 in lieu of present holdings.

(f) Secured loan creditors agree to continue the balance amount of their loans to Charlie Ltd. after adjusting value of pledged security in case of Andrew Ltd. and after waiving 50% of interest due in the case of Barry Ltd.

(g) Unsecured loans are taken over by Charlie Ltd. at 25% of Loan amounts.

(h) Employees are issued fully paid Equity shares in Charlie Ltd. in full settlement of their dues.

(i) Statutory liabilities are taken over by Charlie Ltd. at full values and miscellaneous creditors are taken over at 80% of the book value.

Show the opening Balance Sheet of Charlie Ltd. Workings should be part of the answer.

(16 Marks)

Answer

Balance sheet of Charlie Ltd. as at 31st December, 2007

(in Rs. 'ooos)

Liabilities	Rs.	Assets	Rs.
Share Capital		Goodwill (W.N.4)	9,470
Authorised		Other Fixed Assets (3,400 + 6,800)	10,200
Shares of Rs.10 each		Current Assets(2,880 + 6,720)	9,600
Issued, subscribed & Paid up:		Cash at Bank	2,000
7,00,000 equity shares of Rs.10 each, fully paid up (W.N. 5)	7,000		
(of the above 5,00,0000 shares have been issued for consideration other than cash)			
Secured loans (1,280 + 7,200)	8,480		
Unsecured Loans (25% of 8,600)	2,150		
Current Liabilities (7,200 + 1,000 + 4,000 +1,440))	13,640		
	31,270		31,270

Working Notes:

1. Value of miscellaneous creditors taken over by Charlie Ltd. (in Rs. 'ooos)

	Andrew Ltd.	Barry Ltd.
	Rs.	Rs.
Given in balance sheet	13,000	4,600

Less: Statutory liabilities	5,000	1,000
Liability to employees	3,000	1,800
Miscellaneous creditors	5,000	1,800
80% thereof	4,000	1,440

2. Value of total liabilities taken over by Charlie Ltd.

	Andrew Ltd.		Barry Ltd.	
	Rs.	Rs.	Rs.	Rs.
Current liabilities				
Statutory liabilities	7,200		1,000	
Liability to employees	3,000		1,800	
Miscellaneous creditors (W.N.1)	4,000	14,200	1,440	4,240
Secured loans				
Given in Balance sheet	16,000		8,000	
Interest waived	-		800	7,200
Value of Stock	14,720			
(80% of Rs.184 lakhs)		1,280		
Unsecured Loans				
(25% of Rs. 86 lakhs)		2,150		-
		17,630		11,440

3. Assets taken over by Charlie Ltd.

	Andrew Ltd.	Barry Ltd.
	Rs.	Rs.
Fixed Assets (Assumed on book value basis)	3,400	6,800
Current Assets 80% and 70% respectively of book value	2,880	6,720
	6,280	13,520

4. Goodwill / Capital Reserve on amalgamation

Liabilities taken over (W.N. 2)		17,630	11,440
Equity shares to be issued to Preference Shareholders		200	-
	A	17,830	11,440
Less: total assets taken over (W.N. 3)	B	6,280	13,520
	A-B	11,550	(2,080)
		Goodwill	Capital Reserve
Net Goodwill		9,470	

5. Equity shares issued by Charlie Ltd.

			Number
(i)	For Cash		200000
	For consideration other than cash		
(ii)	In Discharge of Liabilities to Employees	4,80,000	
(iii)	To Preference shareholders	20,000	5,00,000
			7,00,000
	Value of shares	Rs.10x 7,00,000= Rs. 70 Lakhs	

Question 3

(a) From the following information of Beta Ltd. calculate Earning Per Share (EPS) in accordance with AS-20:

			(Rs.)
		Year 31.3.08	Year 31.3.07
1.	Net profit before tax	3,00,000	1,00,000
2.	Current tax	40,000	30,000
	Tax relating to earlier years	24,000	(13,000)
	Deferred tax	30,000	10,000
3.	Profit after tax	2,06,000	73,000
4.	Other information:		
	(a) Profit includes compensation from Central Government towards loss on account of earthquake in 2005 (non-taxable)	1,00,000	NIL

(b) Outstanding convertible 6% Preference shares 1,000 issued and paid on 30.9.2006. Face value Rs.100, Conversion ratio 15 equity shares for every preference share.

(c) 15% convertible debentures of Rs.1,000 each total face value Rs.1,00,000 to be converted into 10 Equity shares per debenture issued and paid on 30.6.2006.

(d) Total no. of Equity shares outstanding as on 31.3.2008, 20,000 including 10,000 bonus shares issued on 1.1.08, face value Rs.100.

(b) From the following details in respect of loan funds of Excellent School of Management for 2007-08, prepare a statement showing changes in fund balance during the year:

	Rs.
Fund balance at the end of the year	30,30,000
Loan fund matching grant from revenues funds	30,000
Private and Government grants	11,00,000

Other transfers from unrestricted revenue funds	1,50,000
Interest on loans	60,000
Investment income	35,000
Loan cancellations and write offs	15,000
Refunded to grantors	60,000
Administrative and Collection costs	25,000

(8 + 8 = 16 Marks)

Answer

(a) Calculation of Earning Per Share (EPS) of Beta Ltd.

			Rs. Year ended 31.3.08	Rs. Year ended 31.3.07
1.	A	Earning after extra ordinary items (2,06,000 – 6,000) (73,000 – 3,000)	2,00,000	70,000
	B.	No. of Equity Shares	20,000	20,000
	C.	Basic Earnings Per share [A/B]	10.00	3.50
	A.	Earning before extra ordinary items	1,00,000	70,000
	B.	No. of Equity Shares	20,000	20,000*
	C.	Basic Earnings Per share [A/B]	5.00	3.50
2.		Tax Rate applicable		
		40,000 + 30,000/2,00,000	35%	
		30,000 + 10,000/1,00,000		40%
3.	A.	Dividend on Weighted Average Preference Shares	6,000	3,000
	B.	Incremental shares	15,000	7,500
	C.	EPS on Incremental Shares [A/B]	0.40 (dilutive)	0.40 (dilutive)
4.		Convertible Debentures		
	A.	Increase in earnings		
		$(1,00,000 \times \frac{15}{100} \times .65)$	9,750	

* Since the bonus issue is without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2007.

	$1{,}00{,}000 \times \frac{15}{100} \times .60 \times \frac{9}{12}$		6,750
B.	Increase in shares	1,000	750
C.	Increase in EPS [A/B]	9.75	9.00
		(Anti dilutive)	(Anti dilutive)

It is anti-dilutive as it increases the EPS from continuing ordinary operations (Para 39, AS 20)

Calculation of Diluted EPS		Year ended 31.3.08 Rs.	Year ended 31.3.07 Rs.
A.	Profit from continuing ordinary activities before Preference Dividend	1,06,000	73,000
	No. of ordinary equity shares	20,000	20,000
	Adjustment for dilutive potential of 6% convertible pref. shares	15,000	7,500
B.	Total no. of shares	35,000	27,500
C.	Diluted EPS from continuing ordinary operations [A/B]	3.02	2.65
D.	Profit including extra ordinary items	2,06,000	73,000
E.	Adjusted No. of shares	35,000	27,500
F.	Diluted EPS including extra ordinary items [D/E]	5.88	2.65

Disclosure of EPS in accordance with AS 20 in the Profit and Loss Account

Earning per share (Face value Rs.100)	31.3.08 (Rs.)	31.3.07 (Rs.)
Basic EPS from continuing ordinary operations	5.00	3.50
Diluted EPS from continuing ordinary operations	3.02	2.65

(b) Excellent School of Management

Statement of Changes - Loan Funds

		Rs.
(i)	Fund Balance at the beginning of the year (Balancing Figure – Refer Working Note)	17,55,000
(ii)	Additions during 2007-08	
	Private and Government Grants	11,00,000
	Interest on loans	60,000
	Investment Income	35,000
		11,95,000

(iii)	Deductions during 2007-08	
	Loan cancellations and write offs	15,000
	Refunded to Grantors	60,000
	Administrative and Collection Costs	25,000
		1,00,000
(iv)	Transfer from other funds during 2007-08	
	Loan fund Matching Grant	30,000
	Other transfers from unrestricted Revenue Funds	1,50,000
		1,80,000
(v)	Net Additions [(ii)- (iii)+ (iv)]	12,75,000
(vi)	Fund Balance at the end of the year	30,30,000

Working Note:

Fund Balance at the end of the year	30,30,000
Less: Net Additions	12,75,000
Fund Balance at the beginning of the year	17,55,000

Question 4

(a) From the following Profit and Loss account of New Mode Reporting Ltd., prepare a gross value added statement for the year ended 31st December, 2007. Show also the reconciliation between GVA and Profit before taxation:

Profit and Loss Account

	Rs.'000s	Rs.'000s
Income		
Sales	12,480	
Other income	110	12,590
Expenditure		
Production and Operational expenditure	8,640	
Administrative expenses	360	
Interest and other charges	1,248	
Depreciation	32	10,280
Profit before tax		2,310
Less: Provision for tax		110
Profit after tax		2,200
Add: balance as per last Balance Sheet		120
		2,320

Less:Transfer to Fixed assets replacement Reserve	800	
Dividend paid	320	1,120
Surplus carried to Balance Sheet		1,200

Additional information:

(i) Production and Operational expenses consists of

	Rs.
Consumption of Raw materials	64,20,000
Consumption of Stores	80,000
Local tax	16,000
Salaries to Administrative staff	12,40,000
Other Manufacturing expenses	8,84,000

(ii) Administrative expenses include salaries and commission to directors – Rs.10,000

(iii) Interest and other charges include-

		Rs.
(a)	Interest on bank overdraft (overdraft is of temporary nature)	2,18,000
(b)	Fixed loan from SIDBI	1,02,000
(c)	Working capital loan from IFCI	40,000
(d)	Excise duties	?

(iv) Excise duties amount to one-tenth of total value added by manufacturing and trading activities.

(b) Anischit Finance Ltd. is a non-banking finance company. It makes available to you the costs and market price of various investments held by it as on 31.3.2008:

(Figures in Rs. Lakhs)

		Cost	Market Price
Scripts:			
A.	Equity Shares-		
	A	60.00	61.20
	B	31.50	24.00
	C	60.00	36.00
	D	60.00	120.00
	E	90.00	105.00
	F	75.00	90.00
	G	30.00	6.00

B.	Mutual funds-			
		MF-1	39.00	24.00
		MF-2	30.00	21.00
		MF-3	6.00	9.00
C.	Government securities-			
		GV-1	60.00	66.00
		GV-2	75.00	72.00

(i) Can the company adjust depreciation of a particular item of investment within a category?

(ii) What should be the value of investments as on 31.3.2008?

(iii) Is it possible to off-set depreciation in investment in mutual funds against appreciation of the value of investment in equity shares and government securities?

(10 + 6= 16 Marks)

Answer

(a) New Mode Reporting Ltd.

Value Added Statement

for the year ended 31st December, 2007

(Figures in Rs.'000)

Sales			12,480
Less:	Cost of Materials and Services:		
	Production and Operational Expenses (8,640 – 16-1,240)	7,384	
	Administrative Expenses (360 – 10)	350	
	Interest on Bank Overdraft	218	
	Interest on Working Capital Loan	40	
	Excise Duties (Refer to working note)	360	
	Other/miscellaneous charges (888 – 360)	528	8,880
Value added by manufacturing and trading activities			3,600
Add:	Other Income		110
Gross value added from operations			3,710

Application of Gross Value Added

		Rs. in '000	Rs.in'000	%
To	Pay Employees:			
	Salaries to Administrative Staff		1240	33.42
To	Pay Directors:			
	Salaries and Commission		10	0.27
To	Pay Government:			

	Local Taxes	16		
	Income Tax	110	126	3.40
To	Pay Providers of Capital:			
	Interest on Fixed Loan	102		
	Dividend	320	422	11.37
To	Provide for maintenance and expansion of the company:			
	depreciation	32		
	Fixed Assets Replacement Reserve	800		
	Retained Profit (1200 – 120)	1080	1912	51.54
			3,710	100.00

Reconciliation between Gross Value added and Profit Before Taxation

		Rs.in'000
Profit before Tax		2,310
Add Back: Depreciation	32	
Salaries to Administrative Staff	1240	
Directors' Salaries and Commission	10	
Interest on Fixed Loan	102	
Local Tax	16	1400
Total value added		3710

Working Note:

Calculation of excise duty	Rs.'000	Rs.'000
Interest and other charges		1,248
Less: Interest on bank overdraft	218	
Interest on SIDBI loan	102	
Interest on IFCI loan	40	360
Excise duty and other charges		888

Assuming that these other /miscellaneous charges will be deducted for arriving at the value added, the excise duty will be calculated as follows:-

Let Excise Duties be denoted by - E

Then, other charges = 888 - E

Excise duty are $1/10^{th}$ of value added

Hence E = $1/10^{th}$ [12,480 – {7,384+ 350+218 + 40+E + (888 – E)}]

= $1/10^{th}$ [12,480 – 8,880]

= $1/10^{th}$ × 3,600= 360

Other/miscellaneous charge 888 – 360 = Rs.528

The above solution has been given accordingly.

Alternatively, if other/miscellaneous charges are considered as application of value added (i.e., not deducted for deriving the value added), calculation of Excise Duties (E) will be as follows:

$E = \frac{1}{10th}$ [12,480 – (7,384 + 350 + 218+40+E)]

$E = \frac{1}{10th} \times (4,488 - E)$

11E = 4,488

E = Rs.408

And thus other/miscellaneous charges will be Rs.888 – 408 = Rs.480

Gross Value added in this case will be Rs. 4,080 + 110 (Other income) = Rs.4,190

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

(b) (i) Quoted current investments for each category shall be valued at cost or market value, whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Therefore, depreciation of a particular item of investments can be adjusted within the same category of investments.

(ii) Value of Investments as on 31.3.2008

Type of Investment	Valuation Principle	Value Rs.in lakhs
Equity Shares (Aggregated)	Lower of cost or market Value	406.50
Mutual Funds	NAV (Market value, assumed)	54.00
Government securities	Cost	135.00
		595.50

As per para 14 of AS 13 “Accounting for Investments”, the carrying amount for current investments is the lower of cost and market price. Sometimes, the concern of an enterprise may be with the value of a category of related current investments and not with each individual investment, and accordingly, the investments may be computed at the lower of cost and market value computed categorywise.

(iii) Inter category adjustments of appreciation and depreciation in values of investments cannot be done. It is not possible to offset depreciation in investment in mutual funds against appreciation of the value of investments in equity shares and Government securities.

Question 5

(a) Golden Eagle Ltd., has been successful jewellers for the past 100 years and sales are against cash only. The company diversified into apparels. A young senior executive was put in charge of Apparels business and sales increased 5 times. One of the conditions for sales that dealers can return the unsold stocks within one month of the end of season. Sales return for the year was 25% of sales. Suggest a suitable Revenue Recognition Policy with references to AS-9.

(b) Discuss the concept of Cost v/s Fair value with reference to Indian Accounting Standards.

(c) Why Human Resources Asset is not recognised in the Balance sheet?

(d) A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively employees can claim a lump sum amount equal to one month pay last drawn.

The company's contentions in this matter are:

(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii) Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer. (4 x 4= 16 Marks)

Answer

(a) As per AS 9 "Revenue recognition", revenue recognition is mainly concerned with the timing of recognition of revenue in statement of profit and loss of an enterprise. The amount of revenue arising on a transaction is usually determined by the agreement between the parties involved in the transaction. When uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

In the case of the Jewellery Business the company is selling for cash and returns are negligible. Hence, revenue can be recognized on sales. On the other hand, in Apparels Industry, the dealers have a right to return the unsold goods within one month of the end of the season. In this case, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 25% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately for both Jewellery and Apparels business.

(b) Cost vs. Fair value

Cost basis: The term cost refers to cost of purchase, costs of conversion on other costs incurred in bringing the goods to its present condition and location. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

Fair value: Fair value of an asset is the amount at which an enterprise expects to exchange an asset between knowledgeable and willing parties in an arm's length transaction.

Indian Accounting Standards are generally based on historical cost with a very few exceptions:

AS 2 "Valuation of Inventories" – Inventories are valued at net realizable value (NRV) if cost of inventories is more than NRV.

AS 10 "Accounting for Fixed Assets" – Items of fixed assets that have been retired from active use and are held for disposal are stated at net realizable value if their net book value is more than NRV.

AS 13 "Accounting for Investments" – Current investments are carried at lower of cost and fair value. The carrying amount of long term investments is reduced to recognise the permanent decline in value.

AS 15 "Employee Benefits" – The provision for defined benefits is made at fair value of the obligations.

AS 26 "Intangible Assets" – If an intangible asset is acquired in exchange for shares or other securities of the reporting enterprise, the asset is recorded at its fair value, or the fair value of the securities issued, whichever is more clearly evident.

AS 28 "Impairment of Assets"– Provision is made for impairment of assets.

On the other hand IFRS and US GAAPs are more towards fair value. Fair value concept requires a lot of estimation and to the extent, it is subjective in nature.

(c) Although human beings are considered as the prime mover for achieving productivity, and are placed above technology, equipment and money, the conventional accounting practice does not assign significance to the human resources. Human resources are not recognized in balance sheet as there are no measurement criteria for recognition of human resources. Human resource accounting is at developing stage and no accounting principles have been established for valuation of human assets. Costs incurred on human resources are recognised as expenses in profit and loss account. Leading public sector units like OIL, BHEL, NTPC and SAIL etc. have started reporting human resources in their annual reports as additional information.

(d) The present case falls under the category of defined benefit scheme under Para 49 of AS 15 (Revised) "Employee Benefits". The said para encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. The contention of the Company that the settlement allowance will be accounted for on claim basis is not correct even if company's obligation under the scheme is uncertain and requires estimation. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control. Thus,

(1) Settlement allowance payable by the company is a defined retirement benefit, covered by AS I5 (Revised).

(2) A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.

(3) Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

Question 6

(a) XYZ Ltd., with a turnover of Rs.35 lakhs and borrowings of Rs.10 lakhs during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.2008. Advise the management the exemptions that are available as per Companies (AS) Rules, 2006.

If XYZ is a partnership firm is there any other exemptions additionally available. (8 Marks)

(b) Briefly explain any two of the following terms:

(i) IFRS

(ii) NACAS

(iii) Convergence of Accounting Standards with IFRS. (2x4= 8 Marks)

Answer

(a) XYZ Ltd. is a small and medium sized enterprise (SME) company as per Companies (AS) Rules, 2006. The following relaxations and exemptions are available.

1. AS 3 "Cash Flow Statements" is not mandatory.
2. AS 17 "Segment Reporting" is not mandatory.
3. SMEs are exempt from some paragraphs of AS 19 "Leases".
4. SMEs are exempt from disclosures of diluted EPS (both including and excluding extraordinary items).
5. SMEs are allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique under AS 28 "Impairment of Assets".

6. SMEs are exempt from disclosure requirements of paragraphs 66 and 67of AS 29 "Provisions , Contingent Liabilities and Contingent Assets".

7. SMEs are exempt from certain requirements of AS 15 "Employee Benefits".

8. Accounting Standards 21, 23, 27 are not applicable to SMEs.

If XYZ is not a company, it will be treated as a level III enterprise instead of level II enterprise; XYZ Ltd. will be exempt from requirements of AS 18 "Related Party Disclosures" and AS 24 "Discontinuing Operations".

(b) (i) IFRS: The term IFRS refers to the International Financial Reporting Standards issued by International Accounting Standard Board (IASB). It also encompasses the International Accounting Standards (IAS) issued by the International Accounting Standard Committee (IASC). Interpretations of IASs and IFRSs are developed by the International Financial Reporting Interpretations Committee (IFRIC). IFRIC is the new name for the Standing Interpretations Committee (SIC) approved by the IASC Foundation Trustees in March 2002. IFRS includes these interpretations also.

(ii) NACAS: Under Section 210 A of the Companies Act 1956, the Central Government, by notification, has constituted a committee to advise the Central Government on the formulation of accounting policies and accounting standards for adoption by companies or class of companies specified under the Act. Based on the recommendations of NACAS, the Central Government has notified AS 1 to AS 7 and AS 9 to AS 29 in Dec. 2006 in the form of Companies (Accounting Standards) Rules, 2006.

(iii) Convergence of Accounting Standards with IFRS: In general, convergence of Accounting Standards (AS) with International Financial Reporting Standards (IFRS) means to achieve harmony with IFRS. The term convergence can be considered as "to design and maintain national accounting standards in a way that financial statements prepared in accordance with rational AS are in convergence with IFRS". IAS I require financial statements to comply with all requirements of IFRS. This does not mean that IFRS should be adopted word by word. The local standard setters can add disclosure requirements or can remove some requirements which do not create non compliance with IFRS. Thus, convergence with IFRS means adoption of IFRS with exceptions wherever necessary.

PAPER – 2 : MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS

Answer all Questions.

Question 1

The Mayfair Rubber Industry Ltd. (MRIL) manufactures small rubber components for the local market. It is presently using 8 machines which were acquired 3 years ago at a cost of Rs.18 lakh each having a useful life of 8 years with no salvage value. The policy of the company is to depreciate all machines in 5 years. Their production capacity is 37 lakh units while the annual demand is 30 lakh units. The MRIL has received an order from a leading automobile company of Singapore for the supply of 20 lakh rubber bushes at Rs.15 per unit. The existing machines can be sold @Rs.12 lakh per machine. It is estimated that the removal cost of each machine would be Rs.60,000. In order to meet the increased demand, the MRIL can acquire 3 new machines at an estimated cost of Rs.100 lakh each which will have a combined production capacity of 52 lakh units.

The operating parameters of the existing machines are as follows:

(i) Labour requirements (Unskilled-18; Skilled-18; Supervisor-3; and Maintenance-2) and their per month salaries are Rs.3,500; Rs.5,500; Rs.6,500 and Rs.5,000 each respectively with an increase of 10 percent to adjust inflation.

(ii) Raw materials cost, inclusive of wastage is 60 per cent of revenues.

(iii) Maintenance cost – years 1-5 (Rs.22.5 lakh), and years 6-8 (Rs.67.5 lakh).

(iv) Operating expenses – Rs.52.10 lakh expected to increase annually by 5 percent.

(v) Insurance cost/premium – year 1,2 per cent of the original cost of the machine, afterwards discounted by 10 per cent.

(vi) Selling Price – Rs.15 per unit.

The projected operating parameters with the replacement by the new machines are as follows:

(i) Additional working capital – Rs.50 lakh.

(ii) Savings in cost of utilities – Rs.2.5 lakh.

(iii) Maintenance cost – years 1-2 (Rs.7.5 lakh); years 3.5 (Rs.37.5 lakh).

(iv) Raw materials cost – 55 per cent of sales.

(v) Employee requirement (6 skilled at monthly salary of Rs.7,000 each and one for maintenance at monthly salary of Rs.6,500).

(vi) Laying off cost of 34 workers – (Unskilled-18; Skilled-12; Supervisors-3; and maintenance-1) Rs.9,21,000, that is equivalent to six months salary.

(vii) Insurance cost/premium-2 per cent of the Purchase cost of machine in the first year and discounted by 10 percent in subsequent years.

(viii) Life of machines – 5 years and salvage value – Rs.10 lakh per machine.

The company follows straight line method of depreciation and the same is accepted for tax purposes. Corporate tax rate is 35 per cent and the cost of capital is 20 percent.

As the Finance Manager of MRIL, prepare a report for submission to the top management with your recommendations about the financial viability of the replacement of the existing machine.

(20 Marks)

Answer

Incremental CFAT and NPV (Rs. in lakhs)

Particulars	1	2	3	4	5
Sales	300	300	300	300	300
Add: Cost Savings:					
Maintenance (note 2)	15	15	30	30	30
Cost of utilities	2.5	2.5	2.5	2.5	2.5
Labour Costs (note 3)	17.16	18.87	20.76	22.84	25.12
Less: Incremental cost					
Raw materials (note 4)	142.5	142.5	142.5	142.5	142.5
Depreciation (note 5)	25.2	25.2	54	54	54
Insurance (note 6)	4.12	3.71	3.34	3	2.71
Earning before Tax	163.04	165.16	153.42	155.84	158.76
Less: Taxes (0.35)	57.064	57.806	53.607	54.544	55.426
Earning after taxes	105.976	107.354	99.723	101.296	102.934
CFAT (EAT + Depreciation)	130.976	132.354	153.723	155.296	156.934
Salvage Value					30
Release of working capital					50
(x) PV factor at .20	0.833	0.694	0.579	0.482	0.402
PV	109.10	91.85	89.01	74.85	95.25
Total present value (t = 1-5)					460.06
Less: cash Outflow					276.55
NPV					183.51

Comments: Since the NPV is positive, replacement of the exiting machines is financially viable.

FINANCIAL ANALYSIS WHETHER TO REPLACE THE EXISTION MACHINES (USING NPV METHOD)

Incremental cash outflows:

Cost of 3 new machines (Rs.100 lakh × 3)	300,00,000
Additional working capital	50,00,000
Less:Sale proceeds of existing machines	96,00,000
Add: Removal cost of existing machines	4,80,000
Tax on profit on sale of machine (working note1)	11,76,000
Cost of layng off 34 workers (Rs.921000 tax advantage @ .35 i.e. to Rs.3,22,350)	5,98,650
Incremental cash outflows	2,76,54,650

Working Notes

1. Tax on profit on sale of existing machine:

Sale proceeds of existing machine:			96,00,000
	(8 × 12,00,000)		
Less: Book value	(Rs.18 lakh × 8 – Original Cost accumulated depreciation 28.80 × 3)		57,60,000
		Gross profit	38,40,000
Less: Removal Cost	(60,000 × 8)		4,80,000
		Net Profit	33,60,000
		Tax rate	0.35
		Taxes payable on profit	11,76,000

2. Saving in Maintenance cost: (Rs. in lakhs)

Year	1	2	3	4	5
Old Machine	22.5	22.5	67.5	67.5	67.5
New Machine	7.5	7.5	37.5	37.5	37.5
Saving in cost	15	15	30	30	30

3. Savings in Labour cost:

Existing labour cost		
Unskilled	(18 × Rs.3,500 × 12 months)	7,56,000
Skilled	(18 × Rs.5,500 × 12 months)	11,88,000
Supervisor	(3 × Rs.6,500 × 12 months)	2,34,000
Maintenance	(2 × Rs.5,000 × 12 months)	1,20,000
		22,98,000

Proposed labor cost

Skilled	(6 × Rs.7,000 × 12 months)		5,04,000
Maintenance	(1 × Rs.6,500 × 12 months)		78,000
		Cost savings	17,16,000

Savings in subsequent years will increase by 10%

4. Incremental cost of raw material:

Raw material required for old machine:	
(3000000 × Rs.15 per unit × 0.60)	2,70,00,000
Raw material required for new machine	
(5000000 × Rs.15 per unit × 0.55)	4,12,50,000
Additional raw material Cost	1,42,50,000

5. Incremental Depreciation: (Rs. in Lakhs)

Years	1 – 2	3 – 5
Depreciation (with new machine)	54.00	54.00
(Rs.100 lakh × 3 – 10 × 3) / 5 years		
Depreciation (with old machine)	28.80	-
(Rs.18 lakh × 8/5 years)		
Incremental Depreciation	25.20	54.00

6. Insurance: (Rs. in lakhs)

Years	1	2	3	4	5
New Machine	6.00	5.40	4.86	4.37	3.94
Old Machine	1.88	1.69	1.52	1.37	1.23
Incremental Insurance	4.12	3.71	3.34	3.00	2.71

Question 2

(a) BA Ltd. and DA Ltd. both the companies operate in the same industry. The Financial statements of both the companies for the current financial year are as follows :

Balance Sheet

Particulars		BA Ltd. Rs.	DA Ltd. Rs.
Current Assets		14,00,000	10,00,000
Fixed Assets (Net)		10,00,000	5,00,000
	Total (Rs.)	24,00,000	15,00,000
Equity capital (Rs.10 each)		10,00,000	8,00,000
Retained earnings		2,00,000	-

14% long-term debt		5,00,000	3,00,00
Current liabilities		7,00,000	4,00,000
	Total (Rs.)	24,00,000	15,00,000

Income Statement

	BA Ltd. Rs.	DA Ltd. Rs.
Net Sales	34,50,000	17,00,000
Cost of Goods sold	27,60,000	13,60,000
Gross profit	6,90,000	3,40,000
Operating expenses	2,00,000	1,00,000
Interest	70,000	42,000
Earning before taxes	4,20,000	1,98,000
Taxes @ 50%	2,10,000	99,000
Earning after taxes (EAT)	2,10,000	99,000
Additional Information :		
No. of Equity shares	1,00,000	80,000
Dividend payment ratio (D/P)	40%	60%
Market price per share	Rs.40	Rs.15

Assume that both companies are in the process of negotiating a merger through an exchange of equity shares. You have been asked to assist in establishing equitable exchange terms and are required to :

(i) Decompose the share price of both the companies into EPS and P/E components; and also segregate their EPS figures into Return on Equity (ROE) and book value/intrinsic value per share components.

(ii) Estimate future EPS growth rates for each company.

(iii) Based on expected operating synergies BA Ltd. estimates that the intrinsic value of DA's equity share would be Rs.20 per share on its acquisition. You are required to develop a range of justifiable equity share exchange ratios that can be offered by BA Ltd. to the shareholders of DA Ltd. Based on your analysis in part (i) and (ii), would you expect the negotiated terms to be closer to the upper, or the lower exchange ratio limits and why?

(iv) Calculate the post-merger EPS based on an exchange ratio of 0.4 : 1 being offered by BA Ltd. Indicate the immediate EPS accretion or dilution, if any, that will occur for each group of shareholders.

(v) Based on a 0.4 : 1 exchange ratio and assuming that BA Ltd.'s pre-merger P/E ratio will continue after the merger, estimate the post-merger market price. Also show the resulting accretion or dilution in pre-merger market prices. (12 Marks)

(b) T Ltd. has promoted an open-ended equity oriented scheme in 1999 with two plans – Dividend Reinvestment Plan (Plan-A) and a Bonus Plan (Plan-B); the face value of the units was Rs.10 each. X and Y invested Rs.5,00,000 each on 1.4.2001 respectively in Plan-A and Plan-B, when the NAV was Rs.42.18 for Plan A and Rs.35.02 for Plan-B, X and Y both redeemed their units on 31.3.2008. Particulars of dividend and bonus declared on the units over the period were as follows:

Date	Dividend	Bonus	NAV	
		Ratio	Plan A	Plan B
15.9.2001	15	-	46.45	29.10
28.7.2002	-	1 : 6	42.18	30.05
31.3.2003	20	-	48.10	34.95
31.10.2003	-	1 : 8	49.60	36.00
15.3.2004	18	-	52.05	37.00
24.3.2005	-	1 : 11	53.05	38.10
27.3.2006	16	-	54.10	38.40
28.2.2007	12	1 : 12	55.20	39.10
31.3.2008	-	-	50.10	34.10

You are required to calculate the annual return for X and Y after taking into consideration the following information :

(i) Securities transaction tax @ 2% on redemption.

(ii) Liability of capital gains to income tax

(a) Long-term capital gain-exempt; and

(b) Short-term capital gains at 10% plus education cess at 3%. (8 Marks)

Answer

(a) Market price per share (MPS) = EPS SP/E ratio or P/E ratio = MPS/EPS

(i) Determination of EPS, P/E ratio, ROE and BVPS of BA Ltd. and DA Ltd.

		BA Ltd.	DA Ltd.
Earnings After Tax	(EAT)	210000	99000
No. of Shares	(N)	100000	80000
EPS	(EAT/N)	2.1	1.2375

Market price per share	(MPS)	40	15
P/E Ratio	(MPS/EPS)	19.05	12.12
Equity Funds	(EF)	1200000	800000
BVPS	(EF/N)	12	10
ROE	(EAT/EF) × 100	17.50%	12.37%

(ii) Estimation of growth rates in EPS for BA Ltd. and DA Ltd.

Retention Ratio	(1-D/P ratio)	0.6	0.4
Growth Rate	(ROE × Retention Ratio)	10.50%	4.95%

(iii) Justifiable equity shares exchange ratio

(a)	Intrinsic value based		= Rs.20 / Rs.40	= 0.5:1 (upper limit)
(b)	Market price based	= MPSb/MPSa	= Rs.15 / Rs.40	= 0.375:1 (lower limit)

Since, BA Ltd. has a higher EPS, ROE, P/E ratio and even higher EPS growth expectations, the negotiable terms would be expected to be closer to the lower limit, based on the existing share prices.

(iv) Calculation of post merger EPS and its effects

Particulars			BA Ltd.	DA Ltd.	Combined
EAT	(Rs.)	(i)	210000	99000	309000
Share outstanding		(ii)	100000	80000	132000*
EPS	(Rs.)	(i) / (ii)	2.1	1.2375	2.341
EPS Accretion (Dilution)	(Re.)		0.241	(0.301***)	

(v) Estimation of Post merger Market price and other effects

Particulars			BA Ltd.	DA Ltd.	Combined
EPS	(Rs.)	(i)	2.1	1.2375	2.341
P/E Ratio		(ii)	19.05	12.12	19.05
MPS	(Rs.)	(i) / (ii)	40	15	44.6
MPS Accretion	(Rs.)		4.6	2.84***	

* Shares outstanding (combined) = 100000 shares + (.40 × 80000) = 132000 shares

** EPS claim per old share	= Rs.2.34 × .04	= Re.0.936
EPS dilution	= Rs.1.2375 – Re.0.936	= Re.0.3015
***S claim per old share	(Rs.44.60 × 0.4)	17.84
Less: MPS and per old share		15.00
MPS Accretion		2.84

(b) X : Plan A

Unit acquired $= \frac{500{,}000}{42.18}$ = 11,854

Date	Units held	Dividend		Reinvestment Rate	New Units	Total Units
		%	Amount			
01.04.00						11,854
15.09.01	11,854	15	17.781	46.45	383	12,237
31.03.03	12,237	20	24.474	48.10	509	12,746
15.03.04	12.746	18	22,943	52.05	441	13,187
27.03.06	13,187	16	21,099	54.10	390	13,577
28.02.07	13,577	12	16,292	55.20	295	13,872

31.03.08	Redemption 13,872 × 50.10	Rs.	694,987
	Less: STT 0.2 %		1,390
			693,597
	Less: Short-term capital gains		-
	Net proceeds		693,597
	Less: Cost of acquisition		500,000
	Total Gain	Rs.	193,597

CVAF
r, 8 6.936
Annual Return 27.67%

Y : Plan B

Unit acquired $= \frac{500{,}000}{35.02}$ = 14,278

Date	Units held	Bonus		Total Units
		Ratio	Number	
01.04.00				14,278
28.07.02	14,278	1 : 6	2,380	16,658
31.10.03	16,658	1 : 8	2,082	18,740
24.03.05	18.740	1 : 11	1,704	20,444
28.02.07	20,444	1 : 12	1,704	22,148

31.03.08	Redemption 22,148 × 34.10	Rs.	755,247
	Less: STT 0.2 %		1,510
			753,737

Less: Short-term capital gains		-
Net proceeds		753,737
Less: Cost of acquisition		500,000
Total Gain	Rs.	253,737

CVAF	
r, 8	7.5374
Annual Return	29.29 %

Question 3

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

Additional information :

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

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

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

(6 Marks)

(b) Mr. A is interested to invest Rs.1,00,000 in the securities market. He selected two securities B and D for this purpose. The risk return profile of these securities are as follows :

Security	Risk (σ)	Expected Return (ER)
B	10%	12%
D	18%	20%

Co-efficient of correlation between B and D is 0.15.

You are required to calculate the portfolio risk and portfolio return of the following portfolios of B and D to be considered by A for his investment.

(i) 100 percent investment in B only;

(ii) 50 percent of the fund invested in B and D both;

(iii) 75 percent of the fund in B and the rest 25 percent in D;

(iv) 25 percent of the fund in B and the rest 75 percent in D; and

(v) 100 percent investment in D only.

Also indicate that which portfolio is the best for him from risk as well as return point of view? (6 Marks)

(c) Write short notes on the following :

(i) Global Depository Receipts

(ii) Interest Rate Swaps. (4×2=8 Marks)

Answer

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

Cost of equipment		Rs. in lakhs
3400 lakh yen at Rs.100 = 340 yen	=	1000
Add: Interest at 4.5% I Quarter	=	45
Add: Interest at 4.5% II Quarter	=	47.03
(on Rs.1045 lakhs)		
Total outflow in Rupees	=	1092.03

Alternatively, interest may also be calculated on compounded basis, i.e.,

Rs.1000 × $[1.045]^2$ = Rs.1092.03

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

Cost of letter of credit		Rs. in lakhs
At 1 % on 3400 lakhs yen at Rs.100 = 340 yen	=	10.00
Add: Interest I Quarter	=	0.45
Add: Interest II Quarter	=	0.47
(A)	=	10.92

Payment at the end of 180 days:

Cost	3400.00 lakhs yen
Interest at 2% p.a. [3400 × 2/100 × 180/365]	33.53 lakhs yen
	3433.53 lakhs yen

Conversion at Rs.100 = 345 yen [3433.53 / 345 × 100] (B) = Rs.995.23

Total Cost: A + B = 1006.15 lakhs

Comments: Option no.2 is cheaper by (1092.03 – 1006.15) lakh or 85.88 lakh

Hence, the offer may be accepted.

(b) We have $E_p = W_1E_1 + W_3E_3 + \ldots\ldots\ldots\ldots W_nE_n$

and for standard deviation $\bar{o}_p = \left[\sum_{i=l}^{n} \sum_{j=l}^{n} \times i \times j\, \rho ij\, \hat{o}i\, \hat{o}j\right]^{1/2}$

Substituting the respective values we get,

a. All funds invested in B
Ep = 12%
$\bar{o}_p$ = 10%

b. 50% of funds in each of B & D
Ep = 16%
$\bar{o}_p$ = 10.9%

c. 75% in B and 25% in D
Ep = 14%
$\bar{o}_p$ = 9.4%

d. 25% in B and 75% in D
Ep = 18%
$\bar{o}_p$ = 14.15%

e. All funds in D
Ep = 20%
$\bar{o}_p$ = 18.0%

In the terms of return, we see that portfolio (e) is the best portfolio. In terms of risk we see that portfolio © is the best portfolio.

(c) Short Notes:

(i) Global Depository Receipts (GDR) : A depository receipts in basically a negotiable certificate denominated in US dollars, that represents a non-US company publicity – traded local currency (INR) equity shares. Depositary Receipts are created when the local currency shares of an Indian company are delivered to the depositary's local custodian bank against which the depository bank issues depository receipts in US dollars. These depository receipts are called as Global Depository Receipts.

(ii) Euro Convertible Bonds : A convertible bond is a debt instrument which gives the holders an option to convert the bond to a pre-determined number of equity shares of the company. In case of Euro-convertible bond, the payment of interest and on the redemption of the bonds will be made by the issuer company in US dollars.

(iii) Currency Futures Contract : A currency futures contract is a standardised agreement that calls for delivery of a currency at some specific future date.

Contracts are traded on exchange and the clearing house interact between buyers and sellers.

(iv) Interest Rate Swaps : An interest rate swap is a contract which commits two counter parties to exchange, over an agreed period, two streams of interest payments each calculated using a different rate index, but applied to a common notional amount.

Question 4

(a) XYZ Ltd. requires an equipment costing Rs.10,00,000; the same will be utilised over a period of 5 years. It has two financing options in this regard :

(i) Arrangement of a loan of Rs.10,00,000 at an interest rate of 13 per cent per annum; the loan being repayable in 5 equal year end instalments; the equipment can be sold at the end of fifth year for Rs.1,00,000.

(ii) Leasing the equipment for a period of five years at an early rental of Rs.3,30,000 payable at the year end.

The rate of depreciation is 15 per cent on Written Down Value (WDV) basis, income tax rate is 35 per cent and discount rate is 12 per cent.

Advise the XYZ Ltd. that which of the financing options is to be exercised and why.

(8 Marks)

(b) ABC Ltd. has been maintaining a growth rate of 10 per cent in dividends. The company has paid dividend @ Rs.3 per share. The rate of return on market portfolio is 12 per cent and the risk free rate of return in the market has been observed as 8 per cent. The Beta co-efficient of company's share is 1.5.

You are required to calculate the expected rate of return on company's shares as per CAPM model and equilibrium price per share by dividend growth model. (6 Marks)

(c) What do you mean by 'Financial Engineering'? State its significance in the present regime of globalisation. (6 Marks)

Answer

(a) Option A

Year	Interest 13% 01	Depreciation 15% WDV 02	Interest + Dep. 03	Tax Shield 03 × 35% 04	Repayment 05	Net 01 + 05 – 04 = 06	PV 12%
01	130,000	150,000	280,000	98,000	200,000	232,000	(207,176)
02	104,000	127,500	231,500	81,025	200,000	222,975	(177,711)

03	78,000	108,375	186,375	65,231	200,000	212,769	(151,492)
04	52,000	92,120	144,120	50,442	200,000	201,558	(128,191)
05	26,000	78,300	104,300	36,505	200,000	189,495	(107,443)
06	Scrap Value					100,000	56,700
							(715,313)

Option B

Lease Rent		330,000
Tax Shield		(115,500)
Outflow		214,500
	×	3,599
	Rs.	771,985

Since PV of outflows is lower in the Borrowing option, XYZ Ltd. should avail of the loan and purchase the equipment.

(b) CAPM formula for calculation of Expected Rate of Return is :

ER $= R_f + B\,(R_m - R_f)$

$= 8 + 1.5\,(12 - 8)$

$= 8 + 1.5\,(4)$

$= 8 + 6$

$+ 14\%$ or 0.14

Applying Dividend Growth Model for the calculation of per share equilibrium price :

$$ER = \frac{D_1}{P_0} + g$$

$$0.14 = \frac{3\,(1.10)}{P_0} + 0.10$$

$$0.14 - 0.10 = \frac{3.30}{P_0}$$

$$0.04\,P_0 = 3.30$$

$$P_0 = \frac{3.30}{0.04} = \text{Rs.}82.50$$

Per share equilibrium price will be Rs.82.50.

(c) FINANCIAL ENGINEERING: "Financial Engineering" involves the design, development and implementation of innovative financial instruments and processes and the formulation of creative solutions and problems in finance. Financial engineering lies in innovation and creativity to promote market efficiency. In involves construction of innovative asset-liability structures using a combination of basic instruments so as to obtain hybrid instruments which may either provide a risk-return configuration otherwise unviable or result in gain by heading efficiently, possibly by creating an arbitrage opportunity. It is of great help in corporate finance, investment management, trading activities and risk management.

Over the years, Financial managers have been coping up with the challenges of changing situations. Different new techniques of financial analysis and new financial instruments have been developed. The process that seeks to adopt existing financial instruments and develop new ones so as to enable financial market participants to cope more effectively with changing conditions is known as financial engineering.

In recent years, the rapidity with which corporate finance and investment finance have changed in practice has given birth to new area of study known as financial engineering. It involves use of complex mathematical modeling and high speed computer solutions. Financial engineering includes all this. It also involves any moral twist to an existing idea and is not limited to corporate finance. It has been practiced by commercial banks in offering new and tailor made products to different types of customers. Financial engineering has been used in schemes of merger and acquisitions.

The term financial engineering is often used to refer to risk management.

Question 5

(a) Followings are the spot exchange rates quoted at three different forex markets :

USD/INR	48.30 in Mumbai
GBP/INR	77.52 in London
GBP/USD	1.6231 in New York

The arbitrageur has USD1,00,00,000. Assuming that there are no transaction costs, explain whether there is any arbitrage gain possible from the quoted spot exchange rates. (6 Marks)

(b) MSN Ltd. has total sales of Rs.4.50 crores and its average collection period is 120 days. The past experience indicates that bad debt losses are 2 per cent on sales. The expenditure incurred by the company in administering its receivable collection efforts are Rs.6,00,000. A Factor is prepared to buy the company's receivables by charging 2 per cent commission. The factor will pay advance on receivables to the company at an interest rate of 18 per cent per annum after withholding 10 per cent as reserve.

You are required to calculate effective cost of factoring to the company. (8 Marks)

(c) Discuss the main features of green-field privatisation. (6 Marks)

Answer

(a) The arbitrageur can proceed as stated below to realize arbitrage gains.

(i) Buy I. Rs. from USD 10,000,000

At Mumbai $48.3 \times 10{,}000{,}000$

Rs.483,000,000

(ii) Convert I. Rs. to GBP at London $\frac{483{,}000{,}000}{77.52}$

GBP = 6,230,650.155

(iii) Convert GBP to USD at New York $6{,}230{,}650.155 \times 1.6231$

USD = 10,112,968.26

There is net gain of USD = 10,112968.26 less 10,000,000

i.e USD = 112,968.26

(b) MSN Ltd.

Average level of Receivables	45000000 × 120 / 360	15000000
Factoring commission	15000000 × 2%	300000
Factoring Reserve	15000000 × 10%	1500000
Amount available for advance	15000000 – (300000 + 1500000)	13200000

Factor will deduct at interest @ 18%	
Interest (13200000 × 18 × 120) / 100 × 360	792000
Advance to be paid = Rs.13200000 – 792000	12408000
Annual cost of factoring to the firm:	
Factoring commission (Rs.300000 × 360 / 1320)	900000
Factoring commission (Rs.300000 × 360 / 120)	2376000
	3276000

Firms savings on taking factoring service:		
Cost of credit administration saved		600000
Cost of bad debts	(45000000 × 2%)	900000
Total savings		1500000

Net cost to the firm = Rs.3276000 – 1500000 = Rs.1776000

Effective rate of interest to the firm = 1776000 × 100 / 12408000 = 14.31%

Note: The number of days in a year is assumed to be 360 days.

(c) GREENFIELD PRIVATISATION: It is the process of reforming PSEs and aims at reducing involvement of the state of the public sector in the nation's economic activities by dividing the industries between public sector and private sector in favour of the latter. The policy of Greenfield Privatization has made considerable progress since the introduction of the new economic policy (NEP) in 1991. The process of the re-divide has been mainly through:

(i) De-licensing

(ii) Reduction in budget allocation

(iii) External aid/grant

(iv) Anomaly in duty structure

(v) Decision-making systems.

Since, October 1999 and with the run-up to Budget 2000, the government has taken several steps. These include a full-fledged Ministry of disinvestments, moving towards leasing out its international airport assets and the intention to privatize the two national air carriers. It would appear that the initiatives on selling off state owned enterprises have come to age.

The Government sector encompasses a wide range of activities outside what may be regarded as Government proper-both commercial and social. A large part of the "Commercial" components of the state sector has been organized as companies, including the Central and State Public Sector Enterprise (PSEs). An equally large part is not including the power sector, railways, department of telecommunications and urban water utilities – although some states have taken steps to corporatise and unbundled their electricity boards.

Privatization of public sector enterprises holds the key to getting out of this quick-sand of fiscal deficit. There is a significant amount of shareholder value locked up in the pubic sector units which the government should en-cash optimally and use the resulting inflows to pay off its debts. This requires political will and support from all major political parties whether in power or not.

Question 6

(a) Calculate the price of 3 months PQR futures, if PQR (FV Rs.10) quotes Rs.220 on NSE and the three months future price quotes at Rs.230 and the one month borrowing rate is given as 15 per cent and the expected annual dividend yield is 25 per cent per annum payable before expiry. Also examine arbitrage opportunities. (5 Marks)

(b) Based on the credit rating of bonds, Mr. Z has decided to apply the following discount rates for valuing bonds :

Credit Rating	Discount Rate
AAA	364 day T bill rate + 3% spread
AA	AAA + 2% spread
A	AAA + 3% spread

He is considering to invest in AA rated, Rs.1,000 face value bond currently selling at Rs.1,025.86. The bond has five years to maturity and the coupon rate on the bond is 15% p.a. payable annually. The next interest payment is due one year from today and the bond is redeemable at par. (Assume the 364 day T-bill rate to be 9%).

You are required to calculate the intrinsic value of the bond for Mr. Z. Should he invest in the bond? Also calculate the current yield and the Yield To Maturity (YTM) of the bond.

(5 Marks)

(c) Discuss the Capital Asset Pricing Model (CAPM) and its relevant assumptions. (5 Marks)

(d) Distinguish between Forward and Futures contract. (5 Marks)

Answer

(a) Future's Price = Spot + cost of carry – Dividend

F = 220 + 220 × 0.15 × 0.25 – 0.025** × 10

= 225.75

** Entire 25% dividend is payable before expiry, which is Rs.2.50.

Thus we see that futures price by calculation is Rs.225.75 which is quoted at Rs.230 in the exchange.

Analysis:

Fair value of Futures less than Actual futures Price:

Futures Overvalued Hence it is advised to sell. Also do Arbitraging by buying stock in the cash market.

Step I

He will buy PQR Stock at Rs.220 by borrowing at 15% for 3 months. Therefore his outflows are :

Cost of Stock	220
Add: Interest @ 15 % for 3 months i.e. 0.25 years	8.25
(220 × 0.15 × 0.025)	
Total Outflows (A)	228.25

Step II

He will sell March 2000 futures at Rs.230. Meanwhile he would receive dividend for his stock.

Hence his inflows are	230
Sale proceeds of March 2000 futures	2.50
Total inflows (B)	232.5

Inflow – Outflow = Profit earned by Arbitrageur

= 232.5 – 228.25

= 4.25

(b) The appropriate discount rate for valuing the bond for Mr. Z is :

R = 9 + 3 + 2 = 14%

TIME	CF	PVIF 14% PV (CF)	PV (CF)
1	150	877	131.55
2	150	769	115.35
3	150	675	101.25
4	150	592	88.80
5	1150	519	596.85
			$\sum$ PV (CF) i.e. P_0 = 1033.80

Since, the current market value is less than the intrinsic value; Mr. Z should buy the bond. Current yield = Annual Interest / Price = 150 / 1025.86 = 14.62%

The YTM of the bond is calculated as follows:

@15%

P $= 150 \times PVIFA_{15\%, 4} + 1150 \times PVIF_{15\%, 5}$

$= 150 \times 2.855 + 1150 \times 0497$

$= 428.25 + 571.55 = 999.80$

@14%

As found in sub part (a) P_0 = 1033.80

By interpolation we get,

YTM = 14.23%

(c) CAPITAL ASSET PRICING MODEL: The mechanical complexity of the Marko-witz's portfolio model kept both practitioners and academics away from adopting the concept for practical use. Its intuitive logic, however, spurred the creativity of a number of researchers who began examining the stock market implications that would arise if all investors used this model As a result what is referred to as the Capital Asset Pricing Model (CAPM), was developed.

The Capital Asset Pricing Model was developed by Sharpe Mossin and Linter in 1960. The model explains the relationship between the expected return, non diversifiable risk and the valuation of securities. It considers the required rate of return of a security on the basis of its contribution to the total risk. It is based on the premises that the diversifiable risk of a security is eliminated when more and more securities are added to the portfolio. However, the systematic risk cannot be diversified and is or related with that of the market portfolio. All securities do not have same level of systematic risk. The systematic risk can be measured by beta, ß under CAPM, the expected return from a security can be expressed as:

Expected return on security = R_f + Beta (R_m – R_f)

The model shows that the expected return of a security consists of the risk-free rate of interest and the risk premium. The CAPM, when plotted on the graph paper is known as the Security Market Line (SML). A major implication of CAPM is that not only every security but all portfolio too must plot on SML. This implies that in an efficient market, all securities are expected returns commensurate with their riskiness, measured by ß.

RELEVANT ASSUMPTIONS OF CAPM:

(i) The investor's objective is to maximize the utility of terminal wealth;

(ii) Investors make choices on the basis of risk and return;

(iii) Investors have identical time horizon;

(iv) Investors have homogeneous expectations of risk and return;

(v) Information is freely and simultaneously available to investors;

(vi) There is risk-free asset, and investor can borrow and lend unlimited amounts at the risk-free rate;

(vii) There are no taxes, transaction costs, restrictions on short rates or other market imperfections;

(viii) Total asset quantity is fixed, and all assets are marketable and divisible.

CAPM can be used to estimate the expected return of any portfolio with the following formula:

$E(R_p) = R_f + B_p [E(R_m - R_f)]$

$E(R_p)$ = Expected return of the portfolio

R_f = Risk free rate of return

B_p = Portfolio beta i.e. market sensivity index.

E (R_m) = Expected return on market portfolio

E (R_m) – R_f = Market risk premium

CAPM provides a conceptual frame work for evaluating any investment decision where capital is committed with a goal of producing future returns.

(d) FORWARD AND FUTURE CONTRACTS:

S.No.	Features	Forward	Futures
1.	Trading	Forward contracts are traded on personal basis or on telephone or otherwise.	Futures Contracts are traded in a competitive arena.
2.	Size of Contract	Forward contracts are individually tailored and have no standardized size	Futures contracts are standardized in terms of quantity or amount as the case may be
3.	Organized exchanges	Forward contracts are traded in an over the counter market.	Futures contracts are traded on organized exchanges with a designated physical location.
4.	Settlement	Forward contracts settlement takes place on the date agreed upon between the parties.	Futures contracts settlements are made daily via. Exchange's clearing house.
5.	Delivery date	Forward contracts may be delivered on the dates agreed upon and in terms of actual delivery.	Futures contracts delivery dates are fixed on cyclical basis and hardly takes place. However, it does not mean that there is no actual delivery.
6.	Transaction costs	Cost of forward contracts is based on bid – ask spread.	Futures contracts entail brokerage fees for buy and sell orders.
7.	Marking to market	Forward contracts are not subject to marking to market	Futures contracts are subject to marking to market in which the loss on profit is debited or credited in the margin account on daily basis due to change in price.
8.	Margins	Margins are not required in forward contract.	In futures contracts every participants is subject to maintain margin as decided by the exchange authorities
9.	Credit risk	In forward contract, credit risk is born by each party and, therefore, every party has to bother for the creditworthiness.	In futures contracts the transaction is a two way transaction, hence the parties need not to bother for the risk.

PAPER – 3 : ADVANCED AUDITING

Answer Question Nos. 1 and 2 and four from the rest.

Question 1

As a Statutory auditor, how would you deal with following?

(a) While finalizing its accounts, a company does not provide for Income-tax payable under the provisions of the Income-tax Act, 1961. A note is however given that since adequate tax has been deducted at source, no additional tax is payable.

(b) A company receives a grant from the State Government as compensation for loss of stocks due to unseasonal floods. The entire grant received is credited to "Capital Reserve".

(c) A company which satisfies the conditions of a Small and Medium sized Company (SMC) as per Companies (Accounting Standards) Rules, 2006 has represented that it does not require to give disclosures required by AS-3 "Cash Flow Statements" and AS-18 "Related Party Disclosures" in its financial statements.

(d) A company which has presented its quarterly results f or a limited review report, has represented that expenditure incurred on heavy repairs carried in that quarter are being spread over the entire year, since it would otherwise, distort the quarterly results.

(5+5+4+4 = 18 Marks)

Answer

(a) Expl.:- The Council of the Institute of Chartered Accounts of India has expressed its view in the Guidance Note on provision for liability for taxation, that provision for anticipated tax liability in respect of profits of the company has to be made while finalizing its accounts. According to it, non-provision for taxation would amount to contravention of the provisions of Sec. 209 and 211 of the Companies Act i.e. maintenance of proper books of account and disclosures of true and fair view of the state of affairs of the company. Accordingly, non-provision for taxation would amount of contravention of the above provision of the Companies Act, 1956.

Conclusion : Hence, in the given case, it is necessary for the auditor to quality his report and such qualification should bring out in what manner the accounts do not disclose "A true and Fair "view of the state of affairs of the Company and its Profit or loss

However, the qualification should also mention clearly that tax deducted at source is in excess of the estimated tax liability for the year.

(b) Accounting of Government Grants: Expl: Government Grants related to revenue should be recognized on a systematic basis in the profit and loss Account over ,the periods necessary to match them with the related costs which they are intended to compensate.

Such Grants should either be shown separately under 'Other Income' in the profit & loss account or should be deducted in reporting the related expenses or losses, if such Grant is received in the same year in which loss is sustained.

In case of such Grant is received towards re-imbursement of losses of past years, the same should be credited to Profit & loss Account under the head 'other Income', Showing separately.

Conclusion: Thus, in the instant case, Grant received by the company from State Govt. as compensation for loss of stocks due to unseasonal floods, and credited to Capital reserve is wrong. In no case, it can be credited to 'CAPITAL RESERVE'. The Auditor should give qualified report.

(c) Compliance of AS-3 and AS-18 by SMC: Expl.:- As per the Companies (Accounting Standards) Rules, 2006, Compliance of Certain Accounting Standards is not mandatory, but optional.

Conclusion: AS-3, as per the above Rules in the initial paragraph mentions that AS-3 (cash flow statement) is not mandatory for SMC.

However, AS-18 does not contain any such mention in the entire Standard. Thus the company, even if it is a SMC, will have to give disclosures for:

(i) related party relationships, and (ii) transactions between a reporting enterprise and its related parties.

(d) Presentation of Quarterly Results (AS-25): Expl.:- presentation of quarterly results is governed by the provisions of AS-25, "Interim Financial Reporting" according to which it is mandatory for all entities preparing Interim Financial Report. Uniform accounting policies are to be applied in interim and annual financial statements. It further says that uneven costs can also be anticipated or deferred only if appropriate to do so at the end of the year.

Conclusion :- In the instant case, in view of the above, as stated in AS-25, heavy repairs can not be deferred to other quarters. If so done by the company, the limited review report will have to contain a qualification for the same.

Question 2

Comment on the following with reference to the Chartered accountants Act, 1949 as amended by the Chartered Accountants (amendment) Act, 2006 and Schedules thereto:

(a) Mr. P, Chartered Accountant, proprietor of M/s P & Co. requests the manager of a Bank branch to sanction him a loan for Rs.10 lakhs. He also offers free services to the manager and the staff for filing Income-tax returns for 3 years.

(b) M/s ABC, a partnership firm carrying on business has complained to the Institute of Chartered Accountants of India (ICAI) that Mr. M, a Chartered Accountant has charged the firm excessive fees for a professional assignment.

(c) Mr. A, a Chartered Accountant in practice has been appointed editor of a monthly journal which analyses performance of the Stock Market and Mutual Fund Schemes.

(d) M/s PQR, a firm of Chartered accountants has been appointed Statutory Auditor of a company on terms whereby fees are payable on a progressive basis. Accordingly, the firm has been paid Rs.50,000 as part of his audit fees, though the audit report is yet to be submitted. (5+5+4+4= 18 Marks)

Answer

(a) Coercive Method for Sanction of Loan

Provisions: Sec. 21 of the Chartered Accounts Act, 1949, deals with provisions relating to "Otheir Misconduct" .

Supreme Court has observed in the matter of professional things relating to the members of the Institute of Chartered Accountants of India that when a member is prima-facie found guilty of any conduct, the Council of the institute is empowered to conduct an inquiry in the affairs of the conduct and can take action against such member even if no specific provisions are made under Schedules of the Chartered Accountant Act.

In the circumstances, a chartered accountant can be held guilty under the clause of “Other Misconduct" who has opted coercive methods on a Bank for having a loan sanctioned to him.

Conclusion: Thus in the instant ease, Mr. P a chartered accountant and proprietor of M/s. P & Co. when offers free services of filing Income tax returns of the staff and manager of the Bank for having sanctioned him a loan of Rs. 10 lacs, is clearly hit by clause of ’Other Misconduct’ and is deemed to be guilty of professional misconduct, as a chartered accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in non professional work would expose him to disciplinary action.

(c) Excessive Fees: Expl.:- The matter of fixation of actual fees charged in individual cases, depends upon the mutual agreements and understanding between chartered accountant and client. The scales of fees recommended by the council of the Institute is only recommendatory.

Conclusion: In the circumstances, the contention of the client of Mr. M that he has charged an excessive fees for a professional assignment, does not constitute professional misconduct in the context of the provisions of Chartered Accountants Act. 1949 and regulations made thereunder.

In view of the above Mr. M is not liable for any professional misconduct under the Chartered Accountants Act, 1949.

(c) Editorship of Stock Market and Mutual Funds Journal : Expl.: Clause 11, Part 1 of the first schedule of the Chartered Accountants Act 1949, has mentioned very clearly that a chartered accountant in practice should not engage himself in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council. This provision is introduced with a intension to restrain a member in practice from engaging himself in any other business in conjunction with the profession of accountancy and combining such wok with any business, which is not in keeping with dignity of the profession.

Under the above clause, the council permits (among other things) editorship of professional journal.

Conclusion: In the instance case Mr. A, a chartered accountant in practice, has been appointed editor of a journal related to stock market and mutual fund schemes which can not be, in any case, called a professional journal. Hence Mr. A would be guilty of professional misconduct.

(d) Fees received on a Progressive Basis:Expl. : As per Sec. 226, clause (d) of Sub-section 3, of the Companies Act, 1956 a person indebted to Company for an amount exceeding Rs. 1000/- or a person who has given my guarantee or providing any security in connection with indebtedness of any third person to the Company for an amount exceeding Rs. 1000/- is not qualified for appointment as auditor of the Company.

However, where auditor, in terms of his appointment, for various professional work and assignment, recovers fees on progressive basis against such assignments as and when part work is done, without waiting for completion of the whole Job or assignment, the Research Committee of the Institute has observed that where, in terms of resolution passed by General meeting, where auditor received fees/remuneration on progressive basis before completion of his job or assignments, he can not be said to be indebted to the Company at any stage.

Conclusion. : Accordingly, M/s. P Q R, a firm of Chartered Accountant is well within the ambit of laws, even if the firm receives Rs. 50,000/- as part of their audit fees, though the audit report is yet to be submitted and hence, there is no professional misconduct on the part of M/ s. P Q R and the firm can not be called indebted to the Company as per the view of the Research Committee of ICAI.

Question 3

(a) Auditor's liability to third parties in relation to issue of Prospectus.

(b) What are the duties of an auditor regarding disqualification of directors under Section 274(1)(g) of the Companies Act, 1956? (8+8 = 16 Marks)

Answer

(a) Auditor's Liability to Third Party in Relation to issue of Prospectus: The Guidance Note was issued by Company Law Committee in 1985, on Reports of Company Prospectus. Accordingly, the Companies. Act, 1956, introduced stringent requirements which the Companies were required to comply with whenever they intended to offer shares or debentures for public subscription, so that the prospective investors in companies make their decision on the basis of proper and adequate information. The requirements, inter alia, included certain reports to be given by the Chartered Accountants about the Companies to the Investors.

See, 62 of the Companies Act, 1956, lays down the civil liability for mis-statement in a prospectus, issued to invite persons to subscribe for shares or debentures of a company. The professional accountant will, in such case, be liable to pay compensation to every person who subscribed for any shares or debentures on the faith of the prospectus for any loss or damage sustained because of an untrue statement made by him as an expert. However, a professional accountant will not liable to third parties in relation to issue of Prospectus if he can prove that:

(a) The prospectus was issued without his knowledge or consent and that on becoming aware of its issue, he forthwith gave reasonable public notice that it was issued without his knowledge or consent. He would withdraw his consent by writing to the company, to the Registrar of Companies, to the stock exchange and through suitable press publicity.

(b) He withdrew his consent in writing before delivery of the prospectus for registration, or

(c) After the delivery of prospectus for registration Int before allotment of shares or debentures, on becoming aware of the untrue misleading statement, he withdrew his consent in writing and gave reasonable public notice of his withdrawal and of the reasons thereof, or

(d) He was competent to make the statement and that he had reasonable grounds to believe up to the time of allotment of the shares or debentures that the statement was true.

(b) Duties of an auditor regarding Disqualification of Directors U/S 274 (1G) of The Companies Act, 1956: U/s. Sec. 227(3) (f), of the companies Act, 1956, it is mentioned that the auditor's report shall state whether any director is disqualified from being appointed as a director under clause(G) of Sub-Section (1) of Sec. 274.

In order to report upon clause (f) of Sub-Sec. (3) of Sec. 227 of the Companies Act, 1956, it is essential that the auditor understands the requirements of clause (G) of sub-sec. 1) of Sec. 274 of the companies Act which states :

That a person shall not be capable of being appointed as director of company if such person is already a director of a public company which -

(a) has not filed the annual accounts and annual returns for any continuous three financial years, commencing on and after the first day of April - 1999. or

(b) has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay divided and such failure continues for one year or more. Provided that such person shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company in which he is a director, failed to file annual accounts and annual returns or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend.

Auditor to comply with Sec. 227(3)(F), should obtain a written representation as to :

(a) Names of directors of the Company during period covered by the auditor's report.

(b) Particulars of appointment/re-appointment or resignation/ retirement of such directors.

(c) Submission of Form DD-A, required to be submitted by such director.

(d) Information of directors contained in the register of directors U /s. 303(1) of companies Act as updated upto the date of balance sheet.

(e) Details of default committed by the Company U/s. 274(1) of the Act.

(f) In case of above default, whether the Company has furnished the form DD-B as required by the Rules.

On the basis of such examination the auditor is required to furnish certificate every year stating therein whether any director is disqualified for appointment as director.

Question 4

(a) Discuss the reporting requirements under the Companies (Auditor's report) Order, 2003 where a company has defaulted in compliance of Section 58AA of the Companies Act, 1956 with regard to public deposits.

(b) As per the directions under Section 619(3)(A) of the Companies Act, 1956 applicable to Insurance Companies, which are the points on which the Statutory Auditor has to report on in respect of System of Accounts? (8+8 = 16 Marks)

Answer

(a) Default in Compliance of Section 58 AA : As per paragraph 4 (vi) of the Companies (Auditor's report) order 2003 as amended companies (Auditor's report) amendment order (2004), the audit report should include the following matters with regard to public deposits.

In case, the company has accepted deposits from the public, whether the directives issued by RBI and the provisions of Sec 58 A and 58 AA or any other relevant provisions of the Act and rules framed thereunder, 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 RBI or any other Court or any other Tribunal, whether the same has been complied with or not.

Sec. 58 AA deals with small depositors. A small depositor is a depositor who has deposited in a financial year, a sum not exceeding Rs. 20,000/- in the Company. Non-Compliance of Sec. 58 AA occurs where Company fails to intimate Company Law Board any default in repayment of deposit to small depositors or part thereof or any interest thereupon. The auditor has, therefore, to first determine whether there is any default in repayment of such deposits. When number of such depositors are large, it may not be feasible for the auditor to first Verify each amount of default in repayment. The auditor, in such case, should examine the internal control in this regard and determine its efficacy. The auditor should obtain a schedule of repayment of loans taken form small depositors from the management of the company and should make reasonable test checks of repayments made by the Company. In case the results of test check reveal that the management has defaulted in repayment of deposits made by small depositors or part thereof or interest thereupon, he should examine whether the same has been intimated to the Company law Board. The auditor should also enquire from the management about the possible instances of non compliance with Sec. 58 AA and the relevant rules. The auditor should also enquire from the management about any order passed by the Company Law Board for contravention of Sec, 58 AA and the relevant rules.

The auditor should obtain management representation to the effect whether :

(a) The company has complied with directives issued by RBI and the provisions of Sec. 58 AA of the Act and

(b) Where an order has been passed by the Company Law Board, the Company has complied with the requirements of the Order.

(b) Directions U/S. 619 (3) (A) of The Companies Act, 1956 applicable to Insurance Company :Points on which the statutory Auditor has to report in respect of System of Accounts, are as under :

(1) Examine the following systems and give views as regards their deficiencies along with suggestions for remedial measures:

(a) Recording of receipts and expenditure

(b) Drawing periodical trial balance

(c) Compilation of accounts

(d) Reconciliation of inter-office accounts.

(e) Reconciliation of registers I records relating to property, assets, investments, premiums, claims, loans etc. with financial books.

(f) Maintenance of up-to-date records in respect of assets which are pledged, encumbered or blocked in any way.

(2) Are the bank accounts of the Company reconciled with the bank statements regularly? If not, describe the failures.

(3) Are Control accounts and subsidiary accounts up-to-date and reconciled regularly? If not, describe the failures.

(4) Examine the accounting policies of the Company. Are these in conformity with the Accounting Standards. Give particular of materials departures from these standard, if any, along with their effect on the financial statements. Quantify the impact wherever possible.

The statutory auditors arc required to submit a copy of their report as above to the C & AG, U / s - 619(3) (A) of the companies Act, 1956.

Question 5

(a) Comment whether the following Companies can be classified as a Small and Medium Sized Company (SMC) as per the Companies (Accounting standards) Rules, 2006:

(i) A Pvt. Ltd., a subsidiary of a multinational company listed on London Stock Exchange. It has a turnover of Rs.12 crores and borrowings of Rs.5 crores.

(ii) B Pvt. Ltd. Has a turnover of Rs.45 crores, other income of Rs.7 crores and bank borrowings of Rs.9 crores.

(iii) C Ltd. Has appointed Merchant bankers to prepare a Red-herring prospectus for the purpose of filing the same with Securities and Exchange Board of India .(12 Marks)

(b) What are the Financial indications to be considered by an auditor for evolution of the going Concern assumption? (4 Marks)

Answer

(a) As per the Companies (Accounting Standards) Rules 2006, "Small and Medium Sized Company" (SMC) means, a company :

(i) Whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;

(ii) Which is not a bank, financial institution or an insurance company;

(iii) Whose turnover (excluding other income) does not exceed rupee; fifty crore in the immediately preceding accounting year,

(iv) Which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; and

(v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Explanation : For the purposes of clause (f) , a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned. therein are satisfied as at the en of. the relevant accounting period.

(a) As per the definition of SMC, point (v), a company will be a SMC if it is not a holding or subsidiary company of another company which is not a SMC. Since A Pvt. Ltd. is a subsidiary of another Company which is listed, on London Stock Exchange (and is therefore not a SMC), A Pvt. Ltd. cannot be a SMC. The turnover and borrowings are not relevant in this case.

(b) As per the definition of SMC, point (iii), a company will be a SMC if it's turnover does not exceed Rs. 50 corers or borrowings do not exceed Rs. 10 crore. For calculating this turnover, other income is not to be included. Since B Pvt. Ltd. has a turnover of Rs. 45 corers and borrowing; of Rs. 9 corers, it will satisfy the definition and can be classified as SMC.

(c) As per the definition of SMC, point (i) a company will be a SMC if it is not listed or in the process of listing. Since C Pvt. Ltd. has appointed merchant bankers to prepare a Red Herring Prospectus for the purpose of filling the same with SEBI, it is in the process of listing on a Stock Exchange. Hence C Ltd. cannot be classified as a SMC.

(b) Going Concern Assumption: Indication of risk that continuance as a going concern may be questionable, could come from the financial statements or from other related sources. As per AAS - 16, following are the financial indication to be considered by an auditor for evolution of the Going Concern assumption.

(i) Negative net worth or negative working capital.

(ii) Long term borrowings not being repaid on due dates and without any realistic prospects of renewals or repayment.

(iii) Substantial operating losses.

(iv) Substantial negative cash flows from operations.

(v) Inability to pay creditors on due dates.

(vi) Arrears or discontinuance of dividend payments to shareholders.

(vii) Adverse key financial ratios.

(viii) Inability to obtain financing for essential new product development.

(ix) Entering into a scheme of arrangement with creditors for reduction of liability.

Question 6

(a) How are investments to be classified in the financial statements of a Bank? (8 Marks)

(b) Discuss the reporting requirement in Form 3CD of Tax Audit Report under Section 44AB of the Income-tax Act, 1961 for the following: (8 Marks)

Answer

(a) Classification of Investmetns in case of a Bank : The entire investment portfolio of the bank (including SLR Securities and non - SLR securities) should be classified under three categories.

(i) Held to Maturity

(ii) Available for sale

(iii) Held for Trading.

However, in the balance sheet, the investments will continue to be disclosed as per the existing six classifications viz :

(i) Govt. Securities

(ii) Other approved securities

(iii) Shares

(iv) Debentures & Bonds.

(v) Subsidiaries / Joint ventures and

(vi) Other (CP, Mutual Fund, Units etc.)

Banks should decide the category of the investment at the time of acquisition and the decision should be recorded on the investment proposals.

Held to maturity

(i) The Securities acquired by the banks with the intention to hold them upto maturity will be classified under 'Held to maturity'.

(ii) The investments included under 'held to maturity' should not exceed 25% of the bank's total investments. The banks may include, at their, discretion, under 'Held to maturity' category securities less than 25% of total investment.

(iii) Following investments will be classified under 'Held to maturity' but will not be counted for the purpose of ceiling of 25% specified for this category.

(a) Re-capitalization bonds received from the Govt. of India towards their re-capitalization requirement and held in their investment portfolio.

(b) Investments in subsidiaries and Joint ventures (A joint venture would be one in which the bank, along with its subsidiaries holds more than 25% of the equity).

(c) The investments in debentures/bonds which are deemed to be in the nature of an advance.

(iv) Profit on sale of investments in this category should be first taken to the Profit & Loss Account and thereafter be appropriated to the 'Capital Reserve Account'. Loss on sale will be recognized in the Profit & Loss Account.

Available for Sale : The securities which do not fall within the above two categories will be classified under Available for Sale.

Held for Trading: The Investments classified under this category are the securities acquired by the banks with an intention to trade by taking advantage of the short term price/interest rate movements. These securities are to be sold within 90 days. Profit or loss on sale of investments will be taken to the Profit and Loss Account.

(b) Tax Audit U/s. 44 AB

(i) Tax Decuted At Source : Under the clause 27(a), following particulars requires to be reported by an auditor on the compliance with the provisions of Chapter XVII-B regarding deduction of tax at source and payment thereof to the credit of the central Govt.

(a) Whether the assessee has complied with the provision of chapter XVII-B regarding deduction of tax at source and regarding the payment thereof the credit of the Central Govt.

(b) If the provisions of chapter XVII-B have not been complied with, please give the following details:

		Amount
(i)	Tax deductible and not deducted at all	-
(ii)	Short fall in account of lesser deduction than required to he deducted	-
(iii)	Tax deducted late	-
(iv)	Tax deducted but not paid to the credit of the Central Govt.	-

In case, test checking has been done for the above (in case of volumes data), an appropriate disclosure for the same is to be given.

(ii) Expenditure incurred at club : Under the clause 17(d), the amount of payments made to clubs by the assesses during the year should be indicated. The payments may be for entrance fees as well as membership and subscription and for catering other services by the club, both in respect of directors/partners/proprietor of the organization. The fact whether such expenses are Incurred in the course of business or whether they are of personal nature should be ascertained. If they are of personal nature, they are to be shown separately under clause 17 (b).

Question 7

(a) What are the areas to be considered in an Environment Audit? (8 Marks)

(b) You have been asked by a company to compile financial statements for the purpose of obtaining loan from a Bank. Draft a report to be given to the Management for the same.

(8 Marks)

Answer

(a) Environmental Audit : Environmental Audits are becoming increasingly common in certain industries. Normally, environmental audits are performed at the request of management and are for internal use.

The main areas over which Environmental Audit should be dealt with in respect of various industrial units are as under :

(i) Layout and Design : Installation of Pollution Control devices, provisions for up gradation of Pollution Control measures to meet requirement of regulation framed by Govt.

(ii) Management of Resources : It include air, water, land, energy, raw materials and human resources and to see that these resources are interlinked and best used with minimum waste.

(iii) Pollution Control System : An effective system of pollution control exist and to inquire whether more measures are required, keeping in view the type of industry and its nature or working.

(iv) Emergent Safety Arrangement :- The Chemical, Gas etc. industries which are prone to sudden requirement of safety arrangements, must remain emergency plans are to be reviewed periodically.

(1) Medical and Healthcare facilities : The medical services should be maintained. The health of the workers should be a big consideration for the management.

(2) industrial Hygiene : Proper system should be maintained to eliminate industrial unhygienic state.

(3) Occupational Health : As the occupational health hazards varies from industry to industry due to the difference in the nature of working atmosphere and the pollution present in it, the concerned industry must pay proper weightage to those diseases which are prone to that particular type of industry.

(4) Information Assimilation and Reporting system : Proper information generated and reported by proper distributor of authorities, responsibilities and delegations. A report of compliance of all statutory environmental laws along with other preventive and precautionary measures should be put to Board at regular internals.

(5) EIA Methodology : The Environmental Impact Assessment is usually pre-requisite to start an industry. This is done considering the known spheres of

activities on the existing environmental conditions. But the predictions necessarily deviate from the actual happenings when the industry starts working. To accommodate the deviation in the system is also to be incorporated in the EIA report.

(6) Compliance to the Regulatory mechanism : As the person who are directly working with the system, may be unaware of the latest developments and requirements for the compliance of standards prescribed by the various regulatory authorities, they should be trained and instructed on regular basis, to avoid making the Board/Owner liable to prosecution and penalty.

(7) Concern of the society: The industry very often transform the agrarian environment into an industrial environment. The people so displaced by industrialization feel alienated, and develop a feeling of facing the gaseous, dutiful, clumsy state of surroundings. The audit should look into this aspect how the industry is making a balance between its own development and the society's concern.

(b) Report to the Management to Compile Financial Statement (Asss – 31)

To,

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On the basis of accounting records and other information and explanations provided to us by the management, we have compiled the unaudited Balance sheet of ABC Company limited as at 31st March 2008 and the related Profit & Loss Account for the period then ended on 31st March 2008.

The management of the ABC Company Limited is responsible for :

(a) Completeness and accuracy of the underlying data and complete disclosures of all material and relevant information's to the accountant

(b) Maintaining adequate accounting and other records and internal controls and selecting appropriate Accounting policies.

(c) Preparation and presentation of financial statements in accordance with applicable laws.

The compilation engagement was carried out in accordance with AAS-31, as recommended by ICAI.

The Balance Sheet and the Profit & Loss Account an in agreement with the books of account. We have not audited or reviewed these financial statements and accordingly express no opinion thereon.

Place:

Date:

For Chartered Accountant

Question 8

Write short notes on any four of the following:

(a) Investor Protection and Education Fund.

(b) Contingent liabilities in case of Banks.

(c) Borrowing costs and Qualifying assets.

(d) Permanent consolidation adjustments.

(e) Facultative reinsurance under Insurance Act, 1938.

(f) Stages in Risk Based Internal Audit. (4x4 = 16 Marks)

Answer

Short Notes:

(a) Investor Protection And Education Fund: The Central Govt. has established Fund U /s. 205-C of the Companies Act, 1956, called Investor Protection and Education Fund.

Features of this Fund are :

(i) The following amount usually are credited to this Fund

(a) Unpaid dividend.

(b) Application money received by the Company or allotment of securities and due for refund.

(c) Matured deposits with Companies.

(d) Matured debentures with Companies.

(e) The interest accrued on the amounts referred to in (a) to (d).

(f) Grants and donations given to the Fund by the Central Govt., State Govt., Companies or any other institutions for the purpose of the fund.

(g) The interest or other income received out of the investments made from the Fund.

Provided that no much amounts referred to in clauses (a) to (d) shall form part of the fund unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they become due for payment.

(i) The Fund shall be utilized for promotion of investor awareness and protection of the interest of the investors.

(ii) The Central Govt. shall, by notification in the Official Gazette, specify an authority or Committee, with such members as the Central Govt. may appoint, to administer the Fund.

(iii) It shall be competent for the authority or committee appointed as above to spend moneys out of the Fund for carrying out the object for which the Fund has been established.

(b) Contingent Liabilities in case of Banks: The Third Schedule to the Banking Regulation Act, 1949, requires the disclosures of the following as a footnote to the balance sheet.

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

(ii) Liability for partly paid investments.

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

(iv) Guarantees given on behalf of constituents.

(a) In India

(b) Out side India.

(v) Acceptances, endorsements and other obligations.

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

(b) Bills for collection.

(c) Borrowing costs and qualifying assets (AS 16) : Borrowing cost requires that financial cost relating the deferred credit or borrowed funds, directly attributable to construction, production or acquisition of qualifying assets should also be included in the cost of assets.

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or Sale.

(d) 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. These adjustments are:

(i) Determination of excess or deficit of the cost to the parent of its investments in subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made.

(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 investment in associates in consolidated financial statements.

Auditor should verify that the above calculations have been made appropriately. 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. The auditor should also examine whether the pre-acquisition reserves have been allocated appropriately between the parents and minorities of the subsidiary. 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 / associate, disposal of the subsidiary /associate in the subsequent years. Auditor should also check whether Goodwill in one company and Capital Reserve in another company have been netted off while preparing consolidated financial statements.

(e) Facultative reinsurance under insurance Act, 1938 : It is that type of reinsurance whereby the Contract relates to one particular risk and is expressed in the reinsurance policy. This is the oldest method of re-insurance and is necessitates consideration of each risk separately. Each transaction under facultative reinsurance has to be negotiated individually, Each party to the transaction has a free choice, i.e. for the Ceding Company to offer and the reinsurer to accept. The main drawbacks of this type of insurance are the volume of work involved and time taken to cover the risk. It is used mainly when :

(i) Automatic covers have already been exhausted

(ii) The risk is excluded from the treaties

(iii) The insurer does not want his reinsurance treaties overburdened with particularly heavy and abnormal risks.

(iv) The insurer has no automatic cover at his disposal in a particular branch, where he issues policies rarely.

(v) The nature of business is such that technical guidance or consultation with the reinsurer is required at every stage of acceptance of the risk it itself.

(f) Audit should be risk-based or focused on areas of greatest risk the achievement of the Audited entity's objectives. Risk-based Internal Audit is an approach to audit that analyzes audit risks, set materiality thresholds, based on audit risk analysis and develops audit programmes that allocate a larger portion of audit resources to high-risk areas.

The auditor does not normally need to perform specific audit procedures on all areas of audit. He only needs to design audit programmers on procedures on areas earlier identified as major risks that could result in the financial statements being materially misstated.

It comprises three stages :

(i) Assessing Risk maturity

(ii) Preparing periodic Audit plan.

(iii) Conducting individual assurance audit assignments and reporting to appropriate levels.

PAPER – 4 : CORPORATE LAWS AND SECRETARIAL PRACTICE

Question Nos. 1, 2 and 3 is compulsory.
Answer any four from the rest of the questions

Answer any two of the following:

Question 1

(a) Mountbay company Limited decided to terminate the services of Mr. Gopal who was employed as Sales Manager. The Company, however, feels that the Sales Manager may not vacate the company's flat at Delhi. What action can be taken by the company under the Companies act, 1956 to regain possession of the flat? Is it necessary to take such action before terminating the services of Mr. Gopal? Will it make any difference, if the flat is not owned by the company, but taken on lease? (5 Marks)

(b) The Executive Committee of a recognized stock exchange desires to transfer certain duties and functions of a clearing house to a recently set up clearing corporation, incorporated as a company under the companies Act,1956, examining the provisions of The Securities Contract (Regulation) Act, 1956. State the purposes for which such transfer of duties and functions can be made to clearing corporation.

What is the procedure to be adopted for such transfer of duties and functions? (5 Marks)

(c) Mr. Bansal holds certain securities on 31st March, 2008, issued in his favour under the "Collective Investment Scheme." For a consideration, Mr. Bansal transferred the said securities in favour of another person. One month after the date on which the income on these securities became due, the transferee lodged the instrument of transfer. Decide in the light of the provisions of the Securities Contracts (Regulation) Act, 1956.

(i) Whether in the given case Mr. Bansal is entitled to receive and retain the income on these securities for the financial year ended 31st March, 2008?

(ii) What would be your answer in case the transferee lodged the instrument of transfer 10 days after the date on which the income on these securities became due?

(5 Marks)

Answer

(a) ACTION AGAINST SALES MANAGER:

The company can take action under Section 630 of the Companies Act, 1956 if the sales manager refuses to vacate the premises provided by the company. According to Section 630, it is an offence if any officer or employee of a company

(1) wrongfully obtains possession of any property of a company or

(2) having any such property in his possession wrongfully withholds it or knowingly applies it to purposes other than those expressed or directed in the articles and authorized by the Act and such an offence is punishable with fine up to Rs. 10000/. Further the court may also order such officer or employee to deliver to the company

any such property wrongly obtained or wrongfully withheld within a time fixed by the court.

So the company can file a complaint under Section 630 as it provides speedy relief. Section 630 covers either existing as well as past officers or employees. Thus, action may also be initiated after termination of the services of Mr. Gopal.

It is not necessary that the property in question should be owned by the company. Even if the company exercises only a leasehold right, the provisions of Section 630 can be invoked.

(b) A recognized stock exchange may, with the prior approval of the Securities Exchange Board of India, transfer the duties and functions of a clearing house to a clearing corporation, being a company incorporated under the Companies Act, 1956 for the purpose of:

(a) The periodical settlement of contracts and differences there under

(b) The delivery of, and payment for, securities;

(c) Any other matter incidental to, or connected with, such transfer

PROCEDURE

Every clearing corporation shall for the purpose of transfer of the duties and functions of a clearing house to clearing corporation, make byelaws and submit the same to the SEBI for approval.

The SEBI may, on being satisfied that it is in the interest of the trade and also in the public interest to transfer the duties and functions of the clearing house to a clearing corporation, grant approval to the byelaws submitted to it under sub-section (2) of Section 8A of the Securities Contracts (Regulation) Act, 1956 and approve transfer of the duties and function of a clearing house to a clearing corporation.

The provision of Sections 4 to 12 of the said act shall as far as may be apply to a clearing corporation as they apply in relation to a recognized stock exchange.

(c) TRANSFER OF SECURITIES:

The problem as asked in the question is based on the provisions of Section 27A of the Securities contracts (Regulation) Act, 1956, wherein it shall be lawful for the holder of any securities, being units or the other instruments issued by collective investment scheme, whose name appears on the books of the scheme, issuing the said security to receive and retain any income in respect of units issued by the scheme in respect thereof for any year, notwithstanding that the said security, being units issued by the scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units issued by the scheme from the transferor has lodged the security and all other documents relating to the transfer which may be required by the scheme with the scheme for being registered in his name within 15 days of the date on which the income in respect of units or other instruments issued under the scheme become due. The period of 15 day can be extended in certain contingencies as stated in explanation to Section 27A (1) of the said Act.

Thus,

(i) the holder of the securities i.e Mr. Bansal, the transferor has right to receive or retain the income of the said securities for the financial year ended 31st March 2008, since the instrument for transfer was lodged one month after the date on which the income became due.

(ii) the answer in the second case would differ. The holder i.e. Mr. Bansal, the transferor can not receive and retain the income since the instrument for transfer was lodged with the company within the statutory period of 15 days by the transferee. Accordingly the transferee would be entitled to receive the income on these securities.

Answer any two of the following

Question 2

(a) Mr. Guilt an Indian National realizes that a penalty may be imposed upon him for violation of the provisions of the Foreign Exchange Management Act, 1999. He therefore desires to compound his offences. Advise Mr. Guilt about the process and procedure of compounding of the offence. (7 Marks)

(b) Mr. Amit, a citizen of India, left India for employment in Australia on 1st June, 2007. Mr. Amit purchased a flat at New Delhi for Rs.15 lakhs in September, 2008. His brother, Mr. Sumit employed in New Delhi, also purchased a flat in the same building in September, 2008 for Rs. 15 lakhs. Mr. Sumit 's flat was financed by a loan from a housing finance company and the loan was guaranteed by Mr. Amit. Examine with reference to the provisions of Foreign Exchange Management Act, 1999, whether purchase of flat and guarantee by Mr. Amit are capital account transactions and whether these transactions are permissible. (7 Marks)

(c) The Competition Commission of India has received a complaint that M/s. XYZ company has been abusing its dominant position in the food processing industry. Explain briefly the factors that will be considered by the commission to ascertain whether M/s. XYZ company enjoys a dominant position in the industry. (7 Marks)

Answer

(a) Sections 15 of Foreign Exchange Management Act, 1999 (FEMA) authorizes the Reserve Bank of India and Enforcement Directorate to compound contravention on an application made by any person who has committed contravention. The process and procedure of compounding is as under:

- An application for compounding of a contravention under the FEMA may be submitted to the compounding authority either on being advised of a contravention or either through a memorandum or suo moto on being made or becoming aware of the contravention. The application should be as per format in the Foreign Exchange (Compounding proceeding) Rules.

- Application for compounding in prescribed form together with a copy of the memorandum wherever applicable with the prescribed fee has to be submitted with relevant facts and supporting documents to the compounding authority.
- The compounding authority may call for any information/record or any other documents relevant to the compounding proceedings.
- Where additional information/documents are called for, such information shall be submitted within thirty days or such additional period as may be given by the compounding authority from the date of the said letter. In case the contravener fails to submit additional information/document called for within the specified period, the application for compounding will be liable for rejection.
- On receipt of the application for compounding, the proceeding would be concluded and the order issued by the compounding authority within 180 days from the date of the receipt of the application for compounding.
- The sum for which contravention has been compounded shall be paid within 15 days from the date of order of compounding.
- The payment towards application fee and the sum for which contravention has been compounded shall be paid by demand draft in favour of compounding authority.

Thus Mr. Guilt will have to follow the above procedure for compounding his offences.

(b) A "capital account transaction" means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India. It also includes following transactions referred to in sub-section (3) of Section 6 of Foreign Exchange Management Act 1999:

(a) Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;

(b) Giving of a guarantee or surety in respect of any debt, obligation or other liability incurred-

Thus purchase of flat at New Delhi and giving of guarantee would be considered as capital account transactions.

A capital account transaction is not permissible, unless otherwise provided in the Act, Rules or Regulations made there under, or with the general or special permission of Reserve Bank of India.

In the case referred, Mr. Amit left India for employment in Australia on 1st June 2007. Therefore, he becomes a person resident outside India from June 2007.

The purchase of flat by Mr. Amit is a capital account transaction. This is permissible in accordance with the regulation framed in this behalf i.e. The Foreign Exchange Management (Acquisition And Transfer Of Immovable Property In India) Regulation,

2000. The Foreign Exchange Management (Acquisition and Transfer of Immovable property In India) Regulation, 2000 imposes restrictions on a person resident outside India from acquiring immovable property in India provided he fulfills both the following conditions:

(a) the person resident outside India is citizen of India and

(b) the immovable property acquired in India is not agricultural/plantation or farmhouse.

Therefore the purchase of flat by Mr. Amit is permissible under FEMA.

Guarantee involves a long term commitment which alters the assets and liabilities of a person and therefore it is considered as a "capital account transaction' and thus restricted under FEMA. Accordingly Mr. Amit can give a guarantee to the housing finance company in respect of purchase of flat by Mr. Sumit with the permission of Reserve Bank of India.

(c) The Competition Commission while inquiring whether the enterprise XYZ Company enjoys a dominant position or not under Section 4 of the Competition Act, 2002 will take the following factors into account:

(a) market share of the enterprise

(b) size and resources of the enterprise

(c) size and importance of the competitors

(d) economic power of the enterprise including commercial advantages over competitors.

(e) vertical integration of the enterprises or sale or service net work of such enterprises.

(f) dependence of consumers on the enterprise.

(g) monopoly or dominant position whether acquired as result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise.

(h) entry barriers including barriers such as regulatory barriers, financial risk , high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or services for consumers.

(i) countervailing buying power.

(j) market structure and size of market .

(k) social obligations and size of market.

(l) relative advantage, by way of contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition.

(m) any other factor which the commission may consider relevant for the inquiry.

Question 3

(a) Mr. DB is a member of RPA Ltd. He obtains an order against the company for redressal of his grievances against the company. But the company fails to redress the grievances of DB within the time fixed by the SEBI. The Board thereafter imposed penalty upon the company U/s 15C of the SEBI Act. RPL Ltd. seeks your advice whether it has any remedy against the order of SEBI. Advise. (8 Marks)

(b) The promoters of ABC Ltd. an unlisted company decide to go for a public issue. They seek your advice in respect of the following matters:

Whether equity shares can be reserved in a firm allotment category for promoters at a price different from the price at which shares are offered to the public.

Circumstances in which the equity shares can be issued in denomination of Rs.2 per share.

Need for past track record of distributable profits.

Requirement of net tangible assets in the previous years. (8 Marks)

(c) The analysis of the language of Section 292 and Section 372A of the Companies Act, 1956 apparently discloses a conflict because the former provision permits the Board of Directors to delegate its powers to make loans whereas the latter provision requires approval of loan by resolution passed at a board meeting with the consent of all the directors present at the said meeting. To what extent the rule of "Harmonious construction" can be applied for the purpose of interpreting these two provisions of the companies Act, 1956. (8 Marks)

Answer

(a) Section 15C of Securities Exchange Board of India Act, 1992 lays down that if any listed company or any person who is registered as an intermediary, after having been called upon by the board in writing, to redress the grievances of investors, fails to redress such grievances within the time specified by the board, such company or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

RPA limited was penalized under the provisions of above-mentioned section. Now two remedies are available to RPA limited in this matter:

(i) Appeal to the Securities Appellate Tribunal: Section 15T of the SEBI Act, 1992 provides that any person aggrieved by an order of the Board made, on and after the commencement of the security laws (second amendment) act 1999, under this act or the rules or regulations made there under may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

Such appeal shall be filed within a period of 45 days from the date on which a copy of the order made by the Board is received and it shall be in such form and be accompanied by such fee as may be prescribed. However the Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within the said period.

The Tribunal may, after giving the parties an opportunity of being heard, pass such orders as it thinks fit, confirming, modifying or setting aside the order appealed against.

(ii) Appeal to the Supreme Court: Section 15Z of the SEBI Act, 1992 provides that any person aggrieved by any decision or an order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or an order to him on any question of law arising out of such order. The Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.

(b) According to SEBI (Disclosure and Investor Protection) Guidelines, 2000 any unlisted company or a listed company making a public issue of equity shares or securities convertible at a later date into equity shares may issue such securities to applicants in the firm allotment category at a price different from the price at which the net offer to the public is made, provided that the price at which the security is being offered to the applicants in firm allotment category is higher than the price at which securities are offered to public (Vide guideline No. 3.4.1)

According to guideline No. 3.7.1 the promoters of ABC Ltd. can issue equity shares in the denomination of Rs.2/- per share provided the issue price is Rs.500/- or more. In such a case the issuer company shall have a discretion to fix the face value below Rs.10/- per share subject to the condition that the face value shall in no case be less than Rs.1/- per share. If the issue pries is less than Rs. 500/- per share, the face value shall be Rs.10/- per share.

The promoters of ABC Ltd. can go for public issue provided that the company has a track record of distributable profits in terms of Section 205 of the Companies Act, 1956 for atleast three (3) out of immediately preceding five (5) years. However, extraordinary items shall not be considered for calculating distributable profits in terms of Section 205 of the Companies Act, 1956.

ABC Ltd. should have net tangible assets of atleast Rs.3 crores in each of the proceeding 3 full years (of 12 month each) of which not more than 50% is held in monetary assets. If more than 50% of the net tangible assets are held in monetary assets, the company has made firm commitments to deploy such excess monetary assets in its business/project.

(c) HARMONIOUS CONSTRUCTION: Where there are in an enactment two or more provisions which can not be reconciled with each other, they should be so interpreted, wherever possible so as to give effect to all of them. This is what is known as the rule of Harmonious Construction. Importance should not be attached to a single clause in one section overlooking the provision of another section. If it is impossible to avoid inconsistency the provision which was enacted or amended later in point of time must prevail .The Rule of Harmonious Construction is applicable only when there is a real and not merely apparent conflict between the provisions of an Act and one of them has not been subject to the other.

Every loan falling within the preview of Section 372A of the Companies Act, 1956, must be sanctioned by a resolution of the Board of Directors passed at its meeting. Every such resolution must be passed with the consent of all the directors present at the Board meets unanimously so that there is no one dissenting.

Every loan covered by Section 372A falls within the preview of Section 292(1)(e). The Section permits delegation by the Board of Directors of its powers of making loans vide proviso to Section 292(I), subject to the conditions stipulated in Section 292(3). The condition is that the resolution delegating the power must specify the total amount up to which loans may made by the delegate, the purpose for which the loans may be made and the maximum amount of loans which may be made for each purpose in individual cases.

However by harmonious interpretation of both the provisions of Section 292 and Section 372A and in the absence of specific prohibition in Section 372A against delegation, the Board's power under Section 372A may be delegated in accordance with the provisions of Section 292 by passing unanimous resolution of the Board. Any other interpretation will make provisions of Section 292 redundant.

Question 4

(a) The Articles of Association of Sunrise Ltd. provide that the qualification of a director shall be holding of at least 10 shares in the company. Mr. Rao has been appointed as a director in the said meeting on 1st May, 2008. Mr. Rao applied for 10 equity shares of the company on 30th July, 2008. The said shares were allotted to him on 20th August, 2008 when the Board meeting was held.

Discuss the relevant provisions of the Companies Act, 1956 in the matter of share qualification requirements and the consequences of non- compliance thereof. Also state whether Mr. Rao has complied with the requirements in this regard. (8 Marks)

(b) Mr. Wilson was appointed in ABC Ltd. as a director and he was to retire by rotation on 1st September, 2008. On account of some unavoidable reasons the annual general meeting of the company could not be held on the said date, nor the vacancy caused be retirement could be filled up at the adjourned meeting .State the relevant provisions of the Companies Act, 1956 and decide whether Mr. Wilson shall be deemed to be retired on 1st September, 2008 when the meeting was scheduled to be held or it will become a case of deemed reappointment.. (7 Marks)

Answer

(a) QUALIFICATION SHARES: The Companies Act, 1956 does not provide for any share qualification of any director but Regulation 66 of Table 'A' provides that a director must hold at least one share in the company. Usually, the articles of the company provide for holding qualification shares by a director. Where a share qualification has been prescribed in the Articles of a company which is a public company or a private company which is a subsidiary of a public company, the provisions of Section 270 of the Companies Act, 1956 is applicable where under a director must take his qualification shares within 2 months after his appointment. Any provision in the articles of the company shall be void in so far as it requires a person to hold the qualification shares before his appointment as a director or to obtain them within a shorter time than two months after his appointment as such. The nominal value of the qualification shares shall not exceed Rs.5000/- or the nominal value of one share where it exceed Rs.5000/.

A person acting as a director without acquiring qualification shares is punishable under Section 272 of the said Act. Moreover, a director who fails to hold qualification shares is also liable to vacate his office under Section 283 of the Companies Act, 1956.

In the instant case Mr. Rao was appointed as Director of Sunrise Limited on 1st may 2008. He applied for shares of the company on 30th July 2008 which were allotted only at the Board meeting held on 20th August 2008. It can not therefore be said that he held the shares before expiry of 2 months from the date of his appointment. In view of this Mr. Rao must vacate his office as director as provided in Section 283(1)(a).

(b) DEEMED REAPPOINTMENT OF DIRECTOR: Section 256 of the Companies Act, 1956 deals with deemed re-appointment of a retiring director. The vacancies caused by retirement of a director by rotation should be filled up at the same meeting or at an adjourned meeting. If it is not so done, the retiring director shall be deemed to have been reappointed at such adjourned meeting except in the following cases-

(i) at any previous meeting, a resolution for his reappointment was put to vote but was lost, or

(ii) the retiring director has, in writing expressed his unwillingness to continue, or

(iii) he is not qualified or is disqualified for the said appointment, or

(iv) a special or ordinary resolution is necessary for his appointment or reappointment by virtue of any provisions of the Companies Act 1956, or

(v) it is resolved to appoint two or more directors by a single resolution, or

(vi) it is resolved not to fill the vacancy.

In the instant case the above mentioned exceptions are not applicable and hence Mr. Wilson cannot be deemed to be retired. He is deemed to be re-appointed as director.

Question 5

(a) M/s X Ltd. and its two directors have received a show cause notice from the Registrar of Companies, Mumbai as to why prosecution proceedings should not be launched against them for violation of he provisions of Section 297 of the Companies Act, 1956 in not obtaining the previous approval of the Central Government in respect of a contract entered into by the company with a firm in which one of the directors of the company is interested as a partner. The company seeks your help. Advise the company the steps that should be taken to avoid prosecution proceedings, assuming that they have committed the offence. (8 Marks)

(b) Sunrise Company Limited was merged with Moonlight Company Limited on account of amalgamation. Some workers of sunrise Company Limited refused to join as workers of Moonlight Company Limited and claimed compensation on the ground of premature termination of their services. Moonlight Company Limited resists the claim of the workers on the ground that their services have been transferred to Moonlight Company Limited in view of the order of amalgamation and marger and hence the workers must join the service of Moonlight Company Limited and cannot claim any compensation.

State the powers of the court about the matters that would be considered while sanctioning the scheme of amalgamation under the provisions of the Companies Act, 1956. Decide whether the contention of the workers is justified. (7 Marks)

Answer

(a) To avoid prosecutions proceedings by the Registrar of Companies, Mumbai the company and its directors can file a compounding application with the Registrar of Companies as provided in Section 621A of the Companies Act, 1956.

In the said compounding applications, they have to admit the charge that the provisions of Section 297 have been violated and that the said default has been made good subsequently. For this purpose, the company should file an application for approval under Section 297 and this power of Central Government has been delegated to the Regional Directors. The power to compound the offence is with the Company Law Board if the maximum fine for the penalty exceeds Rs. 50,000 and if it is below Rs. 50,000 the power to compound is with the Regional Director. The company and its directors have to file the compounding application with the Registrar of Companies who in turn will forward the compounding applications along with his report either to the Company Law Board or to the Regional Director as the case may be. Once the compounding is done, the Regional Director after examination of the relevant factors approves the proposal and approval of the Central Government is conveyed.

(b) While sanctioning the scheme of amalgamation, the Court under Section 394 of the Companies Act, 1956 may make provision for all or any of the following matters:

(i) The transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company.

(ii) The allotment by the transferee company of any shares, debenture etc, in that company which under the scheme are to be allotted by that company to any person.

(iii) The continuation of any legal proceedings by or against any transferor and transferee company.

(iv) The dissolution, without winding up of any transferor company.

(v) The provisions to be made for any persons who within such time and in such manner as the court directs, dissent from the scheme of amalgamation.

(vi) Such incidental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out.

An order under Section 394 of the Companies Act, 1956 transferring the property, rights and liabilities of one company to another does not automatically transfer contracts of personal service which are in their nature incapable of being transferred and no contract of service is thereby created between an employee of the transferor company on the one hand and the transferee company on the other.

In Nokes vs. Doucaster Amalgamated collieries Ltd. (1940 (3) all 2k 549) the House of Lords clearly stated that the workers are not furniture and their services can not be transferred without their consent. Thus the contention of the workers of Sunrise Company Limited against the Moonlight Company Limited is correct and justified.

Question 6

(a) The Board of Directors of M/s. ABC Limited and unlisted company having a paid up capital of Rs. 5 crores and preference share capital of Rs.1 crore and also 1100 small shareholders holding equity shares seeks your advice on the following:

(i) Is it necessary for the company to appoint a director to represent the' Small Shareholder'?

(ii) In case the company decides to appoint such a Director, the procedure to be followed by the company for such appointment and the period for which such appointment can be made.

(iii) Can such a Director be removed by the company before the expiry of his period of appointment without the consent of the 'Small Shareholders'?

Advise explaining the relevant provisions of the Companies Act and the rules. (8 Marks)

(b) Ashes Ltd is a company incorporated outside India. 50% of its preference share capital and 20% of its equity share capital is held by companies incorporated in India. It issued prospectus inviting subscriptions in India for its shares but did not state the country in which it is incorporated.

Examine

(i) Is the prospectus of the company valid?

(ii) What is none of the shares (preference and equity) were held by Companies Incorporated in India?

(iii) What other disclosures and required to be made by a Foreign Company? (7 Marks)

Answer

(a) The provisions relating to small shareholders' director were inserted by the Companies Amendment Act, 2000 by inserting a proviso to Section 252(1). However this proviso will apply to a company if all the following conditions are satisfied:-

(i) the company is a public company.

(ii) the paid-up share capital of the company is five crore rupees or more,

(iii) the numbers of shareholder is 1000 or more (a "small shareholders "means a shareholder holding shares of nominal value of twenty thousand rupees or less).

In the given case, M/s ABC Limited satisfies all the conditions specified above. Therefore, appointment of small shareholders' director can be made by M/s ABC Limited. It is not mandatory that the company shall appoint a director to represent the small shareholders. However a company may act suo-moto to elect a small shareholders' director. Further a small shareholders' director may serve a notice on the company and the company shall be bound to act on such notice.

The procedure for appointment of small shareholders' directors is as follows:

Small shareholders intending to propose a person shall leave a notice of their intention with the company at least 14 days before the meeting under the signature of at least 100 small shareholders specifying name, address, shares held and folio number and particulars of share with differential rights as to dividend and voting, if any, of the person whose name is being proposed for the post of director and of other small shareholders proposing such person as a candidate for the post of director or small shareholders.

A person whose name has been proposed for the post of small shareholders' director shall sign, and file with the company, his consent in writing to act as a director. Tenure of such small shareholders' director shall be for a maximum period of 3 years subject to meeting the requirement of provisions of Companies Act, 1956 except that he need not have to retire by rotation.

The unlisted company may appoint such small shareholders' nominee subject to above conditions if majority of small shareholders recommend his candidature for the post of director in their meeting.

As per rule 6 (viii) of the Companies (Appointment of the Small Shareholders' Director) Rules, 2001, a small shareholders director shall have to vacate the office if he is removed in pursuance of Section 284. As per Section 284 a director shall be removed by an ordinary resolution passed in the general meeting after compliance of the procedural requirement of Section 284. There is nothing in proviso to Section 252(1) or in the Companies (Appointment of the Small Shareholders' Director) Rules, 2001 which requires obtaining consent of small shareholders before removing small shareholder directors from directorship under Section 284. Therefore a small shareholders director can be removed by the company before the expiry of the term without the consent of small shareholders.

(b) Section 591(2) of the Companies Act, 1956, provides that where not less than fifty per cent of the paid up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, or by one or more citizens of India and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the 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.

(i) As 50% of the preference share capital and 20% of the equity share capital of Ashes Ltd. is held by companies incorporated in India, it shall be treated as if it were a company incorporated in India. As such it is not necessary for Ashes Ltd. to comply with the provisions relating to foreign companies. So the prospectus of the company shall be valid.

(ii) If none of the shares (preference and equity) were held by companies incorporated in India, Ashes Ltd. would be a foreign company within the meaning of Section 591 of the Act. Section 595 of the Act provides that every foreign company shall in every prospectus inviting subscriptions in India for its shares or debentures, state the country in which the company in incorporated. As Ashes Ltd. did not mention the name of the country in which it is incorporated, the prospectus shall not be valid.

(iii) Section 595 of the Act provides for the following additional disclosures to be made by a foreign company:

  (a) conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English characters, and also in the characters of the language or one of the languages in general use in the locality in which the office or place is situated;

  (b) cause the name of the company and of the country in which the company is incorporated, to be stated in legible English characters in all business letters, bill heads and letter paper, and in all notices, and other official publications of the company; and

  (c) If the liability of the members of the company is limited, cause notice of the fact-

    - to be stated in every such prospectus as aforesaid and in all business letters, bill heads ,letter paper, notices, advertisements and other official publications of the company, in legible English characters; and

    - to be conspicuously exhibited on the outside of every office or place where it carries on business in India, in legible English characters and also in legible characters of the languages or one of the language in general use in the locality in which the office or place is situated.

Question 7

(a) Supra Limited, a private company, has been converted into a public company and under the provision of the of the Companies Act, 1956. The company proposes to constitute an audit committee. Taking into account the provisions of the Companies Act, 1956 draft a board resolution covering the following matters:

  (i) Member of the audit committee.

  (ii) Chairman of the audit committee.

  (iii) Quorum for meeting of the said committee.

(iv) Any two functions of the said committee. (8 Marks)

(b) M/s Continuous Conflicts Ltd. is a company controlled by two family groups. The first family groups has four directors namely Mr. A, Mr. B, Mr. C and Mr. D on the Board of Directors. The second group has two representatives Mr. X and Mr. Y on the board. Both the groups hold shares in the company according to their directorships viz., the first group of 4 directors hold 67% of the share capital and the second group of 2 directors hold 33% of the share capital. Because of internal family troubles, the first group, by virtue of its majority shareholding removes both Mr. x and Mr. Y as the directors of the company.. Aggrieved by this action,, the second group Is planning to move an application before the Company Law Board .You have been approached for advice.

Advise as to the eligibility restrictions regarding filing the application and the chances of getting relief from the Company Law Board, assuming that there is no other material on record in support of oppression of the minority group. (7 Marks)

Answer

(a) AUDIT COMMITTEE –BOARD RESOLUTION:

"Resolved that pursuant to Section 292A of the Companies Act, 1956 an Audit Committee consisting of the following Directors be and is hereby constituted.

1. Mr. ---- nominee of IDBI
2. Mr. ---- nominee of ICICI
3. Mr. ---- nominee of the SBI.
4. Mr. ---
5. Mr. ----- Managing Director.

Further resolved that the Chairman of the Audit Committee shall be elected by its members from amongst themselves.

Further resolved that the quorum for a meeting of the Audit committee shall be 1/3rd of the total number of members or two directors (other than the Managing Director) whichever is higher.

Further resolved that the Audit Committee shall have the authority to investigate into any matter that may be prescribed under Section 292A of the Companies Act, 1956 and any other matter that may be referred to it by the Board from time to time.

Further resolved that the Audit committee shall conduct discussion with the auditors periodically about internal control systems, the scope of audit including the observation of auditors.

Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations if any".

(b) The management of any company registered under the Companies Act, 1956 is based on the principle of majority rule and the voting power of every member depends upon the number of shares held by them. Thus one single individual holding majority shares can overrule the view of the other member who may be more in numerical numbers but not in voting powers. However certain rights have been given to minority shareholders who complained that the affairs of the company are being conducted in a manner oppressive to any member or members. In such an event the minority shareholder can apply to the Company Law Board (now Tribunal) for relief against oppression and mismanagement.

The eligibility restriction for filling an application to the Company Law Board (now Tribunal) is contained in Section 399 of the Companies Act, 1956. According to the said Section the application to Company Law Board (now Tribunal) can be made in the case of the company having share capital, by not less than 100 members or not less than 1/10th of the total number of members whichever is less or members holding not less than 1/10th of the issued share capital provided the applicants have paid all calls and other dues on their respective shares. In case of a company not having share capital, the application can be filed by members holding not less than 1/5th of the total number of members.

In the present case the majority group has removed the minority directors from the board. The election and removal of directors is the prerogative of the members and such an act cannot be perse treated as oppressive to the minority shareholder, unless there is an allegation of mismanagement to the detriment of the minority shareholders. The application under Section 397/398 requires to prove oppressive conduct to their members in their capacity as members. Thus the minority group consisting of two directors Mr. X and Mr. Y will not be able to successfully prosecute the case against the majority directors in the absence of any material or record in support of oppression and mismanagement of minority group. They have, however the right to file the petition before the Company Law Board as they fulfil the requirements laid down in Section 399.

Question 8

(a) As per the terms of the agreement of service between NOC Ltd. and its employees, an amount equal to 12.5% of the salary shall be transferred to the recognized Provident Fund and shall be payable to the employee either on retirement or termination, as the case may be. An amount equal to 12.5% of the salary shall be contributed by the company to the recognized provident fund.

Mr. A earning Rs. 3000 p.m. has been working with the company since the last four years. Due to some personal reasons Mr. A is in need of Rs. 100,000 and wants to obtain as advance the amount standing to the credit in the fund. With reference to the provisions of the Companies Act, 1956 advice as regards the following:

(i) When and where should the money so collected by the company be deposited?

(ii) Can Mr. A obtain the advance from his accumulated contribution to recognized Provident Fund? (8 Marks)

(b) Mars India Limited, a company incorporated under the Companies Act, 1956 is being wound up by the court. After realization of the assets of the company, the official liquidator has an amount or Rs. 70,00,000 at his disposal towards payment of creditors of the said company. The details of creditors are as follows:

(i)	Unsecured creditors	50,00,000
(ii)	Taxes and duties payable to Government	5,00,000
(iii)	Dues to workers	30,00,000
(iv)	Dues to secured creditors	40,00,000

The available amount with the liquidator, obviously, is not sufficient to meet the claims of all the creditors. Moreover, the company had already created a charge on all the assets of the company in favour of the secured creditors. Explain the procedure to be followed by the liquidator for payment of dues as provided in the Companies Act, 1956. (7 Marks)

Answer

(a) Section 418 of the Companies Act, 1956 dealing with the provident fund of the employees provides that:

(1) Where a provident fund has been constituted by a company for its employees or any class of its employees, all moneys contributed to such fund (whether by the company or by the employees) or received or accruing by way of interest or otherwise to such fund shall, within fifteen days from the date of contribution, receipt or accrual, as the case may be either-

(a) be deposited-

(i) in a post office saving bank account, or

(ii) in a special account to be opened by the company for the purpose in the State Bank of India or in a Scheduled Bank, or

(iii) Where the company itself is a Scheduled Bank, in a special account to be opened by the company for the purpose either in itself or in the State Bank of India or in any other Scheduled Bank; or

(b) be invested in the securities mentioned or referred to in clauses (a) to (e) of Section 20 of the Indian Trusts Act, 1882 (2 of 1882).

(2) Notwithstanding anything to the contrary in the rules of any provident fund to which sub-section (1) applies or in any contract between a company and its employees, no employee shall be entitled to receive, in respect of such portion of the amount to is credit in such fund as is invested in accordance with the provisions of sub-section (1), interest at a rate exceeding the rate of interest yielded by such investment.

(3) Nothing in sub-section (1) shall affect any rights of an employee under the rules of a provident fund to obtain advances from or to withdraw money standing to his credit in the fund, where the fund is a recognized provident fund.

(i) So the money collected by NOC Ltd. from its employees will have to be deposited in any of the following:

(a) in a post office saving bank account, or

(b) in a special account to be opened by the company for the purpose in the State Bank of India or in a Scheduled Bank, or

(c) be invested in securities mentioned or referred to in clauses (a) to (e) of Section 20 of the Indian Trusts Act, 1882 (2 of 1882).

(ii) As per the provision of Section 418 (3), Mr. A can obtain advances from or withdraw money standing to his credit in the fund provided the fund is a recognized provident fund.

(b) WINDING UP (PAYMENT OF CREDITORS): Section 530 of the Companies Act, 1956 lays down the procedure for payment of debts out of available funds with the official liquidator. However Section 529A of the said Act provides for overriding of the preferential payments as mentioned in Section 530. According to Section 529A of the Companies Act, 1956 notwithstanding anything contained in other provisions of this Act or any other law for the time being in force, in the winding up of a company –

(1) Workmen's dues and (2) debts due to secured creditors,

shall be paid in priority to all other debts. Further these debts have to be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportion.

In the light of the above mentioned provisions, the funds available with the official liquidator are not sufficient to meet fully the dues payable to all the creditors. Thus, tax dues to the tune of Rs. 5,00,000 payable to government authorities will not get any payment even though they are to be considered as preferential payments as per Section 530 of the Act. Thus the secured creditors will get Rs. 40,00,000 and the remaining amount of Rs. 30,00,000 shall be paid towards workers dues. The other creditors will get nothing.

Question 9

(a) The Board of Directors of ACE Limited having a paid up share capital of Rs. 70 lakhs reappointed Bre Ltd. As sole selling agent for a period of 5 years W.E.F. 2 May, 2007. The Directors of BRE Ltd. were holding fully paid up shares of face value of Rs. 3 lakhs. In ACE Ltd. the reappointment was approved by the company in the next AGM held on 30th September, 2007 but Central Government approval was not obtained until 31st December, 2007. Give your opinion explaining the relevant provision of the Companies Act, 1956.

(i) Is the reappointment of the sole selling agent in order?

(ii) Will your opinion be different if the directors of BRE Ltd. do not hold any shares in ACE Ltd?

(iii) If the reappointment is valid. When will the reappointment take effect from?

(6 Marks)

(b) Mr. X is a director of several companies. He has approached the following companies in which he is a director for financial help to start his own personal business.

(i) Expandable Industries Ltd.

(ii) Expensive Gadgets Private Ltd.

(iii) Easy Finance Ltd.

The first named company has agreed to grant a loan of Rs. 50 lakhs. The second company also offered another loan of Rs. 50 lakhs .The third company has agreed to provide guarantee for the repayment of a loan sanctioned to Mr. X by a Private Bank to the tune of Rs. One crore. Advise Mr. X about the legal provisions that should be complied with under the Companies Act, 1956 and the consequences if there is a non – compliance. (6 Marks)

(c) The Board of Directors of M/s PQR Ltd .have a practical problem. The registered office of the company is situated in a classified backward area of Maharashtra. The Board wants to keep the account books of the company at its corporate office in Mumbai which is conveniently located. The Board seeks your advice about the feasibility of maintaining the accounting records at a place other than the registered office of the company. Advise. (3 Marks)

Answer

(a) Section 294AA of the Companies Act, 1956 contains the powers of Central Government to prohibit the appointment of Sole Selling Agents in certain cases. The section further provides that no company shall appoint any individual, firm or body corporate, who or which has a substantial interest in the company, as Sole Selling Agent of that company unless such appointment has been previously approved by the Central Government (Section 294AA (2)).

Also no company having a paid up share capital of rupees fifty lakhs or more shall appoint a Sole Selling Agent except with the consent of the company accorded by a Special Resolution and the approval of the Central Government (Section 294AA(3)). Section 294AA (7) provides that if the company in general meeting disapproves the appointment referred to in sub-section (3), such appointment shall, notwithstanding anything contained in sub-section (6), cease to have effect from the date of the general meeting.

The explanation to this section provides that “appointment“ includes “re-appointment “ and “substantial interest “ in relation to a body corporate, means the beneficial interest held by such body corporate or one or more of its directors or any relative of such director, whether singly or taken together, in the shares of the company , the aggregate amount paid up on which exceeds five lakhs of rupees or five per cent of the paid up share capital of the company, whichever is the lesser.

(i) So the re- appointment of BRE Ltd. as sole selling agent is in order as general meeting approval was obtained by way of special resolution. Further, ACE Ltd. has to obtain the approval of the Central Government as required under Section 294AA (3) and the same was also obtained by 31st December 2007.

(ii) No, even if BRE Ltd. does not hold any shares in ACE Ltd. the appointment shall remain valid as ACE Ltd has obtained the approval of the Central Government under Section 294AA(3).

(iii) Effective date of reappointment is the date from which he is re appointed by the company. As such the re-appointment shall be valid from 2nd May 2007.

(b) According to Section 295 of the Companies Act, 1956 no public company shall directly or indirectly make any loan to or give any guarantee or provide any security in connection with a loan made by any other person to a director of the company without obtaining the previous approval of the Central Government. Thus M/s. Expandable Industries Ltd, being a public company has to take approval of the Central Government before the loan amount of Rs. 50 lakhs is disbursed. However no approval of the Central Government is required in the case of Expensive Gadgets Private Ltd. being a Private Company. However, if the said Private Company is a subsidiary of a Public Company, the approval of Central Government is required. In the case of Easy Finance Ltd. the approval of Central Government is required and thereafter only the transaction can be entered into without committing violation of the provision of the Companies Act, 1956. If there is any violation, Mr. X the director will vacate his office as a director as provided in Section 283 (1) (h) of the Act. The said violations is however compoundable under Section 621A of the Act.

(c) According to Section 209 of the Companies Act, 1956 every company shall keep the books of accounts at its registered office. However, the books of account can be kept at such other places in India as the Board of directors may decide and when the Board of directors so decide, the company shall within 7 days of the decision file with the Registrar of Companies a notice in Form No. 23AA in writing giving full address of the other place. Thus in the present case, the company can follow the above procedure and keep its accounts book at Mumbai office.