PRIME ACADEMY

27th SESSION PROGRESS TEST

FINAL - ADVANCED ACCOUNTING

TIME : 2 HOURS **TOTAL : 75 MARKS**

ANSWER ALL QUESTIONS

PART - A

1. State bank of India, received a gross Rs 1500 crores demand deposits from customers withdrawn Rs 1300 of demand deposit during the financial year 2007-08. How will you classify such receipts and payments in cash flow statement of SBI and the manner of such presentation? Choose any one.

a. Operating activities, on net basis (Rs 200 crores inflow)
b. Operating activities, on net basis (Rs 200 crores outflow)
c. Financing activities, on total basis (Rs 1300 crores outflow)
d. Investing activities, on total basis (Rs 1500 crores inflow) **(3 Marks)**

2. A Ltd purchased fixed assets from USA for $50000 on 1-10-2007. It entered into currency option contract for purchase of foreign exchange to pay for fixed assets and paid a premium of Rs 25000. How will you classify such premium in cash flow statement of A LTD.?

a. Operating activities
b. Investing activities
c. Financing activities
d. None of the above. **(2 Marks)**

3. On January 1 2006, A Ltd Company purchased for Rs 240000 a machine with a useful life of 10 years and no salvage value. The machine was depreciated by diminishing balance method and the carrying amount of the machine was Rs 153600 on December 31 2007. The company changed to the straight line method on Jan 1, 2008. What should be the depreciation expenses on this machine for the year ended Dec 31 2008?

a. Rs 15360
b. Rs 19200
c. Rs 24000
d. Rs 30720 **(3 Marks)**

4. On January 2, 2007, M Ltd bought machinery under a contract that required a down payment of Rs 1000 plus 24 monthly payments of Rs 5000 each for total cash payment of Rs 130000. The cash equivalent price of the machinery was Rs 110000. The machinery was estimated to have useful life of 10 years and salvage value of Rs 5000. The company uses straight line depreciation. In its 2007 income statement, what amount should the company report as depreciation for this machinery?

a. Rs 10500
b. Rs 11000
c. Rs 12500
d. Rs 13000 **(3 Marks)**

5. On June 18, 2007 A Ltd incurred the following costs for one of its printing press:

Purchase of collating and stapling attachment	Rs 84000
Installation of attachment	Rs 36000
Replacement parts for overhaul of press	Rs 26000
Labour and overhead in connection with overhaul	Rs 14000

The overhaul resulted in a significant increase in production. Neither the attachment nor the overhaul increased the estimated useful life of the press. What amount of the above costs should be capitalized?

a. Rs 10500
b. Rs 11000
c. Rs 12500
d. Rs 13000 **(3 Marks)**

6. During 2007, King Company made the following expenditures relating to its plant building:

Continuing and frequent repairs	Rs 40000
Repainting the plant building	Rs 10000
Major improvement to the electrical wiring system	Rs 32000
Partial replacement of roof tiles	Rs 14000

How much should be charged to repairs and maintenance expenses in 2007?

a. Rs 96000
b. Rs 82000
c. Rs 64000
d. Rs 54000 **(3 Marks)**

7. A Ltd acquired 30% of B Ltd equity shares for Rs 200000 on 1/06/2006. A's 30% interest in B Ltd gave A Ltd the ability to exercise significant influence over B in operating and financial policies. During the financial year 2005-06 B Ltd earned Rs 80000 and declared dividend of Rs 50000 on 12/08/2006. B Ltd reported earning of Rs 300000 for the financial year 2006-07 and declared dividend of Rs 60000 on 12/06/2007. Calculate the carrying amount of investment in the financial statement of A ltd.

a. Rs 125000
b. Rs 195000
c. Rs 185000
d. Rs 200000 **(3 Marks)**

8. X Ltd purchased a flat in a group housing co-operative society on 30/04/2002 for Rs 1500000. It also purchased a membership share for Rs 25000 to acquire the flat so purchased. Calculate the value of investment property.

a. Rs 1475000
b. Rs 1820000
c. Rs 1270000
d. Rs 1525000 **(2 Marks)**

9. During 2006-07 AD softex India Ltd engaged in the following transactions:

Salary expenses to key employees who are also principal owners	Rs 100000
Sales to affiliated enterprises	Rs 250000

Which of the two transactions would be disclosed as related party transactions in AD Softex India Ltd 2006-07 financial statements?

a. Neither transaction.
b. Rs 100000 transaction only
c. Rs 250000 transaction only
d. Both transactions. **(3 Marks)**

PART – B

1. Induga ltd manufacture computers, during the year ended 31st March 2007 the company manufactured 550 computers, it has the policy of valuing finished stock of goods at a standard cost of Rs 1.8 lakhs per computer. The details of the cost are as under:-

Raw Materials consumed	Rs. 400 lakhs
Direct Labour	Rs. 250 lakhs
Variable production overheads	Rs. 150 lakhs

Compute the value of cost per computer for the purpose of closing stock. **(5 Marks)**

2. The company sells IMFL and beer to the customers. Some of the customers consumed beer in the bars run by it. While leaving the bar, the consumers left the empty bottles in the bars and the company takes the possession of these empty bottles. These empty bottles are disposed off by the company. The company has laid down detailed procedures for the maintenance of the records, tenders to be called for the disposal of empty bottles etc. Keeping in view the above:

a. Whether the stock of empty bottles is an asset of the company?
b. If so, whether the stock of empty bottles existing as on the date of the balance sheet is to be considered as inventories of the company.
c. If the answer to (b) above is positive, whether the stock of empty bottles existing as on the date of the balance sheet is to be valued at net realizable value and considered as income to be shown in the profit and loss account or is to be considered as a stock suspense account on the liabilities side of the balance sheet if the cost of empty bottles is NIL.

(6 Marks)

3. A company entered into an agreement to sell its immovable property included in the Balance sheet at Rs 5 lakhs to another company for Rs 20 lakhs. The agreement to sell was concluded on 31st January 2007 and the sale deed was registered on 30th April 2007. Comment.

(5Marks)

4. M Ltd is manufacturing machinery used in steel plants. It quotes prices in various tenders issued by steel plants. As per terms of contract, full price of machinery is not released by the steel plants, but 10% thereof is retained and paid after one year if there is satisfactory performance of the machinery supplied. The company accounts for only 90% of the invoice value as sales income and the balance amount in the year of receipt to the extent of actual receipts only. State your views as an auditor.

(4 Marks)

5. Someshwar Ltd imported a machine on 04/01/2002 for Euros 12000 on deferred payment basis, payment in six equal annual instalments at the end of every financial year, commencing from 31/03/2002 onwards. Use revised AS 11 provisions irrespective of financial year and determine the exchange differences and carrying amounts of the liability at the end of each financial year, if the following exchanges are given. One Euro equals Indian rupees on

04/01/2002	31/03/2002	31/03/2003	31/03/2004	31/03/2005	31/03/2006	31/03/2007
50.4872	45.5208	41.8463	41.0175	42.6400	51.4400	53.10000

(15 Marks)

6. The following are the Balance Sheets of C Ltd and T Ltd as on 31st December 1998.

Liabilites	C Ltd	T Ltd	Assets	C Ltd	T Ltd
Share Capital	1500000	500000	Land and Building	1030000	360000
Reserves	950000	20000	Machinery	300000	271000
Profit and loss	800000	360000	Sundry debtors	600000	138000
Current A/c with T	18000		Stock	340000	202000
Sundry Creditors	132000	161000	Investments in T Ltd	800000	
			Other Investments	130000	35000
			Cash at Bank	200000	15000
			Current A/c with C		20000
TOTAL	3400000	1041000	TOTAL	3400000	1041000

a. C Ltd acquired 80% shares of T Ltd on 1.4.98. On 1st Jan 1998 the Reserve and Profit and loss account of T Ltd were Rs 10000 and Rs 200000
b. Land and building of T Ltd, whose book value on 1.1.98 was Rs 400000, were revalued at Rs 380000 at the date of acquisition, but it was not passed in the books.
c. T Ltd declared 16% dividend for the year 1997 and paid it on 1st June 1998 and C Ltd credited the entire amount of dividends received from T Ltd to its profit and loss account.
d. Stock of C Ltd includes Rs 30000 for goods purchased from T Ltd.
e. Sundry creditors of C Ltd include Rs 60000 purchased from T Ltd on which T Ltd made a profit of Rs 15000.
f. On 31st December 1998, C Ltd remitted cash Rs 2000 on current account to T Ltd.

From the above information, prepare a Consolidated Balance Sheet of C Ltd and its Subsidiary T Ltd as at 31.12.1998.

(15 Marks)

PRIME ACADEMY
PROGRESS TEST
FINAL- ADVANCED ACCOUNTING

SUGGESTED -ANSWERS

PART A

1. (a)
2. (b)
3. (c)
4. (d)
5. (d)
6. (c)
7. (c)
8. (d)
9. (d)

PART B

1. As Per AS 2 Valuation of Inventories finished Goods shall be valued on absorption costing Basis. In this case finished stock has been valued at Standard cost of 1.8 Lakh/computer which need not be considered when actual cost data for 550computers are given.

   Cost per Computer = (400+250+150)/550 = 1.45

2.
   (a) The stock of empty bottles is an asset of the company being a resource controlled by the company as a result of past events from which future economic benefits are expected to flow to it.

   (b) The stock of empty bottles existing at the balance sheet date is the inventory of the company

   (c) The stock of empty bottles should be valued at the lower of cost and net realizable value. The same is not considered as income. In case, the cost of empty bottles is Nil, the total stock of bottles should be reflected at the nominal value of Re 1 in the balance sheet.

3. As per Para 13 of AS 4, the assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. In this case sale of immovable property was concluded before approval by the board. This is clearly an event occurring after the balance sheet date. Agreement to sell was entered into before the balance sheet date. Registration of the sale deed simply provides additional information relating to the conditions existing at the balance sheet date. So adjustments to assets are necessary.

4. AS 9 on Revenue recognition states that revenue from sale of goods should be recognised when the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership and no significant uncertainty exists regarding the amount of consideration. In the case of M Ltd, the goods as well as the risks and rewards of ownership have been transferred to the steel plants. The invoice raised by M Ltd is for the full price, but 10 % less is received as the same is kept as “Retention Money”. In this case, therefore, revenue has to be recognised at the full invoice price i.e. 100% has to be accounted as sales income.

1

Depending on the past experience of recovering the balance 10% from steel plants, M Ltd can, however make a provision for sales income that is not likely to be realized. In the absence of the above, the auditor will have to qualify his report.

5. Calculation of carrying amounts of liability:

Financial year ending 31st March	Euro Amount due	Closing rate	Carrying Amount
2002	10000	45.5208	455208
2003	8000	41.8463	334770
2004	6000	41.0175	246105
2005	4000	42.6400	170560
2006	2000	51.4400	102880
2007	Nil	53.1000	Nil

Financial year ending 31st March	Exchange differences due to settlement	Exchange differences due to reporting
2002	9933 Gain	49664 Gain
2003	7349 Gain	29396 Gain
2004	1658 Gain	4973 Gain
2005	3245 Loss	6490 Loss
2006	17600 Loss	17600 Loss
2007	3320 Loss	Nil

6. CONSOLIDATED BALANCE SHEET OF C AND T LTD AS ON 31ST DECEMBER 1998

LIABILITIES			**ASSETS**		
	Rs.	**Rs.**		**Rs.**	**Rs.**
Share Capital		1500000	Goodwill		190000
Reserves	950000		L & B		
Add: transfer	6000	956000	C Ltd	1030000	
Profit and loss A/c	800000		T Ltd	360000	
Add: current profit	144600			1390000	
	944600		Less: Overvaluation	10000	
Less: Dividend	64000			1380000	
	880600		Add: Dep on above	750	1380750
Less: unrealized	6000	874600	Machinery		
Minority Interest		174150	C Ltd	300000	
Sundry Creditors			T Ltd	271000	571000
C Ltd	132000		Investments		
T Ltd	161000		C Ltd	130000	
	293000		T Ltd	35000	165000
Less:	60000	233000	Stock	542000	
			Less: Unrealized	6000	536000
Current A/c of T ltd	18000		S Debtors	738000	
Less: C Ltd	18000		Less:	60000	678000
			Cash and bank		215000
			Cash in transit		2000
Total		**3737750**	Total		**3737750**

PRIME ACADEMY

27TH SESSION PROGRESS TEST

FINAL MAFA

PART – A

TIME:2 HOURS | Total 75 MARKS

Answer all the questions

(25 x 1 = 25 marks)

1. A ltd paid a dividend of Rs 12 per share for the financial year ended today; The dividend is expected to perpetually grow at a rate of 8%. If the cost of equity is 12%, the intrinsic value per share today, according to Gordon's dividend growth model is
   a) Rs 100
   b) Rs 150
   c) Rs 324
   d) Rs 342.3

2. X ltd's has a policy of maintaining its dividend payout ratio at 40%.. X ltd had been historically earning 20% return on its networth, and this trend is expected to continue in the future as well. An investor of X ltd approaches you to give him an indication of the likely growth rate of dividends. What would you suggest? Use Gordon's model.
   a) 12%
   b) 8%
   c) 20%
   d) None of the above

3. Which of the following theories argue that dividend decision does not have any effect on the value of a firm?
   a) Graham and dodds
   b) Walter
   c) Gordon
   d) Modigillani- Miller

4. Who articulated the theory - "The value of a firm is sum of the present value of its future dividend and the present value of the expected capital gain"
   a) Modigillani- Miller
   b) Walter
   c) Gordon
   d) Graham and dodds

5. Which of the following is an assumption of Gordon's dividend model?
   a) Cost of equity is higher than the retention rate but lower than the growth rate of dividend
   b) Cost of equity is higher than dividend growth rate and the rate of return on investments.

c) Cost of equity is higher than dividend growth rate, but does not bear any logical relationship with return on investments or retention ratio
d) Cost of equity is lower than the retention ratio, but higher than dividend growth rate

6. The radical approach is distinct from other models because it considers which of the following factors in arriving at the dividend decision?
   a) The incidence of tax
   b) The incidence of leverage (i.e debt financing)
   c) The clientele effect
   d) All of the above

7. According to Modigillani- Miller, when a company wants to pay dividend but does not have cash, then
   a) It borrows money
   b) It issues new shares at face value
   c) It issues new share at current market price
   d) It issues new shares at fair value

8. For a project, there is a 40% chance that it will earn a profit of Rs 20,000, 30% chance that it will earn a profit of 5,000 and 30% chance that it will result in a loss of Rs 8,000. The expected value of the project is
   a) Rs 11,900
   b) Rs 7,100
   c) Rs 17,000
   d) Rs 9,500

9. Which of the following are NOT true?
   i. Between two projects with same return, the one with lower risk will be preferred
   ii. Between two projects with different risks and return, the one with higher return will be preferred
   iii. Between two projects with same risks, the one with lower return will be preferred
   iv. Between two projects with different risks and return, the choice will depend upon the risk preference of the investor
   a) ii & iii
   b) ii,iii & iv
   c) iii & iv
   d) i & iii

10. The estimated outlay of a project is Rs 100 crores which is planned to be financed by debt/equity mix of 40:60. It is also estimated that the lenders would demand an interest of 12% and equity holders would expect a return of 17%. Given that the rate of tax is 30%, what is the hurdle rate at which the free cashflows from the project should be discounted?
    a) 15.2%
    b) 13.56%
    c) 17%
    d) 10.5%

11. Under the certainity equivalent approach, in order to arrive at the NPV,
    a) The uncertain cashflows are discounted at risk free rate
    b) The certain cashflows are discounted at risk free rate
    c) The uncertain cashflows are discounted at risk adjusted discount rate
    d) The certain cashflows are discounted at the marginal cost of capital assuming a reasonable debt/equity mix

12. The NPV of a project turns zero when the discount rate is increased by 20% or when the initial cost increased by 10% or when the annual cash inflows reduce by 15%; This said, which of the following is NOT true?
    a) The project is more sensitive to initial cost than to discount rate
    b) The project is less sensitive to cash inflows than to initial cost
    c) The project is less sensitive to discount rate than to cash inflow
    d) The project is more sensitive to cash inflows than to initial cost

13. The initial cost of a project is Rs 10,000 ; the project has a life of 3 years giving an annual net cash inflow of Rs 4,000. If the NPV of the project is Rs 275 , What is the sensitivity of the project to the discount rate?
    a) 11%
    b) 16.6%
    c) 15%
    d) 1.6%

14. The base discount rate is 8% and the risk premium is 7%; If the corporate tax rate is 30%, According to Irvin fisher model, the risk adjusted discount rate is
    a) 8%
    b) 15.5%
    c) 15%
    d) 10.1%

15. The following are the return from four projects:

	A	B	C	D
Yr 1	5,000	8,000	10,000	9,000
Yr 2	15,000	9,000	10,000	12,000
Yr 3	10,000	13,000	10,000	9,000
Avg annual return	10,000	10,000	10,000	10,000

Which of the above projects is the riskiest?

a) A
b) B
c) C
d) D

16. The spot rate for Euro is Rs 50-52. The forward rate is 53-56. What is the swap ask?
    a) 2
    b) 3
    c) 4
    d) 5
17. The Re/Pound spot rate is 70-72. what is the relevant pound/Re spot rate?
    a) 0.0139 - 0.0143
    b) 0.0143 – 0.0139
    c) 0.972 – 1.028
    d) 1.028 – 0.972

18. Which of the following are NOT correct?
    i. Bid (Re/$) =1/Ask (Re/$)
    ii. Ask (Re/$) = 1/Bid ($/Re)
    iii. Bid (Re/$) =1/Ask ($/Re)
    iv. Ask (Re/$) = 1/Ask ($/Re)
    a) i & ii
    b) i & iv
    c) ii & iii
    d) iii & iv

19. Which of the following are correct?

    i. If fwd rate is > spot, then foreign currency is appreciating, in a direct quote
    ii. If fwd rate is > spot, then foreign currency is depreciating, in a direct quote
    iii. If spot rate is > fwd rate, then home currency is depreciating, in an indirect quote
    iv. If spot rate is > fwd rate, then home currency is appreciating, in an indirect quote
    a) I & iv
    b) Ii & iii
    c) ii & iv
    d) I & iii

20. Interest in India and USA are 10% and 4% respectively.If the spot Re/US$ is 43.20, what is the 1 year fwd rate, if IRPT holds good?
    a) 43.2
    b) 43.5
    c) 45.6
    d) 47.1

21. Which of the following is an European Quotes?
    i. Re/Euro
    ii. US$/Euro
    iii. Euro/US$
    iv. US$/CAD
    a) iv
    b) i & ii
    c) iii
    d) iii & 1v

22. The spot rate for Euro is Rs 50-52. The forward rate is 53-56. What is the Forward spread?
    a) 2
    b) 3
    c) 4
    d) 5

23. Which of the following rules is used to find the expected NPV as per Hilliers model for independent cash flows?
    a) Standard deviation the cashflows is discounted at (1+r) ^2n and summed up
    b) Variance of the cashflows is discounted at (1+r) ^2n and summed up
    c) Standard deviation of the cashflows is discounted at (1+r) ^ n and summed up
    d) Variance of the cashflows is discounted at (1+r) ^ n and summed up

24. For the quote Rs 40 – 41 per US$, the bid, ask & spread respectively are
    a) 1, 41, 40
    b) 41, 40 & 1
    c) 40,41 & 1
    d) 40,1 & 41

25. The spot rate Re/CAD is Rs 35.00 – 20. 1 month swap points are 30-20. What is the likely rupee realisation if you want to sell 25,000 CAD 1 month Fwd?
    a) Rs 885,000
    b) Rs 867,500
    c) Rs 882,500
    d) Rs 875,000

PART B

ANSWER ALL QUESTIONS

1. a) Briefly explain any three approaches of fixing a dividend policy. **(3 marks)**

b) X Ltd's share price is Rs 200 and it plans to declare a dividend of Rs 20 per share. The cost of equity is 15%.

- Using MM approach, compute the value of the share if the dividend is (i) declared and (ii) not declared **(6 marks)**

c) The earnings of a company is Rs 10 million. The cost of equity is 10% and the return on investment is 12%. The company is totally debt free.

- If the pay out ratio is 40%, What is the value per share as per Gordon's model? **(3 marks)**

- The company needs to decide whether to declare dividends or not. The tax rate for the investor is 20% and for the company is 40%. The coroporate dividend tax rate is 12.5%. You are required to give your opinion. **(5 marks)**

2. a) What is sensitivity analysis? **(3 marks)**

b) ABC Ltd is evaluating a proposal to buy machinery that is expected to cost Rs 20 crores (Plus 10% for taxes and other incidental costs). The life of the machine is 5 years, and the estimated revenues and costs, along with the attached probability, is tabulated below

Revenues	Probability	Costs	Probability
Rs 18 crores	35%	Rs 10 crores	40%
Rs 20 crores	25%	Rs 13 crores	35%
Rs 22 crores	40%	Rs 7 crores	25%

You are required to decide the viability of the project by running a simulation model. You are given the random numbers 02,86 & 40 for revenues and 54,01 & 32 for costs.

The risk free rate is 8% and you believe that a risk premium of 5% would be appropriate for the project. **(6 marks)**

c) A machine (expected life – 2 years) is expected to cost Rs 40 lakhs and the expected cashflows for the 2 years are given below:

	Year 1	Year 2	Terminal value
Good (60%)	25 lakhs	22 lakhs	1 lakh
Bad (40%)	22 lakhs	20 lakhs	50,000

The company has an option to dispose the machine at the end of year 1 for Rs 19 Lakhs. Assuming a discount rate of 10%,

- Assess the viability of taking up the project, without the option **(3 marks)**

- Suggest the course of action, keeping in mind the right to exercise the option **(5 marks)**

3.a) Explain in brief any three techniques of hedging against foreign currency exposure.

(3 marks)

b) Determine the % of appreciation/depreciation in home currency as well as foreign currency in each of the following situation.

- Spot Re/US$ is 43 ; and if (i) 3 month fwd is 44; (ii) if the 6 month fwd is 42.5 **(4 marks)**

- Spot Yen/US$ is 106.; and if (i) I month fwd is 106.03 ; (ii) if I year fwd is 106.98

(4 marks)

c) A customer had promised to pay you US$ 50,000 on July 19, 2008. Based on this, you took a fwd contract for the above sum at 43.20. However, today (i.e July 18th) the customer informs you that he can honour his commitment only after three months. You check with your bank immediately and the banker gives you the following quotes

Spot Re/US$ July 19, 2008 = 43.45 – 60
3 months fwd Re/US$ = 43.35-50.
You are required to determine the cost of rollover, if any.

(5 marks)

PRIME ACADEMY
27TH SESSION PROGRESS TEST
FINAL- MANAGEMENT ACCOUNTING
AND FINANCIAL ANALYSIS
SUGGESTED ANSWERS

PART A

1	c
2	a
3	d
4	b
5	c
6	a
7	d
8	b
9	a
10	b
11	b
12	d
13	b
14	b
15	a
16	c
17	a
18	b
19	d
20	c
21	c
22	b
23	b
24	c
25	b

PART B

1. a) Constant dividend approach: The amount of dividend is fixed
Constant dividend rate: The payout ratio is fixed
Residual approach: Free cashflows (i.e operating cashflows *Less* capex) is paid out as dividend

b)

	Div declared	Not declared
a) P0	200	200
b) Ke	15%	15%
c) DPS	20	0
d) P1 *	210	230

* P1 = P0 x (1+ ke)- DPS

Amount of shortfall if dividend is declared = Rs 20
To compensate this, additional shares will be issued at P1 (the intrinsic value)
Total new share to be issued (for every existing share held) = 20/210 = .095 shares

The value of the firm after the issue is as follows:

Market value	Div declared	Not declared
No of shares	1.095	1.000
Price per share	210	230
Value of the firm	230	230

Thus, the total value of the firm remains unchanged irrespective of whether dividends are declared or not.

(i) *If dividends are declared*:The value per share reduces as no of shares has increased (due to additional issue of shares to compensate for cash outflow in the form of dividend)

(ii) *If dividends are declared:* The value per share remains the same.

c) Intrinsic value as per Gordon , given constant growth of dividend = D1/(ke-g)
g (the growth rate) = retention rate (b) x return on equity (r)
Here, g = (100%-40%) x 12% = 7.2%
Dividend = Earnings x payout ratio = 10L x 40% = 4L
Thus, using Gordon, we get the fair value of the company to be Rs 1531L

Note: Since the no of shares is not given, a reasonable assumption can be taken.
If dividends are not declared :

1	Money saved	Rs. 4,000,000
2	Investment rate	12%
3	Effective investment rate (net of 30% tax)	7.2%
4	The above Compound for 5 years	Rs. 5,662,835
5	*The above Distributed after 5 years net of 12.5% dividend distribution tax*	*Rs. 5,033,631*

If dividends are declared

Shareholders will currently receive Rs.3,555,556 net of dividend distribution tax of 12.5%. In order for this to be equal to Rs 5,033,631 at end of 5 years, the amount needs to be compounded at 7.2% per annum for 5 years. Considering that the tax rate for the individual is 20%, the individual investment rate should at minimum be 9% (7.2%/80%) so that dividends become beneficial for the shareholder.

Conclusion: If the individual investment rate is

a) >9%, dividends should be declared
b) =9%, there is a "tie"
c) <9%, the funds should be reinvested by the company in the business

Note : The period of 5 years have been taken for illustration purpose. Workings on the same lines can be done for any reasonable time frame.

2. a)

- Sensitivity analysis is an analysis that attempts to quantify the degree of vulnerability of a project (aka the project's NPV) to changes in key input parameters like project cost, discount rate, terminal growth rate etc.

- The sensitivity rate depends upon the quantum of change in the input parameter that would turn the NPV to zero. For instance, a project is said to be 10% sensitive to discount rate if a 10% hike in discount rate makes the NPV of the project to be zero

- Generally, higher the sensitivity rate of a parameter, the lower is the sensitivity of the project to that parameter..

b) Cost of the machine = 20L+10% = 22L

Probability distribution to revenue:

Revenue	**Probability**	**Cumulative probability**	**Random no range**
18	0.35	0.35	00-34
20	0.25	0.60	35-59
22	0.40	1.00	60-99

Probability distribution to cost:

Cost	**Probability**	**Cumulative probabilit**	**Random no range**
10	0.40	0.40	00-39
13	0.35	0.75	40-74
7	0.25	1.00	75-99

Computation of net cashflow :

Random no		Range		Outcomes	
Revenue	Cost	Revenue	Cost	Revenue	Cost
2	54	00-34	40-74	18	13
86	1	60-99	00-39	22	10
40	32	35-59	00-39	20	10
			Average	**20**	**11**
			Net cashflow	**9**	

Note: All financial figures in tables are in crores, unless stated otherwise Cr implies crores

Computation of NPV
Annuity factor @ 13 % for 5 years = 3.53
PV of annuity cashflows 5 years = 32cr (9 cr x 3.53)
Cost of the project =22cr
NPV of the project = 33 cr-22 cr = 9 cr.

Note: Discount rate = Risk free rate + risk premium = 8%+5%= 13%.

c)

	Favourable	**Unfavourable**	
Initial cost	-40	-40	
Year 1 Df	0.91	0.91	
Year 2 DF	0.83	0.83	
Year 1 DCF	23	20	
Year 2 DCF	18	17	
Year 2 PV ofRV	1	0	
Total PV of cash inflows	42	37	
NPV	2	(3)	
Proab	0.6	0.4	
Weight	1.04	(1.22)	**(0.18)**

Thus, the NPV without the option is -.018L Hence the project is not viable.

Note: All financial figures in tables are in Rs lakhs unless stated otherwise

	Favourable	Unfavourable	
Initial cost	-40	-40	
Year 1 Df	0.91	0.91	
Year 2 DF	0.83	0.83	
Year 1 DCF	23	20	
Year 2 DCF	18	16	
Year 2 PV ofRV	1		
Total PV of cash inflows	42	36	
NPV	2	(4)	
Proab	0.6	0.4	
Weight	1.04	(1.72)	**(0.68)**

The option is worthless, since its NPV dilutive.

3) a) **Home currency invoicing** *:* All the billings/invoices are made at the home currency thereby transferring currency risk to the counterparty

Forward cover: By taking a forward cover, the exchange rate can be frozen at the date of transaction

Netting*:* Maintaining the balance between forex assets and liabilities & income and expenditure, so that the net exposure to foreign currency is minimum.

b)

	(i)	**(ii)**	**(i)**	**(ii)**
Quote	RE/$	RE/$	Yen /$	Yen /$
Spot rate	43	43	106	106
Fwd	44	42.5	106.03	106.98
Foregin currency (commodity)	$	$	$	$
No of months fwd	3	6	1	12
Observation	F>S	F<S	F>S	F>S
Hence $	App	Dep	App	App
% movement, $				
Formula	(F-S/S)*12/m	(F-S/S)*12/m	(F-S/S)*12/m	(F-S/S)*12/m
%	9.3%	2.3%	0.3%	0.9%
Direction	App	Dep	App	App
% movement, Rupee				
Formula	(F-S/F)*12/m	(F-S/F)*12/m	(F-S/F)*12/m	(F-S/F)*12/m
%	9.09%	2.35%	0.34%	0.92%
Direction	Dep	App	Dep	Dep

c).

a	Original fwd rate	43.2
b	Cancellation of above @ spot rate	43.6
c	Gross loss due to roll over (a-b_	-0.4
d	Revised fwd rate	43.35
e	Gain in revised fwd rate compared to original fwd rate	0.15
f	Net cost of rollover (c+e)	-0.25
g	Amount of exposure ($)	50,000
h	Total net cost (g x f) - Rs	(12,500)

PRIME ACADEMY

27th SESSION PROGRESS TEST

FINAL - ADVANCED AUDITING

TIME : 2 HOURS **TOTAL : 75 MARKS**

ANSWER ALL QUESTIONS

PART - A

1. A sampling risk is a risk

a) Which arises when the auditor uses any audit procedures
b) Which arises during the audit sampling
c) Which arises due to persuasive nature of the audit evidence
d) All of the above

2. Which of the following should be considered in the design of the sample Specific audit objectives

a) Population
b) Sample size
c) None of the above
d) All of the above

3. The nature, timing and extent of auditor's testing of calculations will depend on

a) The complexity involved, auditor's evaluation of the procedures used by the entity and materiality of the estimate
b) The complexity involved, materiality and the evidence produced
c) Complexity involved, materiality of the evidence and management approval
d) All of the above

4. A subsequent event refer to
a) Events occurring after the balance sheet date
b) Significant events , which occur after the balance Sheet Date affecting the prior period
c) Significant event which occur between the balance sheet date and the date of auditor's report
d) None of the above

5. An adjusting event should be
a) Disclosed in the accounts
b) Disclosed in the report of board of Directors
c) Adjusted in the financial statements under report

d) All of the above

6. The Going Concern assumption is considered inappropriate when

a) In the auditor's opinion the entity will not be able to continue its operation for the foreseeable future
b) When the financial ,operating and other indications assessed gives a bad state of affairs
c) All of the above
d) None of the above

7. Persons having Supervisory responsibilities in audit work should

a) Monitor, reply and resolve
b) Monitor, reply, resolve and consider
c) Monitor and reply
d) Monitor ,reply, consult and resolve

8. Accounting estimate is

a) An approximation of both financial and non-financial items
b) An approximation of an measurable amount
c) An approximation of the amount of an item in the absence of a precise means of measurement
d) All of the above

9. Insurer's Liability for outstanding Claims is n

a) An Estimate
b) A Contingent Liability
c) A subsequent event
d) None of the above

10. A related party transaction

a) Is a transaction between two related parties
b) Is a transaction involving transfer of resources or obligations between parties
c) Is a transaction involving transfer of resources or obligations between related parties involving a price
d) Is a transaction involving transfer of resources or obligations between related parties, regardless of whether or not a price is charged

11. Tolerable Error is

a) The error that is expected
b) The error that the auditor can tolerate
c) The maximum error in the population, the auditor can accept and achieve his audit objective
d) None of the above

12. Test Checking
a) Is an audit procedure
b) Is a sampling technique
c) Is an error detection mechanism
d) All of the above

13. For performing the audit of a business organization, an auditor should possess
a) Expert knowledge and exercise his professional judgment
b) Working knowledge and exercise his professional judgment
c) Knowledge of the business and exercise his professional judgment
d) All of the above

14. Monitoring legal requirements and its compliance is the responsibility of the
a) Auditor
b) Management
c) Regulatory authority
d) All of the above

15. Modes of obtaining evidence in respect of opening balances are
a) Audited statements of preceding years
b) Un audited statements of preceding years
c) Both a & b
d) Only a

16. Auditors' Duties under AAS22 include
a) To ensure that appropriate accounting policies are consistently applied
b) To express a qualified or disclaimed opinion is unable to obtain sufficient audit evidence
c) To express a qualified or disclaimed opinion on the effect of misstatements
d) All of the above

17. Reference in the financial statements which are integral part of the Current period and can only be read in relation to the current period are
a) Comparatives
b) Corresponding figures
c) Preceding year's figures
d) Prior period items

18. Time sharing and service bureaus
a) Is a EDP Accounting System
b) Is a EDP Accounting Processing System
c) All of the above
d) None of the above

19. When individual transactions are entered at a terminal device after validation along with other transactions for the period is called

a) An online real-time processing system
b) A Real time processing system
c) An On-line batch processing system
d) A Batch Processing system

20. System software control is a

a) General Control
b) General EDP Control
c) Application Control
d) All of the above

21. Date of the Audit report should be the

a) The actual date of closing of accounts
b) The actual date of audit
c) The actual date of completion of audit
d) The actual date on which the auditor signs the report and submits to the members

22. An auditor makes a statement of fact

a) When the accounts give the information required
b) When he has obtained all the information and explanation which are necessary for the purpose of his audit
c) When he has obtained all the information and explanation which to the best of knowledge and belief are necessary for the purpose of his audit
d) All of the above

23. Management audit is

a) The audit of management
b) The evaluation of the managers' ability to manage
c) Is a systematic independent appraisal activity
d) All of the above

24. Operational audit

a) Refers to Audit of Effectiveness of the management decisions and actions
b) Is subjective in nature
c) Is the evaluation of actual as against standards
d) Is the evaluation of the managers' ability to manage and achieve results

25. Purchase is

a) A procedure
b) A subsystem of an business environment
c) A System
d) All of the above

PART - B (Total 50 Marks)

Question 1 is compulsory and answer any three from the rest

1a. The method of collecting Audit evidence and evaluating the same changes drastically under EDP Auditing". Comment on the above. **(8 Marks)**

1b. The Companies (Auditor's Report) Order, 2003 is applicable to specified category of Companies. Explain?

(7 marks)

1c. What are the factors to be considered while determining the sample size

(5 marks)

2a. What are the Management Audit Questionnaires? **(5 Marks)**

2b. Explain what you understand by the following terms:
i) attribute sampling (ii) Monetary-unit sampling **(5 Marks)**

3. What are Auditing and Assurance Standards(AAS)?What is the procedure for issuing AAS? What is the duty of the member of the Institute in respect of compliance with the AAS's while discharging their attest function?

(10 Marks)

4. What procedure an auditor is required to follow to verify the items while reporting under CARO,2003 in respect of Repayment of Dues

(10 Marks)

5. What you understand by the term 'going-concern basis' in relation to the preparation of financial statements. Describe the audit procedures necessary in order to gain sufficient audit evidence to be able to form an opinion on the going-concern status of a company. List any six factors which might cast doubt on the going-concern status of a company.

(3+5+2=10 Marks)

PRIME ACADEMY
27th SESSION PROGRESS TEST
FINAL – ADVANCED AUDITING
SUGGESTED ANSWERS

PART A

1. b. which arises during the audit sampling
2. d. All of the above
3. a. The complexity involved, auditor's evaluation of the procedures used by the entity and materiality of the estimate
4. c. Significant event which occur between the balance sheet date and the date of Auditor's report
5. c. Adjusted in the financial statements under report
6. a. In the auditor's opinion the entity will not be able to continue its operation for the foreseeable future
7. b. Monitor, reply, resolve and consider
8. c. An approximation of the amount of an item in the absence of a precise means of measurement
9. a. An Estimate
10. d. Is a transaction involving transfer of resources or obligations between related parties, regardless of whether or not a price is charged
11. c. the maximum error in the population, the auditor can accept and achieve his audit objective
12. a. Is an audit procedure
13. c. Knowledge of the business and exercise his professional judgement
14. b. Management
15. c. Both a & b
16. d. All of the above
17. b. Corresponding figures
18. b. Is a EDP Accounting Processing System
19. c. An On-line batch processing system
20. b. General EDP Control
21. c. The actual date of completion of audit
22. c. When he has obtained all the information and explanation which to the best of knowledge and belief are necessary for the purpose of his audit
23. d. all of the above
24. c. is the evaluation of actuals as against standards
25. b. A subsystem of an business environment

PART B

1.a.

Effects of EDP Auditing: Auditor must provide a competent, independent opinion as to whether the financial statements records and report a true and fair view of the state of affairs of an entity. However, computer systems have affected how auditors need to collect and evaluate evidence. These aspects are discussed below:

(1) Changes to Evidence Collection - Collecting evidence on the reliability of a computer system is often more complex than collecting evidence on the reliability of a manual system. Auditors have to face a diverse and complex range of internal control technology that did not exist in manual system, like:

(a) Accurate and complete operations of a disk drive may require a set of hardware controls not required in manual system,

(b) System development control include procedures for testing programs that again are not necessary in manual control. Since, Hardware and Software develop quite rapidly, understanding the control technology is not easy. With increasing use of data communication for data transfer, research is focused on cryptographic controls to project the privacy of data. Unless auditor's keep up with these developments, it will become difficult to evaluate the reliability of communication network competently. The continuing and rapid development of control technology also makes it more difficult for auditors to collect evidence on the reliability of controls. Even collection of audit evidence through manual means is not possible. Hence, auditors have to run through computer system themselves if they are to collect the necessary evidence. Though generalized audit softwares are available the development of these tools cannot be relied upon due to lack of information. Often auditors are forced to compromise in some way when performing the evidence collection.

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

(a) Whether a control is functioning reliably or multi functioning,

(b) Traceability of control strength and weakness through the system. In a shared data environment a single input transaction may update multiple data item used by diverse, physically disparate user, which may be difficult to understand. Consequence of errors in a computer system is a serious matter as errors in computer system tend to be deterministic, i.e., an erroneous program will always execute data incorrectly. Moreover, the errors are generated at high speed and the cost and effort to correct and rerun program may be high. Errors in computer program can involve extensive redesign and reprogramming. Thus, internal controls that ensure high quality computer systems should be designed implemented and operated upon. The auditors must ensure that these control are sufficient to maintain assets safeguarding, data integrity, system effectiveness and system efficiency and that they are in position and functioning.

1. b.

Companies Covered by the Order: The Order applies to all companies except certain categories of companies specifically exempted from the application of the Order. The Order also applies to foreign companies as defined in section 591 of the Act. According to sub-section (1) of the aforesaid section, companies falling under the following two classes are construed as foreign companies:

(a) Companies incorporated outside India which, after the commencement of the Act, establish a place of business within India; and

(b) Companies incorporated outside India which have, before the commencement of the Act, established a place of business within India and continue to have an established place of business within India at the commencement of the Act.

In respect of foreign companies, an established place of business in India would include a liaison office. The Order is also applicable to the audits of branch(es) of a company under the Act since subsection 3(a) of section 228 of the Act clearly specifies that a branch auditor has the same duties in respect of audit as the company's auditor. It is, therefore, necessary that the report submitted by the branch auditor contains a statement on all the matters specified in the Order, except where the company is exempt from the applicability of the Order, to enable the company's auditor to consider the same while complying with the provisions of the Order.

Companies not Covered by the Order: Paragraph 2 of the Order provides that it shall not apply to:

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);

(ii) an insurance company as defined in clause (21) of section 2 of the Companies Act, 1956 (1of 1956);

(iii) a company licensed to operate under section 25 of the Companies Act, 1956 (1 of 1956); and

(iv) a private limited company with a paid-up capital and reserves not more than rupees fifty lakh and which does not have outstanding loan exceeding rupees twenty five lakhs from any bank or financial institution and does not have a turnover exceeding rupees five crores at any point of time during the financial year.

1.c.

The factors which the auditor should consider in determining the sample size are as follows:

(i) The efficiency and effectiveness of the internal control systems to process transactions without error: The auditor has to determine the expected error rate. The auditor's estimate of this depends, amongst other things, upon his evaluation of internal control.

(ii) *The level of assurance which the auditor requires*: The auditor has to determine the amount of the risk which he is prepared to accept. This would be determined by the auditor's assessment of the audit risk attached to a particular client. There is considerable information available to the auditor about the organisation, its management and the expectations of company performance, for example, and these factors would play a role in determining sample size.

(iii) *The results of previous audit work*: The auditor has to assess the expected error rate based upon the results of audit work in this and previous years. The higher the expected error rate, the greater the sample size, although if very high error rates are expected it may not be appropriate to use a sampling approach.

(iv) *Stratification*: This is the process of dividing a population into strata so that items in each sub-population are expected to have similar characteristics. Sample sizes can be made smaller because the auditor can spend more time on those strata deemed to be high risk.

2.a.

Management Audit Questionnaire: A management audit questionnaire is an important tool for conducting the management audit. It is through these questionnaires that the auditors make an inquiry into important facts by measuring current performance. Such questionnaires aim at a comprehensive and constructive examination of an organisation's management and its assigned tasks. Overall it is concerned with the appraisal of management actions in accomplishing the organisation's objectives. Its primary objective is to highlight weaknesses and deficiencies of the organisation. It includes a review of how well or badly the management functions of planning, organising, directing and controlling are being performed. In addition it evaluates how effective the decision-making process is accomplishing the stated organisation objectives. Within this framework, the questionnaire provides a means for evaluating an organisation's ongoing operations by examining its major functional areas. There are three possible answers to the management audit questions: "Yes", "No" and "N.A.", (not applicable). A "Yes" answer indicates that the specific area, function, or aspect under study is functioning in an acceptable manner; no written explanation is needed in that case. On the other hand, a "no" answer indicates unacceptable performance and should be explained in writing. Questionnaire comments on negative answers not only provide documentation for future reference, but, more important, provide background information for undertaking remedial action. Those questions that are not applicable and should be ignored in the audit are checked in the "N.A." column. The management audit questionnaire does not give answers, but simply asks questions. If all questions are answered with a 'yes', operations are proceeding as desired. On the other hand, if there are one or more 'no' answers, difficulties are being experienced and must be explained in writing. If the question does not apply, the N.A. (not applicable) column is checked. Thus, management audit questionnaire for this part of the audit not only serves as a management tool to analyse the current situation; more importantly, it enables the management auditors to synthesise those elements that are causing organisational difficulties and deficiencies.

2. b.

(i) Attribute sampling is a statistical method used to estimate the proportion of items in a population containing a particular characteristic. This proportion is called the occurrence rate and is the ratio of items containing the specific attribute to the total number of population items. Auditors are usually interested in the occurrence of exceptions in populations and refer to the occurrence rate as a deviation rate or an error rate. An exception in attribute sampling may be a test of an internal control deviation or a monetary error. For example the signature of the credit controller on a sales order is an attribute and the absence of a signature is a deviation/error. By design, attribute sampling enables the auditor to conclude that the population contains errors (with an allowance for statistical error) in the same proportion as in the sample. Auditors use attribute sampling to determine the appropriateness of the assessed level of control risk, although it can be used for substantive tests particularly when tests of controls and substantive tests are performed concurrently.

(ii) Monetary unit sampling is a method of sampling which attempts to place a value on the errors in a population. The auditor is interested not only in error rates but also in the monetary effects of those errors. The population is divided up into units of one rupee and not into transactions or balances. The size of the sample is determined by the confidence level required and by the auditors tolerable error. Each transaction to which a Rs1 unit is attached is tested for accuracy and if there is an error in the transaction, the Rs1 unit is said attached is tested for accuracy and if there is an error in the transaction, the Rs1 unit is said to be 'tainted' by the percentage of the error in the transaction. Thus Rs500 recorded as Rs550 would be 'tainted' by 10%. This method of sampling enables the auditor to determine the value of the most likely error and the maximum possible error in the population.

3.

AAS are auditing standards, which prescribe the way the auditing should be conducted. AAS are the benchmark by which the quality of audit performance can be measured and the achievement of the audit objective can be documented. By using standards an auditor can determine the professional qualities necessary for effective audit performance.

Procedure for issuing AASs - Broadly, the following procedure is adopted for the formulation of AASs:

. The AASB determines the broad areas in which the AASs need to be formulated and the priority in regard to the selection thereof. In the preparation of AASs, the AASB is assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision is made for participation of a cross-section of members of the Institute. On the basis of the work of the Study Groups, an exposure draft of the proposed AAS is prepared by the Committee and issued for comments by members of the Institute. After taking into consideration the comments received, the draft of the proposed AAS is finalised by the AASB and submitted to the Council of the Institute. The Council of the Institute considers the final draft of the proposed AAS, and, if necessary, modifies the same in consultation with the AASB. The AAS is then issued under the authority of the Council.

Compliance with the AASs: While discharging their attest function, it is the duty of the members of the Institute to ensure that the AASs are followed in the audit of financial information covered by their audit reports. If for any reason a member has not been able to perform an audit in accordance with the AASs, his report should draw attention to the material departures there from. Auditors are expected to follow AASs in the audits commencing on or after the date specified in the Standard

4.

Repayment of Dues: Whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported.

(a) Under this clause, the auditor is required to report whether the company has defaulted in repayment of dues to a financial institution or bank or to debenture holders. If the answer is in the affirmative, the auditor is also required to mention the period of default and the amount of default. A question that arises is whether the scope of the auditor's inquiry would cover defaults made by the company during the year only or whether the defaults committed in previous years and continuing until the year end would also be covered. It is clarified that the auditor should report the period and amount of all defaults existing at the balance sheet date irrespective of when those defaults have occurred.

(b) Dues to financial institutions, banks or debenture holders would include the principal as well as any interest on any kind of dues payable to the financial institutions, banks or debenture holders.

(c) The auditor should obtain a schedule of repayments to banks, financial institutions and debenture holders from the management of the company. The schedule should indicate the amount and the due dates of the payments that the company is required to make to banks, financial institutions and debenture holders.

(d) The auditor should examine the agreement or other documents containing the terms and conditions of the loans and borrowings of the company from banks and financial institutions. The auditor should also examine the debenture trust deed. This examination would enable the auditor in verifying the amount and due dates of the payments mentioned in schedule of repayments provided by the management of the company. The auditor should then verify whether the repayments as per the books of account are in accordance with the terms and conditions of the relevant agreement. The auditor should also satisfy himself that the repayment have actually been made to the party concerned.

(e) Though the word "default" has not been defined, in this regard, the word "default" would mean non-payment of dues to banks, financial institutions or debenture holders on the last dates specified in loan documents or debentures trust deed, as the case may be. For example, in the case of term loans, fixed dates are prescribed for repayment in the agreement or terms and conditions of the loans. The dates prescribed for repayments would operate as the last date of payments and any delay after this fixed date would amount to default.

(f) It may happen that the company might have submitted application for reschedulement / restructuring proposals to the lenders, which may be in different stages of processing. Submission of application for reschedulement /restructuring does not mean that no default has occurred. Accordingly, in such situations also the auditor should report the period of default and the amount of default. However, if the application for reschedulement of loan has been approved by the concerned bank or financial institution or if the default has been made good by the company during the accounting period covered by the auditor's report, the auditor should state in his audit report the fact of reschedulement of loan or the fact of default having been made good.

(g) The auditor may come across a situation where there may be disputes between the company and the lender on certain issues relating to repayments. In all such situations, the auditor should give a disclaimer that since there is a dispute between the company and the lender; he is unable to determine whether there is a default in repayment of dues to the lender concerned.

(h) The following is an example of negative reporting under the clause: "The company has defaulted in repayment of dues to debenture holders. Debentures amounting to Rs.50,00,000/- became due for redemption on 30th May 20XX which were redeemed by the company on 15th March 20XX."

5.

When financial statements are prepared on a going concern basis then it means that :

(i) Assets are recorded on the basis that the company will be able to realise or recover them at or above recorded amounts in the normal course of business.

(ii) Liabilities are recognised and recorded on the basis that they will be discharged in the normal course of business.AS 1, "Disclosure of Accounting Policies" defines the going-concern concept as meaning that the enterprise will continue in operational existence for the foreseeable future. This means that the financial statements are prepared on the assumption that there is no intention or necessity of liquidate or curtail significantly the scale of operation.

The auditor should plan and perform procedures designed to identify material matters which might enable the auditor to form an opinion on the going-concern status of a company. These procedures should include the following:

(i) A review of forecast and budget information produced by a company, and the quality of the systems in place for producing this information. This would include a review of the key assumptions underlying the forecasts and budgets, and a review of the cash flow budget.

(ii) A review of the evidence relating to the adequacy and period of borrowing facilities. The auditor may need to obtain written information from banks or other third parties in order to be able to assess the degree of their commitment.

(iii) A review of the inherent risk assigned to the audit client. The sensitivity of forecasts and budgets to variable factors both within the directors' control and outside their control will be scrutinised, including relevant economic factors.

(iv) A review of the directors' plans for overcoming any problems their company is having or resolving any matters giving rise to doubts about the appropriateness of the going concern basis. The auditor should consider the basis on which they have been prepared, whether they are realistic and whether the plans are likely to resolve the company's problems.

(v) A consideration of any professional advice obtained by the directors as to the extent of the company's difficulties and the practicalities of overcoming them. It may be necessary for the directors to obtain legal advice on the consequences of the company continuing to trade while it is known by the directors not to be a going concern.

(vi) A review of the financial records including the order book, director' minutes and an analytical review of the financial statements. The nature and scope of the auditor's procedures will depend upon the circumstances of the client. The extent of the procedures will be determined by the extent of the resources it requires to continue as a going concern.

The following are examples of factors which might cast doubt on the going-concern status of a company:

(i) internal matters such as loss of key management, labour difficulties or excessive dependence upon a few product lines where the market is depressed

(ii) external matters such as loss of key suppliers or customers or technical developments which render a key product obsolete

(iii) an excess of liabilities over assets

(iv) default on terms of loan agreements

(v) significant liquidity or cash flow problems

(vi) major litigation in which an adverse judgment would imperil the company's continued existence

(vii) denial of normal terms of credit by suppliers

(viii) major debt repayment falling due where refinancing is necessary to the company's continued existence.

PRIME ACADEMY

27th SESSION PROGRESS TEST

FINAL – CORPORATE LAWS AND SECRETARIAL PRACTICE

TIME : 2 HOURS **TOTAL : 75 MARKS**

PART A **(25 x 1 = 25)**

1. Directors are trustees of
a) Individual shareholder
b) Creditors
c) Company
d) Other outsiders

2. Minimum number of qualification shares that are require to be taken by a director as per Table A is.
a) 5000
b) 1
c) 500
d) Nil

3. Which of the following cant be considered for the purpose of reckoning qualification shares.
a) Share warrants
b) Preference shares
c) Partly paid up-equity
d) Mortgaged shares

4. Small shareholder means a shareholder who is holding
a) Shares worth nominal value of Rs.20,000/- or less in a private company.
b) Preference shares worth nominal value of Rs.20,000/- or less in any company including a private company.
c) 20000 equity shares of Rs.10/- each in any company.
d) Equity or preference shares worth nominal value of Rs.20,000/- or less in any public limited company.

5. A person can hold directorship in ………….. Private limited companies.
a) 15
b) 12
c) Unlimited
d) None of the above

6. First directors are appointed by
a) Shareholders
b) Directors
c) Registrar of companies
d) None of the above

7. Provisions of Automatic reappointment relates to
a) Director retiring by rotation
b) Director appointed in casual vacancy
c) Alternate Director
d) Additional director

8. Resignation once tendered
a) Can't be withdrawn by a Director without the consent of the company.
b) Can be withdrawn before it is considered by the board.
c) Can't be withdrawn, if all the other existing directors have agreed to it.
d) Will take effect from the date of the next annual general meeting.

9. A special notice under sec 284 for removal of a director is to be served on the company by
a) A member
b) Minimum of 100 members
c) Members holding not less than 10 % of the total voting power
d) Central government

10. Notice of board meeting
a) Must be in accordance with the articles
b) May be sent by telegram or telex or fax
c) Must be sent to the Indian address of the foreign director
d) All of the above

11. The audit committee shall have
a) Not less than three directors
b) 2/3rd of the total members, as directors other than managing / whole-time directors
c) A chairman elected amongst themselves
d) All of the above.

12. Recommendations of the audit committee are
a) Not Binding on the board.
b) Binding on the shareholders
c) Binding on the board
d) Binding on other committees.

13. The following company shall not be allowed to make political contribution during the year 2008-2009.

a) Government company incorporated on 31.03.2006
b) Public company incorporated on 01.01.2008
c) Government company which was inexistence on the commencement of Companies Act, 1956.
d) All of the above

14. General disclosure of directors must be in

a) FORM 24A
b) FORM 24AA
c) FORM DDA.
d) None of the above

15. An exception under section 295 of the Act.

a) Loan to any director of its holding company
b) Loan made by a holding company to its subsidiary company
c) Loan to any relative of a director of a holding company
d) Loan to any PRIVATE company in which the director of a holding company is a director

16. Contacts covered under 297

a) Purchase / sale of land exceeding Rs.5000/- in value.
b) Underwriting the subscription of any shares
c) Sale of negotiable instruments by a non-banking company in CREDIT
d) None of the above

17. Any director who is interested in any contract or arrangement shall

a) Disclose his interest or concern
b) Not take part in discussion.
c) Not vote for the resolution
d) All of the above

18. Disclosure by directors, managing director, manager, secretary under sec 305 shall be made

a) Within thirty days
b) Within seven days
c) Within twenty days
d) Within the next board meeting

19. Approval of the central government must be obtained under sec 297

a) Within 3 months from the date of entering into contract
b) Prior to entering into contract
c) Prior to the board's approval
d) Immediately upon entering into contract

20. Particulars of contract requiring board's approval under sec 297 shall be entered in the Register maintained u/s 301
a) Within 7 days of the meeting
b) Within 7 days of the receipt of particulars
c) Within 30 days of the date of contract or arrangement.
d) Immediately upon entering into contract

21. The term of office of a director appointed under casual vacancy is
a) Till the date upto which the predecessor would have held office.
b) Upto the date of the ensuing annual general meeting
c) Till the next director is appointed
d) Upto the completion of next three months

22. The term of office of an additional director is
a) Till he resigns
b) Till the ensuing annual general meeting
c) For a period of five years
d) None of the above

23. A director cant assign his office because
a) An agent cant sub-delegate
b) He is a trustee to the company
c) He is not an employee
d) He is an agent of the managing director

24. The office of a director shall become vacant on account of failure to pay the call money
a) Immediately on such failure.
b) Within 6 months
c) Within 3 months
d) Within 1 year

25. Disqualification to directors apply upon
a) Non filing of annual accounts for three consecutive years.
b) Non filing of annual return for three consecutive years
c) Failure to pay interest on debentures.
d) Failure to file annual accounts & returns for three consecutive years.

PART B (5 x 10 = 50)

Answer any five Questions:

1. What do you mean by doctrine of indoor management ?

2. Explain the provisions regarding appointment of directors by central government?

3. a. Practice company limited held four Board meetings in a calendar year with an interval of more than 3 months in between two board meetings. Comment.

b. List out the parties covered under sec 297 ?

4. a. Advice the board of directors of a public company which has recorded an average net profit of Rs.1 crore for the last three financial years about their powers in respect of a proposal to donate Rs.1,00,000/- to a charitable institution.

b. list out the parties covered under section 295 ?

5. Explain the provisions of the companies Act, relating to adjournment of a meeting? In a private limited company, there are only two directors on the board. A Board meeting convened was adjourned for want of quorum. At the adjourned meeting, in spite of quorum not being present, resolutions were passed as per the agenda. Discuss the validity of resolutions so passed?

6. Draft a Board Resolution for constitution of an audit committee taking into consideration the provisions of Sec 292A of the Companies Act, 1956.

PRIME ACADEMY

27th SESSION PROGRESS TEST

FINAL – CORPORATE LAW AND SECRETARIAL PRACTICE

SUGGESTED ANSWERS

PART A

Question No	Answer
1.	C
2.	B
3.	A
4.	D
5.	A
6.	D
7.	A
8.	A
9.	A
10.	D
11.	D
12.	C
13.	D
14.	B
15.	B
16.	B
17.	D
18.	C
19.	B
20.	A
21.	A
22.	B
23.	A
24.	B
25.	D

CORPORATE LAWS AND SECRETARIAL PRACTICE

PART - B

1

Step 1 – 5 marks.

The doctrine of indoor management operates to protect the outsiders against the company. Sec 290 of the Act, gives legal recognition to the doctrine of indoor management and gives protection to the third party who is dealing with the company by giving validity to the acts done by a director although it may afterwards be discovered that his appointment was invalid or that it had terminated under any provision of the Act or Articles of the Company.

Where a person say Mr. A, represents to the third party that he is a director of ABC Ltd, such third party may, at best, satisfy himself as to the truth of his claim by inspecting the public records maintained by the Registrar. Thereupon, he may presume in his favour that appointment of Mr. A. was valid and that the same has not been terminated by operation of law. Acts done by Mr.A, as a director shall be valid, notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in Act or articles of association of the company. The company is bound by such acts. [Royal British Bank v Turquand]

Step 2 – 5 marks.

Exceptions to the above - Circumstances where the acts of a Director becomes invalid.

- Proviso to sec 290 doesn't give validity to the acts done by a director after his appointment is shown to the company to be invalid or to have been terminated.
- No appointment of the so-called Director was made.[Morris vs. Kanssen (1964) I, A.E.R. 586(H,L).], [Karnal Distillery vs. Ladli Prasad]
- The appointment is illegal.
- Where the acts done by the director were ultra vires the Act.
- This section doesn't protect the outsider who transacts with the director after having received the notice of such disqualification [Re, Staffordshire Gas and Coke Co. Ltd. Exp .Nicholson (1892) 66 LT 413.]

2

Step 1 – 3 marks

Section 408 of the Act, vests overriding powers with central government to nominate directors in the board of companies. Sub-section (1) of this section provides that the central government may appoint such number of persons as the tribunal may, by order in writing, specify as being necessary to effectively safeguard the interest of the company, or its shareholders or the public interest to hold office as directors thereof for such period not exceeding three years.

Step 2 – 5 marks

Tribunal may order such appointment of directors on a reference made to it by the central government or on an application of not less than 100 members or members holding not less than one-tenth of the total voting power therein, and is satisfied after such inquiry as it deems fit to make, that it is necessary to make the appointment or appointments in order to prevent the affairs of the company being conducted either in a manner which is oppressive to any members of the company or in a manner which is prejudicial to the interest of the company or to public interest.

Step 3 – 2 marks

The directors appointed under sec 408 may or may not be the members of the company. The period of three years mentioned herein means full term of three years excluding the period during which an injunction by court on instance of company restraining director for acting operates.

3a

5 marks

Section 285 of the Act prescribes that in the case of every company, a meeting of the board of directors shall be held at least once in every three months and at least four such meetings shall be held in every year. It has been clarified so long as four board meetings are held in a calendar year, one in each quarter, the interval between two meetings may be more than three months [Letter No. 10/3/72-CL-III, dated 2-6-1973].

For instance, if a meeting is held on January 1, the next meeting may be held on June 30, the third on 1st July and the fourth on the 31st December.

Accordingly, **if the Practice Company limited has held four board meetings in a calendar year,** one in each quarter, the interval between two meetings may be more than three months.

3b

Sec 297 requires the sanction of the board for entering into contracts with the following persons:

1. a Director of the company; - **½ mark.**
2. a relative of a Director of the company; - **½ mark.**
3. a firm in which a director is a partner; **½ mark.**
4. a firm in which a relative of a director is a partner; **½ mark.**
5. any other partner of a firm in which a Director is a partner; **½ mark.**
6. any other partner of a firm in which a relative of a Director is a partner; **½ mark.**
7. a private company in which a director is a Director **1 mark.**
8. a private company in which a director is a member **1 mark.**

4a.

Step 1- 2 ½ marks.

As per sec 293 (1)(e) of the Companies Act, the consent of a company in general meeting is required for contribution to charitable and other funds not directly relating to the business of the company or to the welfare of its employees, any amounts the aggregate of which will in any financial year exceed Rs.50,000/- or 5% of its average net profits during the three immediately preceding financial years, whichever is greater.

The contributions to charitable and other funds directly relating to the business of the company or welfare of its employees are not subject to any ceiling limits.

Step 2- 2 ½ marks.

In the instant case, the contribution is not directly relating to the business of the company. the average net profits of a company for the immediately preceding 3 financial years is Rs. 1 Crore. 5 % thereof amounts to Rs.5, 00,000/- . the proposed donation of Rs. 1,00,000/- being well within this ceiling limit, the company may proceed with this assuming that the other contribution during the year so as to make the aggregate of such contribution and the proposed contribution is more than Rs.5,00,000/-.

Since the proposed donation is well within the ceiling limit the company can make the same after the approval of the board. The approval of the general meeting is required only when the aggregate contribution in any financial year exceeds the ceiling limit.

4b.

Parties covered under sec 295.

Previous approval of the central government is required for a company to carryout the transactions covered under sec 295 with any of the following persons.

- Any director of the lending company.- **½ mark**
- Any director of its holding company. – **½ mark**
- Any partner or relative of any such director. **½ mark**
- Any firm in which such director or relative is a partner. **½ mark**
- Any private company of which such director is a director or member **1 mark**.
- Any body corporate at a general meeting of which not less than 25% of the total voting power may be exercised or controlled by any such director or two or more directors taken together. –

  1 mark
- Any body corporate, the board of directors, managing director or manager of which is accustomed to act in accordance with the directions or instructions of the board or of any of the directors of the lending company. - **1 mark**

5

Step 1 - 2 ½ marks.

Sec 288 provides that, if the required quorum is not present in a board meeting, then, unless the articles otherwise provide, a meeting cannot be held and must automatically stand adjourned till the same day in the next week, at the same time and place, and if that day is a public holiday, to the succeeding day.

Step 2 – 5 marks.

Regulation 75 of Table A provides that if the number of directors is reduced below the quorum fixed by the Act for a meeting of the Board, the continuing directors or director may act for the purpose of increasing the number of directors to that fixed for the quorum or for summoning a general meeting of the company, but for no other purpose. It has been held that where a single director is validly in office, he cannot act for anything else than for calling a general meeting for the purpose of appointing directors so as to complete the quorum.

Step 3 - 2 ½ marks.

Where the articles of association of a company provided that the quorum for a meeting of the board of directors shall be two directors and meetings called for was adjourned for want of quorum and in the adjourned meeting only one director was present, it was held that the resolution passed in that meeting was void. [Maharani Yogeshware Kumari v. Lake Shore Palace Hotel [1996] 21 CLA 107 (Raj)]

6

Step 1 - 2 ½ marks.

According to the provisions of Section 292A of the Companies Act, 1956 every Public Limited Company having a paid-up capital of Rs.5 Crores or more is required to constitute an Audit Committee which shall consist of not less than 3 directors of which two-thirds of the total number of members shall be directors, other than managing or whole-time directors.

Step 2 - 7 ½ marks.

Draft resolution for constitution of an audit committee

RESOLVED that pursuant to Sec 292A of the Companies Act, 1956, a committee of the Board designated as 'Audit Committee', be and is hereby constituted with the following directors as its members.

Mr..…………….., Nominee of IDBI.
Mr…..………….., Nominee of LIC
Mr………………, Director
Mr……...………., Director
Mr………………, Director – Finance.
Ms………………, Managing Director

RESOLVED FURTHER that the Committee shall have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half-yearly and annual financial statements before submission to the Board and also ensure compliance of internal control systems.

RESOLVED FURTHER that the Audit Committee shall have the authority to investigate any matter in relation to the items specified under Section 292A of the Companies Act, 1956 or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the Company and external professional advice, if necessary

RESOLVED FURTHER that Mr……………. shall be the Chairman of the Audit Committee.

RESOLVED FURTHER that the quorum for meetings of the Audit Committee shall be one – third of the members of the committee or two member, which ever is higher.