

**PRIME ACADEMY
MODEL QUESTION PAPER
DG**

TIME: 3 hours

Maximum Marks:100

Answer all questions

1. The summarised Balance Sheet of R Ltd and P Ltd for the year ending on 31.3.2008 are as under:

Liabilities	R Ltd Rs.	P Ltd Rs.	Assets	R Ltd Rs.	P Ltd Rs.
Equity share capital	24,00,000	12,00,000	Fixed Assets	55,00,000	27,00,000
8% Pref Shares	8,00,000		Current Assets	25,00,000	23,00,000
10% Pref shares		4,00,000			
Reserves	30,00,000	24,00,000			
Current liabilities	18,00,000	10,00,000			
Total	80,00,000	50,00,000	Total	80,00,000	50,00,000

The following information is provided.

1.

Particulars	R Ltd Rs.	P Ltd Rs.
Profit before tax	10,64,000	4,80,000
Taxation	4,00,000	2,00,000
Preference dividend	64,000	40,000
Equity dividend	2,88,000	1,92,000

2. The equity shares of both the companies are quoted in the market. Both the companies are carrying on similar manufacturing operations.

3. R Ltd proposes to absorb P Ltd as on 31.3.2008. The terms of absorption are as under:

(a) Preference shareholders of P Ltd will receive 8% preference shares of R Ltd, sufficient to increase the income of preference shareholders of P Ltd by 10%

(b) The equity shareholders of P Ltd will receive equity shares of R Ltd on the following basis:.

- The equity shares of P Ltd will be valued by applying to the earnings per share of P Ltd. 75% of price earnings ratio of R Ltd based on the results of 2007-2008 of both the companies.
- The market price of equity shares of R Ltd is Rs 40 per share.
- The number of shares to be issued to the equity shareholders of P Ltd will be based on the above market value.
- In addition to equity shares, 8% preference shares of R Ltd will be issued to the equity shareholders of P Ltd to make up for the loss in income arising from the above exchange based on the dividends for the year 2007-2008.

4. The assets and liabilities of P Ltd as on 31.3.2008 are revalued by professional valuer as under:

	Increased by Rs.	Decreased by Rs.
Fixed Assets	1,00,000	
Current Assets		2,00,000
Current liabilities		40,000

5. For the next two years, no increase in the rate of equity dividend is expected

You are required to

(i) Set out in detail the purchase consideration.

(ii) Give the Balance sheet as on 31.3.2008 after absorption. Journal entries not required.

(16 Marks)

2. On September 30th 2005 Beta Enterprises Ltd was incorporated with an Authorised capital of Rs 50 Lakhs. Its first accounts were closed on 31st March 2006 by which time it had become a listed company with an issued subscribed and paid up capital of Rs 40 lakhs in 400000 equity shares of Rs 10 each.

The company started off with two lines of business namely 'Engineering division' and 'Chemicals division' with equal asset base with effect from 1st April 2007. The 'Ceramics division' was added by the company on 1st April 2008. The following data is gathered from the books of account of Beta Enterprises Ltd

Trial Balance as on 31 st March 2009.		
	Amount in Rupees'000	
Engineering division sales		6000
Cost of Engineering division sales	2600	
Chemicals division sales		8000
Cost of sales of Chemical division	4300	
Ceramic division sales		1500
Cost of sales of Ceramics division	900	
Administration costs	2000	
Distribution costs	1500	
Dividend – interim	1200	
Fixed assets at cost	9000	
Depreciation on Fixed assets		1500
Stocks as on 31 st March 2009	400	
Trade debtors	440	
Cash at bank	160	
Trade creditors		500
Equity share capital of Rs 10 each		4000
Retained profits		1000
Total	22500	22500

Additional information

- Administration costs should be split between the divisions in the ratio 5:3:2
- Distribution costs should be spread over the divisions in the ratio 3:1:1
- Directors have proposed a final dividend of Rs 8 Lakhs
- Some of the users of Ceramics division are unhappy with the product and have lodged claims against the company for damages of Rs 7.5 lakhs. The claim is hotly contested by the company on legal advice.
- Fixed assets worth Rs 30 lakhs were added in the Ceramics division on 1.4.2008
- Fixed assets are written off over a period of 10 years on straight line basis in the books. However for income tax purpose depreciation at 20% on written down value of the assets is allowed by Tax authorities.
- Income tax rate may be assumed at 35%.
- During the year Engineering division has sold to Alpha Ltd goods having a sales value of Rs 25 Lakhs. Mr. Gamma, the Managing director of Beta Enterprises Ltd owns 100% of the issued Equity shares of Alpha Ltd. The sales made to Alpha Ltd were at normal selling price of Beta Enterprises LTD.

You are required to prepare Profit and Loss account for the year ended 31st March 2009 and the Balance sheet as at that date. Your answer should include notes and disclosures as per the Accounting Standards.

(16 Marks)

3. Capital structure of L Ltd as at 31.3.2008 is as under:

Equity share capital	10 lakhs
10% Preference share capital	5 lakhs
15% Debentures	8 lakhs
Reserves and surplus	4 lakhs

L Ltd earns a profit of Rs 5 lakhs annually on an average before deduction of interest on debentures and income tax which works out to 40%

Normal return on equity shares of companies similarly placed is 12% provided:

- Profit after tax covers fixed interest and fixed dividends at least 3 times.
- Capital gearing ratio is 0.75
- Yield on share is calculated at 50% of profits distributed and at 5% on undistributed profits.

L Ltd has been regularly paying equity dividend of 10%.

Compute the value per equity share of the company.

(16 Marks)

4. The Balance sheet of Sun Ltd and Moon Ltd as on 31.3.2008 are given below:

Liabilities	Sun Ltd Rs.	Moon Ltd Rs.	Assets	Sun Ltd Rs.	Moon Ltd Rs.
Share capital	1,20,000	1,00,000	Fixed Assets	44,000	84,000
General Reserve	20,000	36,000	Investments in Moon Ltd 8000 shares @ Rs 11	88,000	
Profit and loss account	12,000	20,000	Sundry Debtors	6,000	15,000
Bills payable	2,000	5,000	Bills receivable	4,000	16,000
Sundry creditors	4,000	7,000	Stock in trade	10,000	40,000
			Cash at Bank	6,000	13,000
Total	1,58,000	1,68,000	Total	1,58,000	1,68,000

Shares were purchased on 1.4.2005. When the shares were purchased General Reserve and Profit and loss account of Moon Ltd stood at Rs 30,000 and Rs 16,000 respectively. Dividends have been paid @10% every year after acquisition of shares, first dividend being paid out of pre-acquisition profits. No dividend has been proposed for 2007-2008 as yet and no provision need be made in consolidated Balance sheet. Sun Ltd has credited all dividends received to the Profit and loss account.

On 31.3.2008, bonus shares has been declared by Moon Ltd @ 1 fully paid share for 5 held but no effect has been given to that in the above accounts. The Bonus was declared out of profits earned prior to 1.4.2005 from general reserve.

When the shares were purchased, agreed valuations of fixed assets of Moon Ltd was Rs 1,08,000 although no effect has been given thereto in accounts.

Depreciation has been charged @ 10% per annum on the book value as on 1.4.2005 (on straight line method), there being no addition or sale since then.

Out of Current profits, Rs 2,000 has been transferred to general reserve every year. Bills receivable of Sun Ltd include Rs 2,000 bills accepted by Moon Ltd and Bills discounted by Sun Ltd, but not yet matured include Rs 1,500 accepted by Moon Ltd. Sundry creditors of Sun Ltd include Rs 2,000 due to Moon Ltd whereas Sundry debtors of Moon Ltd include Rs 4,000 due from Sun Ltd. It is found that Sun Ltd has remitted a cheque of Rs 2,000 which has not yet been received by Moon Ltd.

Prepare consolidated Balance sheet as at 31.3.2008 of Sun Ltd and its subsidiary.

(20 Marks)

5. (a) G Ltd has initiated a lease for 3 years in respect of an equipment costing Rs 1,50,000 with expected useful life for 4 years. The asset would revert to G Ltd under the lease agreement. The other information available in respect of lease agreement is:
- The unguaranteed residual value of the equipment after the expiry of the lease term is estimated at Rs 20,000.
 - The implicit rate of interest is 10%.
 - The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of asset.

Ascertain in the hands of G Ltd.

- The annual lease payment.
- The unearned finance income
- The segregation of finance income
- Show how necessary items will appear in its profit and loss account and balance sheet for the various years.

(8 Marks)

(b) Swift Ltd acquired a patent at a cost of Rs 80,00,000 for a period of 5 years and the product life-cycle is also 5 years. The company capitalized the cost and started amortizing the asset at Rs 10,00,000 per annum. After two years it was found that the product life cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were expected to be Rs 36,00,000, Rs 46,00,000, Rs 40,00,000 and Rs 34,00,000. Find out the amortisation cost of the patent for each of the years.

(4 Marks)

(c) The chief accountant of Sports Ltd gives the following data regarding its six segments:

Particulars	Rs. In lakhs						
	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segment Results	50	(190)	10	10	(10)	30	(100)
Segment Revenue	300	620	80	60	80	60	1200

The chief accountant is of the opinion that segments M and N alone should be reported. Justify.

(4 Marks)

6. (a) A company has a capital base of Rs 1 crore and has earned profits to the tune of Rs 11 lakhs. The return on investment of the particular Industry to which the company belongs is 12.5%. If the services of a particular executive are acquired by the company, it is expected that the profits will increase by Rs 2.5 lakhs over and above the target profit. Determine the amount of maximum bid price for that particular executive and the maximum salary that could be offered to him.

(6 Marks)

(b) Briefly describe the progress made by India so far in the field of human resource accounting.

(4 Marks)

(c) Give an account of the growing scope of human capital reporting.

(6 Marks)

PRIME ACADEMY
28th SESSION MODEL EXAM
ADVANCED ACCOUNTING
SUGGESTED ANSWERS

1.

(i) Computation of Purchase Consideration

Rs.

(a) Preference Shareholders	
Current income of preference shareholders of P Ltd	40,000
Add: 10% increase thereof	<u>4,000</u>
	<u>44,000</u>
Preferences shares to be issued	
100	
=44,000 x $\frac{100}{8}$ =	5,50,000

(b) Equity Shareholders

(1) Issue of Equity Shares

P/E ratio in R Ltd

Rs.

Profit before tax	10,64,000
Less: Tax	<u>4,00,000</u>
	6,64,000
Less: Preference dividend	<u>64,000</u>
Profit available for equity shareholders	<u>6,00,000</u>

$$\text{Earnings per share (EPS)} = \frac{6,00,000}{2,40,000} = \text{Rs.2.50}$$

$$\text{Price earnings ratio} = \frac{40}{2.50} = \text{Rs.16}$$

EPS of P Ltd:

Rs.

Profit before tax	4,80,000
Less: Tax	<u>2,00,000</u>
Profit after tax	2,80,000
Less: Preference dividend	<u>40,000</u>
Profit available for equity shareholders	<u>2,40,000</u>

$$\text{EPS} = \frac{2,40,000}{1,20,000} = \text{Rs.2}$$

Valuation of equity shares of P Ltd:

$$= 1,20,000 \text{ shares} \times (\text{Rs.2} \times 16 \times 0.75 \text{ i.e. Rs.24})$$

$$= \text{Rs.28,80,000}$$

Number of equity shares to be issued:

$$\frac{28,80,000}{40} = 72,000$$

	Rs.
Equity Share Capital	7,20,000
Share (Securities) Premium	<u>21,60,000</u>
	28,80,000
(2) Issue of Preference Shares	Rs.
Current equity dividend	1,92,000
Less: Expected equity dividend from P Ltd. (Rs. 7,20,000 x 2,88,000 / 24,00,000)	<u>86,400</u>
Loss in income	<u>1,05,600</u>

$$8\% \text{ Preference Shares to be issued} = \frac{1,05,600}{0.08} = \text{Rs. } 13,20,000$$

Total Purchase Consideration:		Rs.
Preference shares to be issued	5,50,000	
	<u>13,20,000</u>	18,70,000
Equity shares to be issued (at premium)		<u>28,80,000</u>
		<u>47,50,000</u>

(ii)

R Ltd.

Balance Sheet as at 31st March, 2008

(after absorption)

	Schedule No.		Rs.
I. SOURCES OF FUNDS			
(1) Shareholders' funds:			
(a) Capital	A	57,90,000	
(b) Reserves and Surplus	B	<u>51,60,000</u>	1,09,50,000
(2) Loan funds			--
Total			<u>1,09,50,000</u>
II. APPLICATION OF FUNDS			
(1) Fixed assets:			
Net block	C		91,10,000
(2) Investments			--
(3) Net Current assets	D		<u>18,40,000</u>
Total			<u>1,09,50,000</u>

Schedules to Balance Sheet

	Rs.
A. Share Capital:	
3,12,000 Equity Shares of Rs.10 each (of the above shares, 72,000 Equity shares are allotted as fully paid up for consideration other Than cash)	31,20,000
2,67,000 8% Preference Shares of Rs.10 each (of the above, 1,87,000 are allotted as fully paid up for consideration other than cash)	<u>26,70,000</u>
	<u>57,90,000</u>

B. Reserves and Surplus:	
As per last Balance Sheet	30,00,000
Share (Securities) Premium	<u>21,60,000</u>
	<u>51,60,000</u>
C. Fixed Assets:	
As per last Balance Sheet	55,00,000
Taken over on absorption of P Ltd.	<u>28,00,000</u>
	83,00,000
Goodwill	<u>8,10,000</u>
	<u>91,10,000</u>
D. Net Current Assets:	
As per last Balance Sheet	7,00,000
Taken over on absorption of P Ltd.	<u>1,40,000</u>
	<u>18,40,000</u>

Working Note:

Calculation of Goodwill on Absorption

		Rs.
Purchase consideration		47,50,000
Fixed assets taken over	28,00,000	
Current assets taken over	<u>21,00,000</u>	
	49,00,000	
Less: Current liabilities	<u>9,60,000</u>	
Net assets taken over		<u>39,40,000</u>
Goodwill		<u>8,10,000</u>

2.

Beta enterprises ltd.
Profit and Loss Account for the year ending 31st March, 2009

		Rs.`000
Sales		15,500
Cost of Sales		<u>(7,800)</u>
		7,700
Distribution costs		(1,500)
Administration costs		<u>(2,000)</u>
Profit before tax		4,200
Provision for tax	1,239	
Deferred tax (35% of Rs.60)	<u>231</u>	<u>(1,470)</u>
Profit after tax		2,730
Dividends (Rs.1,200 + Rs.800)		(2,000)
Profit for the year		730
Retained profit brought forward (Rs.1,000 – Rs.210)		<u>790</u>
Retained Profit Carried forward		<u>1,520</u>

Beta Enterprises Ltd.
Balance Sheet as at 31st March, 2009

Liabilities	Amount Rs.`000	Assets	Rs.`000	Amount Rs.`000
Share Capital		Fixed Assets		
Issued and subscribed		Gross block	9,000	
4,00,000 shares of Rs.10 each,	4,000	Less:	<u>1,500</u>	7,500
fully paid up		Depreciation		
Reserves and Surplus		Current Assets, Loan And Advances		
Retained profits	1,520	(a) Current assets		
Deferred Tax Liability	441	Stock	400	
Current liabilities and Provisions		Debtors	440	
(a) Current liabilities		Cash at bank	<u>160</u>	1,000
Creditors	500	(b) Loans and Advances	NIL	
(b) Provisions				
Provision for tax	1,239			
Proposed dividend	<u>800</u>			
	8,500			<u>8,500</u>

Notes to Accounts:

1. Segmental Disclosures (Business Segments)

	(Figures in Rs.000`s)			
	Engineering Division	Chemical Division	Ceramics Division	Total
Sales	6,000	8,000	1,500	15,500
Cost of Sales	2,600	4,300	900	7,800
Administration Cost (5:3:2)	1,000	600	400	2,000
Distribution Cost (3:1:1)	900	300	300	1,500
Profit / Loss	<u>1,500</u>	<u>2,800</u>	<u>(100)</u>	<u>4,200</u>
	6,000	8,000	1,500	15,500
Original cost of Assets (Equal Capital Base)	3,000	3,000	3,000	9,000
Depreciation @ 10% p.a.				
For the year ended 31.03.2001	300	300	NIL	600
For the year ended 31.03.2002	300	300	300	900

Note: Ceramics division is a reportable segment as per assets criteria.

2. Tax computation

	(Rs. In 000`s)
Profit before tax for the year ended	4,200
Add: Depreciation provided in the books (300+300+300)	<u>900</u>
	5,100
Less: Depreciation as per Income Tax Act (480+480+600)	<u>1,560</u>
Taxable Income	<u>3,540</u>
Tax at 35%	<u>1,239</u>

3. Deferred Tax liability (as per AS 22 on Accounting for Taxes on Income)

	Rs.`000
Opening Timing Difference on 01.04.2001	
WDV of fixed assets as per books	5,400
WDV of fixed assets as per Income Tax Act	4,800
Difference	600
Deferred Tax Liability @ 35% on 600	210
This has been adjusted against opening balance of retained profits.	
Current year (ended 31 st March, 2002)	Rs.`000
Depreciation as per Books	900
Depreciation as per Income Tax Act (480+480+600)	<u>1,560</u>
Difference	<u>660</u>
Deferred Tax Liability @ 35% on 660 (to be carried forward)	231

4. **Contingent Liabilities not provided:** Company is contesting claim for damages for Rs. 7,50,000 and as such the same is not acknowledged as debts.

5. **Related Party Disclosure:** Para 3 of AS 18 lists out related party relationships. It includes individuals owning, directly or indirectly, an interest in voting power of reporting enterprise which gives them control or significant influence over the enterprises, and relatives of any such individual. In the instant case, Mr. Gamma as a managing director controls operating and financial actions of Beta Enterprises Ltd. He is also owning 100% share Capital of Alpha Ltd. Thereby exercising control over it. Hence, Alpha Ltd. Is a related party as per para 3 of AS 18.

Disclosure to be made:

Name of the related party and nature of relationship	Alpha Ltd. Common director
Nature of the transaction	Sale of goods at normal commercial terms
Volume of the transaction	Sales to Alpha Ltd. Worth Rs.25 lakhs.

3.

(i) Profit for calculation of interest and fixed dividend coverage:	Rs.
Average profit of the Company (before interest and taxation)	5,00,000
Less: Debenture interest (15% on Rs.8,00,000)	<u>1,20,000</u>
	3,80,000
Less: Tax @ 40%	<u>1,52,000</u>
Profit after interest and taxation	2,28,000
Add back: Debenture interest	<u>1,20,000</u>
Profit before interest but after tax	<u>3,48,000</u>

(ii) Calculation of interest and fixed dividend coverage: Rs.

Fixed interest and fixed dividend:

Debenture interest	1,20,000
Preference dividend	<u>50,000</u>
	<u>1,70,000</u>

$$\text{Fixed interest and fixed dividend coverage} = \frac{3,48,000}{1,70,000} = 2.05 \text{ times}$$

Interest and fixed dividend coverage 2.05 times is less than the prescribed three times.

(iii) Capital gearing ratio:

Equity share capital + reserves = Rs.10,00,000 + Rs.4,00,000

= Rs.14,00,000

Preference share capital + debentures = Rs.5,00,000 + Rs.8,00,000

= Rs.13,00,000

$$\text{Capital Gearing Ratio} = \frac{13,00,000}{14,00,000} = 0.93 \text{ (approximately)}$$

Ratio 0.93 is more than the prescribed ratio of 0.75.

(iv) Yield on equity shares: Rs.

Average profit after interest and tax	2,28,000
Less: Preference Dividend	50,000
Equity Dividend (10% on Rs.10,00,000)	<u>1,00,000</u>
Undistributed profit	78,000
50% of distributed profit (50% of Rs.1,00,000)	50,000
5% of undistributed profit (5% of Rs.78,000)	<u>3,900</u>
	<u>53,900</u>

$$\text{Yield on equity shares} = \frac{53,900}{10,00,000} \times 100 = 5.39\%$$

(v) Expected yield of equity shares:

	%
Normal return	12.00
Add: For low coverage of fixed interest and fixed dividends (2.05<3)	0.50*
Add: For high capital gearing ratio (0.93>0.75)	<u>0.50**</u>

(vi) Value per equity share:

$$\frac{5.39}{13.00} \times \text{Rs.}100^{***} = \text{Rs.}41.46$$

Notes: * When interest and fixed dividend coverage is low, riskiness of equity investors is high. So they should claim additional risk premium over and above the normal rate of return. Here, the additional risk premium is assumed to be 0.50%. Students may make any other reasonable assumption.

** Similarly, higher the ratio of fixed interest and dividend bearing capital to equity share capital plus reserves, higher is the risk and so higher should be risk premium. Here also the additional risk premium has been taken as 0.50%. The students may make any other reasonable assumption.

*** Paid up value of a share has been taken as Rs.100.

4.

Consolidated Balance Sheet of sun Ltd.

And its Subsidiary Moon Ltd.

As at 31st March, 2008

	Rs.		Rs.
Liabilities	Amount	Assets	Amount
Share Capital (Rs.10)	1,20,000	Fixed Assets	
Minority Interest	29,520	Sun Ltd.	44,000
Capital Reserve	19,200	Moon Ltd.	
General Reserve	24,800	(84,000-12,000+3,600)	<u>75,600</u>
Profit and Loss Account	18,080	Stock in Trade	1,19,600
Bills Payable		Sun Ltd.	10,000
Sun Ltd	2,000	Moon Ltd.	<u>40,000</u>
Moon Ltd.	<u>5,000</u>	Sundry Debtors	50,000
	7,000	Sun Ltd.	6,000
Less: Mutual		Moon Ltd.	
Indebtedness	<u>2,000</u>	(15,000 – 2,000, Cheque	
Sundry Creditors		in transit)	<u>13,000</u>
Sun Ltd.	4,000		19,000
Moon Ltd.	<u>7,000</u>	Less: Mutual	

	11,000		indebtedness	<u>2,000</u>	17,000
Less: Mutual			Cash at Bank		
Indebtedness	<u>2,000</u>	9,000	Sun Ltd.	6,000	
			Moon Ltd.	<u>13,000</u>	19,000
			Remittance in transit		2,000
			Bills Receivable		
			Sun Ltd.	4,000	
			Moon Ltd.	<u>16,000</u>	
				20,000	
			Less: Mutual		
			Indebtedness	<u>2,000</u>	<u>18,000</u>
		<u>2,25,600</u>			<u>2,25,600</u>

Contingent Liability

Bills discounted not yet matured Rs.1,000

Working Notes:

(1) Analysis of Profit of Moon Ltd.

	Capital Profits Rs.	Revenue Reserve Rs.	Revenue Profits Rs.
General reserve on	30,000		
Less: Bonus issue	<u>20,000</u>	10,000	
Increase in reserve (Annual transfer of Rs. 2,000 for 3 years) (36,000 – 30,000)		6,000	
Profit and loss account on 01.04.97	16,000		
Less: Dividend for 1997-98	10,000	6,000	
Increase in profit (20,000-6,000)			14,000
Loss on revaluation [84,000 x 100/70 i.e. 1,20,000) – 1,08,000]	(12,000)		
Additional depreciation written back (12,000 x 10/100 x 3)			3,600
	<u>4,000</u>	<u>6,000</u>	<u>17,600</u>
Sun Ltd'.s share (80%)	<u>3,200</u>	<u>4,800</u>	<u>14,080</u>
Minority's share (20%)	<u>800</u>	<u>1,200</u>	<u>3,520</u>

(2) Minority Interest		Rs.
Share capital (including bonus shares)		
(20,000+20,000x1/5)		24,000
Capital profits		800
Revenue reserve		1,200
Revenue profits		<u>3,520</u>
		<u>29,520</u>
(3) Cost of Control	Rs.	Rs.
Investment in Moon Ltd.	88,000	
Less: Dividend of capital profits	8,000	80,000
Less: Face value of investment (including		
Bonus shares) (80,000+80,000x /5) 96,000		
Capital profits	<u>3,200</u>	<u>99,200</u>
Capital Reserve		<u>19,200</u>
(4) General Reserve – Sun Ltd. Balance		20,000
Add: Share in Moon Ltd.		<u>4,800</u>
		<u>24,000</u>
(5) Profit and Loss Account – Sun Ltd. Balance		12,000
Less: Dividend Credited to investment		<u>8,000</u>
		4,000
Add: Share in Moon Ltd.		<u>14,080</u>
		<u>18,080</u>

Note: As regards bills receivable of Sun Ltd., the students may, alternatively, assume that out of bills of Sun Ltd. Accepted by Moon Ltd. Rs.2,000, Rs.1,500 have been discounted. In such case, only Rs.500 will be deducted as mutual indebtedness from bills receivable and bills payable in the balance sheet instead of Rs.2,000.

5.

A) (i) Calculation Of Annual Lease Payment *

	Rs.
Cost of the equipment	1,50,000
Unguaranteed Residual Value	20,000
PV of residual value for 3 year @ 10%(Rs.20,000x0.751)	15,020
Fair value to be recovered from Lease Payment (Rs.1,50,000 – Rs.15,020)	1,34,980
PV Factor for 3 years @ 10%	2,487
Annual Lease Payment (Rs.1,34,980/PV Factor for 3 years @ 10% i.e.	

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

2.487 54,275

(ii) Unearned Financial Income

Total lease payment [Rs.54,275x31]	1,62,825
Add: Residual value	20,000
Gross Investments	1,82,825
Less: Present value of Investments (Rs.1,34,980+Rs.15,020)	1,50,000
Unearned Financial Income	32,825

(iii) Segregation of Finance Income

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

(iv) Profit and Loss Account (Relevant Extracts)

Credit side		Rs
I Year	By Finance Income	<u>15,000</u>
II Year	By Finance Income	<u>11,073</u>
III Year	By Finance Income	<u>6,752</u>
Balance Sheet(Relevant Extracts)		
Assets Side	Rs.	Rs.
I Year Lease Receivable	1,50,000	
Less: Amount Received	<u>39,275</u>	<u>1,10,725</u>
II Year Lease Receivable	1,10,725	
Less : Received	<u>43,202</u>	<u>67,523</u>
III Year: Lease Amount Receivable	67,523	

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

Less : Amount receiver	47,523	
Residual value	<u>20,000</u>	<u>NIL</u>

Notes to Balance Sheet

Year I Rs.

Minimum Lease Payments (54,275+54,275)	1,08,550
Residual Value	<u>20,000</u>
	1,28,550
Unearned Finance Income(11,073+6,752)	<u>17,825</u>
Lease Receivables	<u>1,10,725</u>
Classification:	
Not later than 1 year	43,202
Later than 1 year but not more than 5 year	<u>67,523</u>
Total	<u>1,10,725</u>

Year II:

Minimum Lease payments	54,275
Residual Value (Estimated)	<u>20,000</u>
	74,275
Unearned Finance Income	<u>6,752</u>
Lease Receivables (not later than 1 year)	<u>67,523</u>

III Year:

Lease Receivables (including residual value)	67,523
Amount Received	<u>67,523</u>
	<u>NIL</u>

B). Swift Limited amortised Rs.10,00,000 per annum for first two years i.e. Rs.20,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the product. The amortization may be found as follows:

Year	Net cash flows	Amortization Ratio	Amortization Amount
	Rs		Rs
I	-	0.125	10,00,000
II	-	<u>0.125</u>	10,00,000
III	36,00,000	0.180	10,80,000
IV	46,00,000	0.230	13,80,000

It has been assumed that the company had amortized the patent at Rs.10,00,000 per annum in the first two years on basis of economic benefits derived from the product manufactured under the patent.

V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	<u>34,00,000</u>	<u>0.170</u>	<u>10,20,000</u>
Total	<u>2,00,00,000</u>	<u>1.000</u>	<u>80,00,000</u>

It may be seen from above that from above that from third year onwards, the balance of carrying amount i.e., Rs.60,00,000 has been amortized in the ratio of net cash flows arising from the product of Swift Ltd.

Note: The answer has been given on the basis that the patent is renewable and Swift Ltd. got it renewed after expiry of five years.

C). As per Para 27 of AS17 Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if:

- i. Its revenue from sales to external customers and from other transactions with other segment is 10% or more of the total revenue-external and internal and of all segments; or
- ii. Its segment result whether profit or loss is 10% or more of:
 - (1) The combined result of all segments in profit; or
 - (2) The combined result of all segments in loss,
 Whichever is greater in absolute amount; or

iii. Its segment assets are 10% or more of the total assets of all segments.
 If the total external revenue attributable to reportable segments constitutes less than 75% of total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% thresholds until at least 75% of total enterprise revenue is included in reportable segments.

- (a) On the basis of turnover criteria segments M and N are reportable segments.
- (b) On the basis of the result criteria, segments M,N and R are reportable segments (since their results in absolute amount is 10% cr more of Rs.200 Lakhs).
- (c) On the basis of asset criteria all segments except R are reportable segments.

Since all the segments are covered in at least one of the above criteria all segments have to be reported upon in accordance with Accounting Standard (AS) 17. Hence, the opinion of chief accountant is wrong .

6.)

A: Human resource accounting can be defined as the process of identifying, measuring and communication information about human resources in financial statements in order to facilitate effective management. Human resource accounting is a recent phenomenon in India. Leading public sector units like OIL, BHEL, NTPC, MMTC and SAIL etc. have started reporting Human resources in their annual reports as additional information. The Indian Companies basically adopted the model of human resource valuation as advocated by Lev and Schwartz (1971). Measure of their human capital. However the Indian Companies have suitably modified the Lev and Schwartz model to suit their individual circumstances.

B. of late is a growing trend of shift from the traditional focus on financial reporting of quantifiable resources (which can be measured in monetary terms) to a more comprehensive approach of reporting under which human resources are also considered as measurable assets. Having followed the methods of accounting of fixed assets, one can take into account the employee-related costs like cost of recruitment, training and orientation of employees, for the purpose of capitalization and then the appropriate portion thereof can be amortised each year over the estimated years of effect of such costs.

The relevance of human resource information lies in the fact that it concerns organizational changes in the firm's human resources. The ratio of human to non-human capital indicates the degree of labour intensity of an organization. Comparison of the specific values of human capital based on the organization's scales of wages and salaries with the general industry standards, can be good source of information to the management. There is no standard human capital reporting format as employment reporting is relatively a new form of reporting. Usually, the report inter alia contains data pertaining to employee numbers, employment and training policies, collective bargaining arrangements, industrial disputes, pension and pay arrangement and disabled employee numbers.

Human capital reporting provides scope for planning and decision-making in relation to proper manpower planning. Also, such reporting can bring out the effect of various rules, procedures and incentives relating to work force, and in turn, can act as an eye opener for modifications of existing statutes, laws and the like.

C. Capital base	=	Rs. 1,00,00,000
Actual profit	=	Rs. 11,00,000
Target profit @ 12.5%	=	Rs. 12,50,000

Expected profit on employing the particular executive

$$= \text{Rs. } 12,50,000 + 2,50,000 = \text{Rs. } 15,00,000$$

Additional profit = Expected profit – Actual profit

$$= 15,00,000 - 11,00,000 = \text{Rs. } 4,00,000$$

$$\begin{aligned} \text{Maximum bid price} &= \frac{\text{Additional profit}}{\text{Rate of Return on investment}} \\ &= \frac{4,00,000}{12.5} \times 100 = \text{Rs. } 32,00,000 \end{aligned}$$

Maximum salary that can be offered = 12.5% of Rs.32,00,000 i.e., 4,00,000

Maximum salary can be offered to that particular executive upto the amount of additional profit i.e., Rs. 4,00,000.

TIME: 3 hours

Maximum Marks: 100

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

1. As a Statutory auditor, how would you deal with following?
 - a) C Ltd. holds shares of D Ltd. which also entitles it to 51% voting power. These shares are held as "Stock-in-Trade" since C Ltd.'s intention is to dispose them in the near future. Due to this, C Ltd. is of the view that the financial statements of D Ltd. need not be consolidated.
 - b) 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.
 - c) 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".
 - d) A Ltd. was under audit for the year ended 31.03.2008. An appeal filed by A Ltd. Against the demand of Excise Duty of Rs. 26 crores was pending before the Supreme Court for which neither provision was made nor was disclosed in the notes to the financial statements. On 12th July, 2008, the auditor came to know through paper reports that the point involved in the appeal of A Ltd. was adjudicated by the Supreme Court in the case of some other assessee, which is in favour of the department of Excise Duty. The auditor insisted that provisions be made of Rs. 26 crores in the financial statements. The Management was of the view that since its own case is still pending, no provision is called for. It was also of the view that the event does not have any effect on the financial position of the company on the date of the Balance Sheet. Is the view of the Management tenable? **(5+4+4+5 = 18 Marks)**
2. Comment on the following with reference to the Chartered Accountants Act, 1949, Code of Ethics and Schedules to the Act:
 - a) P, a Chartered Accountant in practice provides management consultancy and other services to his clients. During 2005, looking to the growing needs of his clients to invest in the stock markets, he also advised them on Portfolio Management Services whereby he managed portfolios of some of his clients.
 - b) B, a Chartered Accountant in practice is a partner in 3 firms. While printing his personal letter heads, B gave the names of all the firms in which he is a partner.
 - 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+4+4+5= 18 Marks)**

3. Answer the following:

- a) Designing an Audit Strategy is the backbone of the “Audit Planning” process. Discuss.
- b) What are the special points in the audit of a Non-Banking Equipment Leasing Finance Company? **(10+6 = 16 Marks)**

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)**

5.

- a) State the specific problems, which may arise in the implementation of internal control in an EDP system.
 - b) What are the characteristics of ‘On-line Computer System’?
 - c) Explain : Tagging and Tracing
- (8+4+4 = 16 Marks)**

6. Answer the following:

- a) Discuss the various aspects to be considered by the Statutory Auditor before qualifying his report.
- 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)**

7.

- a) What are the important aspects to be looked into a due diligence review of Cash flow?
- b) What is the meaning of “Small and Medium sized Company” as per the Companies (Accounting Standards) Rules, 2006? **(8+8 = 16 Marks)**

8. Write short notes on (any **four**):

- a) Disclosure under “Basis of Issue Price” in prospectus.
 - b) Test Packs
 - c) Certificate for Special Purpose vs. Audit Report
 - d) Advantages of Cost Audit to Government
 - e) Corporate Governance
 - f) Responsibility of Joint Auditors
- (4 × 4 = 16 Marks)**

PRIME ACADEMY
28th SESSION MODEL EXAM
ADVANCED AUDITING
SUGGESTED ANSWERS

1.

- a. Consolidation of Accounts: AS 21, "Consolidated Financial Statements", requires that a subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future. In this case it needs consideration as to whether C Ltd.'s intention is to dispose off shares or hold the same. Since shares are being held as 'stock-in-trade' and the intention is to dispose off in near future, it is quite clear that control is temporary.

Accounting Standards Interpretation issued by the Institute of Chartered Accountants of India specifies that where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise would be considered temporary. Hence in a such a case the concerned subsidiary should be excluded from consolidation. Therefore, the contention of the C Ltd. that D Ltd. can be excluded from consolidation is correct.

- b. 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 qualify 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.

- c. 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.

d. **Subsequent Events:**

Accounting Standard 4 on "Contingencies and Events Occurring after the Balance Sheet Date" deals with all those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors of the company. As per AS 4, those events can be identified as adjustable events which provide further evidence of conditions that existed at the balance sheet date; and non-adjustable events are those

Which are indicative of conditions that arise subsequent to the Balance Sheet Date. AAS19 on "Subsequent Events" lays down that the "auditor should consider the effect of subsequent events on the financial statements and on the auditor's report". In the instant case, A Ltd. had a pending demand of Rs. 26 crores made by the Excise Department for which appeal was made in the Supreme Court. Since the issue involved in the appeal of A Ltd. was similar to the point in case of some other company and since the appeal of that company was decided against that company and in favour of the Excise Department,

It is necessary for A Ltd. to make a provision of Rs. 26 crores. The case settled by the Supreme Court on similar point reflects significant developments affecting the assessment about the potential risk faced by the company. The view of the management that its own appeal is undecided or that it has no effect on the financial position as on 31.03.2008 is not at all tenable. Since the financial position is materially affected, the auditor should express a qualified opinion or an adverse opinion as may be appropriate.

2.

- a. Advising on Portfolio Management Services: The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that CAs in practice are not permitted to undertake the activities of broking, underwriting and portfolio management Services. Thus, a chartered accountant in practice is not permitted to manage portfolios of his clients. In view of this, P would be guilty of misconduct under the Chartered Accountants Act, 1949

- b. Advertisement of Professional Attainments: Clause 7 of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a Chartered Accountant in documents through which the professional attainments of the member would come to the notice of the public. Even a member is not permitted to specify the date of setting up of practice or establishment of firm. However, there is no prohibition for printing names of all the three firms on the personal letterheads in which a member holding Certificate of Practice is a partner. Thus B is not guilty of any misconduct under the Chartered Accountants Act, 1949.
- c. Editorship of Stock Market and Mutual Funds Journal : 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 cannot be, in any case, called a professional journal. Hence Mr. A would be guilty of professional misconduct.

- d. Fees received on a Progressive Basis: As per Sec. 226, clause (d) of Subsection 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 cannot be called indebted to the Company as per the view of the Research Committee of ICAI.

3.

a. Audit strategy is concerned with designing optimised audit approaches, that seeks to achieve the necessary audit assurance at the lowest cost within the constraints of the information available. The formulation of audit strategy as shall be evident from the process as explained in the following paragraphs in fact shall form the basis of audit planning to achieve the audit objectives in the most efficient and effective manner. Audit strategy generally involves the following steps:

(i) Obtaining Knowledge of Business: AAS 20, "Knowledge of Business", states that in performing an audit of financial statements, the auditor should have or obtain knowledge of the business sufficient to enable the auditor to identify and understand the events, transactions and practices that, in the auditor's judgement, may have a significant effect on the financial statements or on the examination or audit report.

Knowledge of the business is a frame of reference within which the auditor exercises professional judgement. Understanding the business and using this information appropriately assists the auditor in assessing risks and identifying problems, planning and performing the audit effectively and efficiently. It also ensures that the audit staff assigned to an audit engagement obtains sufficient knowledge of the business to enable them to carry out the audit work delegated to them. This would also ensure that the audit staff understands the need to be alert for additional information and the need to share that information with the auditor and the other audit staff.

(ii) Performing Analytical Procedures: The purpose of analytical procedures at the planning stage is attention-directing; corroboration is not normally necessary at this stage. The use of the analytical procedures during the planning stage requires the extensive use of accounting and business knowledge and experience to assess the potential for material misstatement in the financial statements as a whole, because the key aspect of the task is to identify the relevant risk indicators and to interpret them properly. Furthermore, analytical techniques applied during the planning stage are not generally as precise as the analytical techniques at the substantive stage.

(iii) Evaluating Inherent Risk: To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors such as quality of accounting system, unusual pressure on management, etc. having regard to his experience of the entity from previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which, might have taken place since his last assessment.

(iv) Evaluating Internal Control: The auditor's assessment of the control environment is crucial to the decision on whether to make an extended assessment of controls. This is because a good control environment is conducive to the maintenance of a reliable system of accounting and control procedures. For strategy purposes, the auditor should obtain a sufficient understanding of the control environment. The auditor needs an understanding of the accounting systems, regardless of whether the audit strategy will involve an extended assessment of internal accounting controls. This is done by:

- (a) Considering the results of gathering or updating information about the client; and
 - (b) Making preliminary judgements about materiality, inherent risk and control effectiveness. These will include identification of the system(s) the auditor proposes to subject to an extended assessment of controls. Thus, the audit strategy is evolved after considering the engagement objectives, the results of the business review, preliminary judgements as to materiality and identified inherent risks. Audit strategy also considers main points relating to planning and controlling the audit or comments on adequacy of the existing arrangements. Thus, the overall audit plan involving determination of timing, manpower, coordination and the directions in which the audit work has to proceed is dependent upon the audit strategy formulated by the audit firm
- b. Special Points in the Audit of Non Banking Equipment Leasing Finance (NBELF) Company:
- (i) Ascertain whether the NBFC has an adequate appraisal system for extending equipment leasing finance.
 - (ii) Verify whether there is an adequate system in place for ensuring installation of assets and their periodic physical verification. In respect of some major transactions, an auditor should arrange for physical verification of the leased assets so as to dispel any doubts that equipment leasing finance was not extended without the corresponding assets being created.
 - (iii) Ascertain whether the NBFC has an adequate system for monitoring whether the assets have been adequately insured against and regular maintenance of the leased assets is being carried out by the lessee.
 - (iv) Verify the lease agreement entered into with the lessee in respect of the equipment given on lease.
 - (v) Verify whether the AS 13 issued by the Institute of Chartered Accountants of India in respect of "Accounting for Investments" has been complied with.

4.

- a. 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 from 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.

- (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.

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

5.

a. Specific problems of EDP relating to Internal Control: In an EDP system, the following specific problems arise in the implementation of internal control:

- (i) **Separation of duties:** In a manual system, separate individuals are responsible for initiating transactions, recording transactions, and custody of assets. As a basic control, separation of duties prevents or detects errors and irregularities. In a computer system, however, the traditional notion of separation of duties does not always apply. For example, a program may reconcile a vendor invoice against a receiving document and print a cheque for the amount owed to a creditor. Thus, the program is performing functions that in a manual systems would be considered incompatible. In minicomputer and PC environments, separation of incompatible functions may be even more difficult to achieve. Some minicomputers and PCs allow users to change programs and data easily; furthermore, they provide no record of these changes. If the minicomputer or PC does not have an inbuilt capability

to provide a secure record of changes, it may be difficult to determine whether incompatible functions have been performed by systems users.

- (ii) **Delegation of authority and responsibility:** A clear line of authority and responsibility is an essential control in both manual and computer systems. In a computer system, however, delegating authority and responsibility in an unambiguous way may be difficult because some resources are shared among multiple users. For example, one of the objectives of using a database management system is to provide multiple users with access to the same data, thereby reducing the control problems that arise with maintaining redundant data. When multiple users have access to the same data and integrity of the data is somehow violated, it is not always easy to trace who is responsible for corrupting the data and who is responsible for identifying and correcting the error. Some organizations have attempted to overcome these problems by designating a single user as the owner of data. This user assumes ultimate responsibility for the integrity of the data.
- (iii) **Competent and trustworthy personnel:** The technology of data processing is now exceedingly complex-much more complex than in the days of manual systems. Highly skilled personnel are needed to develop, modify, maintain, and operate today's computer systems. Thus, the existence of competent and trustworthy personnel becomes even more important when computer systems are used to process an organization's data, since a relatively small number of individuals assume major responsibility for the integrity of the data.
- (iv) **System of authorizations:** Management issues two types of authorizations to execute transactions. General authorizations establish policies for the organization to follow: for example, a fixed price list is issued for personnel to use when products are sold. Specific authorisations apply to individual transactions: for example, acquisitions of major capital assets may have to be approved by the board of directors. In a manual system, auditors evaluate the adequacy of procedures for authorisation by examining the work of employees. In a computer system authorisation procedures often are embedded within a computer program. For example, the order entry module in a sales system may determine the price to be charged to a customer. Thus, when evaluating the adequacy of authorization procedures, auditors have to examine not only the work of employees but also the veracity of program processing.
- (v) **Adequate documents and records:** In a manual system, adequate documents and records are necessary to provide an audit trail of activities within the system. In computer systems, documents may not be used to support the initiation, execution and recording of some transactions. For example, in an on line order entry system customers orders received by telephone may be entered directly into the system. Similarly, some transactions may be activated automatically by a computer system: For example, an inventory replenishment program may initiate purchase orders when stock levels fall below a set amount. Thus, no visible audit or management trail may be available to trace the transaction. The absence of a visible audit trail is not a problem for the auditor provided that systems have been designed to maintain a record of all events and there is a means of accessing these records. In well designed computer systems, audit trails are often more extensive than those maintained in manual systems.

- (vi) **Physical control over assets and records:** Physical control over access to assets and records is critical in both manual systems and computer systems. Computer systems differ from manual systems, however, in the way they concentrate the data processing assets and records of an organization. For example, in a manual system, a person wishing to perpetrate a fraud may be maintained at a single site the data processing installation. Thus, the perpetrator does not have to go to physically distance locations to execute the fraud.
- (vii) **Adequate management supervision:** In a manual system management supervision of employee activities is relatively straight forward because managers and employees are often at the same physical location. In computer systems, however, data communications may be used to enable employees to be closer to the customers they service. Thus, supervision of employees may have to be carried out remotely. Supervisory controls must be built into the computer system to compensate for the controls that usually can be exercised through observation and inquiry.
- (viii) **Comparing recorded accountability with assets:** Periodically, data and the assets that the data purports to represent should be compared to determine whether incompleteness or inaccuracies in the data exist or shortages in the assets have occurred. In a manual system, independent staff prepares the basic data used for comparison purposes. In a computer system, however, programs are used to prepare this data. For example, programs may sort an inventory file by warehouse location and prepare counts by inventory item at different warehouses. If unauthorized modifications occur to the programs or data files that the programs use, an irregularity may not be discovered.

b. Characteristics of 'On-line Computer System'

- (i) **Validation Checks:** When data are entered on-line, they are usually subject to immediate validation checks. Data failing this validation would not be accepted and a message may be displayed on the terminal screen, providing the user with the ability to correct the data and re-enter the valid data immediately. For example, if the user enters an invalid inventory part number, an error message will be displayed enabling the user to re-enter a valid part number.
- (ii) **On-Line Access:** Users may have on-line access to the system that enables them to perform various functions, e.g., to enter transactions and to read, change or delete programs and data files through the terminal devices. Unlimited access to all of these functions in a particular application is undesirable because it provides the user with the potential ability to make unauthorised changes to the data and programs. The extent of this access will depend upon such things as the design of the particular application and the implementation of software designed to control access to the system.
- (iii) **Transaction Trail:** An on-line computer system may be designed in a way that does not provide supporting documents for all transactions entered into the system. However, the system may provide details of the transactions on request or through the use of transaction logs or other means. Illustrations of these types of systems include orders received by a telephone operator who enters them on-line without written purchase orders, and cash withdrawals through the use of automated teller machines.

- (iv) **Programmer Access:** Programmers may have on-line access to the system that enables them to develop new programs and modify existing programs. Unrestricted access provides the programmer with the potential to make unauthorised changes to programs and obtain unauthorised access to other parts of the system. The extent of this access depends on the requirements of the system. For example, in some systems, programmers may have access only to programs maintained in a separate program development and maintenance library; whereas, in emergency situations which require changes to programs that are maintained on-line, programmers may be authorised to change the operational programs. In such cases, formal control procedures would be followed subsequent to the emergency situation to ensure appropriate authorisation and documentation of the changes.

c. Tagging and Tracing: It is a technique better than Integrated Test Data Facility. It involves tagging the client's input data in such a way that relevant information is displayed at key points. It uses the actual data, and so the question of elimination of 'special entries' test data designed under Integrated Test Data Facility does not arise. The hard copy, so produced is available only to the auditor and may describe such inputs as hours worked in a pay period in excess of 50; or sales orders processed in excess of Rs.1,00,000. This enables the auditor to examine transactions at the intermediate steps in processing. The advantage of the tagging and tracing approach lies in the use of actual data and elimination of the need for reversing journal entries. The disadvantage is that the erroneous data will not necessarily be tagged. An effective combination approach may be to use the ITF approach (integrated test facility) for a few hypothetical transactions and the tagging and tracing approach to follow line data through a complex system.

6. a. **Aspects to be Considered Before Qualifying the Audit Report:** AAS 28, "The Auditor's Report on Financial Statements", specifies that auditor's report may need modification on account of certain matters which may or may not affect the auditor's opinion. There may be certain circumstances when an auditor may not be able to express an unqualified opinion because the effect of such circumstances in the auditor's

Judgment, is or may be material to the financial statements:

- (i) there is a limitation on the scope of the auditor's work; or
- (ii) there is a disagreement with management regarding the acceptability of the Accounting policies selected the method of their application or the adequacy of financial statement disclosures.

Further, while qualifying a report, it is important to appreciate as to which of the various items of statement of fact or statement of opinion require a qualification in respect of audits under the Companies Act, 1956, the auditor may also see whether the matters constituting the qualification involve a material contravention of any requirements of the Companies Act, 1956 which have a bearing on the accounts.

Finally, whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and,

unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the auditor's report. A quantified opinion should be expressed as being "subject to" or "except for" the effects of the matter to which qualification related.

- 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 subsec. 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 dividend 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.

7.

a. Due Diligence review of cash flow :

- (i) Review the historical pattern of cash flows of the organization and look for change in trends.
- (ii) See whether the company is able to meet its cash requirements from internal generations/accruals or does it seek outside sources from time to time.
- (iii) Check whether the company honours its commitments to creditors, Government and other stock holders.
- (iv) Verify the ability of the company to turn its stock into Debtors i.e sale ability of its products.
- (v) Ensure that the company follows up with Debtors and that the Debtors collection period is not very large.
- (vi) Check the ability of the company to deploy its funds in profitable investment opportunities.
- (vii) Look into the investment pattern of the company, whether they give maximum benefits to the company and are easily realizable.

b. In exercise of the powers conferred by clause (a) of sub-section (1) of section 642 of the Companies Act, 1956 (1 of 1956), read with sub-section (3C) of section 211 and subsection (1) of section 210A of the said Act, the Central Government, in consultation with National Advisory Committee on Accounting Standards, made the Companies (Accounting Standards) Rules, 2006. As per these rules "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 rupees 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 this a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

8.

(a) Disclosures under 'Basis of Issue Price': Under this heading, the following information is to be disclosed:

(i)

- a. Earnings per share, i.e., EPS pre-issue for the last three years (as adjusted for changes in capital);
- b. P/E pre-issue and comparison thereof with industry P/E where available (giving the source from which industry P/E has been taken);
- c. Average return on net worth in the last three years;
- d. Minimum return on the increased net worth required to maintain pre-issue EPS;
- e. Net Asset Value per share based on last balance sheet;
- f. Net Asset Value per share after issue and comparison thereof with the issue price.

Provided that projective earnings shall not be used as a justification for the issue price in the offer document.

- (ii) The accounting ratios disclosed in the offer document in support of basis of the issue price shall be calculated after giving effect to the consequent increase of capital on account of compulsory conversions outstanding, as well as on the assumption that the options outstanding, if any, to subscribe for additional capital will be exercised.

(b) Test Packs: Test pack is a technique to determine the correctness of the computer programming used to record transactions through the computer. Preparation of test pack requires a great deal of expertise. It may be prepared by the auditor himself with the help of the entity's staff or by the Internal Control department of the entity. Normally test packs are used where:

- (i) a significant part of the control system is embodied in the programme;
- (ii) there are gaps in audit trail making it difficult to trace output from input and to verify intermediate calculation; and
- (iii) the volume of records is large, so that it may be more economical and more effective to use test packs rather than to trace the transactions manually. The operations of a test pack involve following steps:

- (i) The auditor or the Internal Audit Department prepares a set of special data covering different types of transactions containing valid and invalid conditions.

- (ii) Data will include both that falling outside the control parameters (and printed out as an error or conception) and that falling within the parameters (and hence should be processed normally).
- (iii) The test data are seen on the clients' computer with the client's programme but under audit supervision.
- (iv) The results of the test data are also prepared separately, independent of the computer/programme, and are compared with the results obtained by running the programme through the computer.
- (v) If the results are identical, reliability of the computer programme is proved.

(C) Certificate for Special Purpose vs. Audit Report: A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. Government authorities may, under various statutes or notifications, require reports or certificates from auditors in support of statements or other information prepared by an enterprise. Reports or certificates on specific matters may also be required from auditors by an enterprise, for its own special purposes. These reports or certificates to specific requirements of the individual users is unlike a 'general purposes report' e.g. an auditor's report on financial statements which is intended for general use. A report, on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein, e.g., certification of export turnover, etc. On the other hand, when the reporting auditor gives the report, he is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill.

(d) Advantages of Cost Audit to Government: Cost auditor's approach is to ensure that the cost accounting plan is in consonance with the objectives set by the organisation and the system of accounting is geared towards the attainment of the objectives. A cost accounting system designed to exercise control over cost may be different from the one if the objective is to fix price. Accordingly, over a period of time particularly in view of administered pricing system the cost accounting becomes quite important. Some of the specific advantages which can be reaped by the Government are:

- (i) It helps in the fixation of selling prices of essential commodities and thereby avoiding undue profiteering.
- (ii) In the case of cost plus contracts of Government, it helps to fix the price at reasonable level.
- (iii) It enables the Government to focus the attention on inefficient units.

- (iv) It enables the Government to lay down policies in favour of protecting certain industries.
- (v) It facilitates the settlement of disputes brought to the Government.
- (vi) It creates healthy competition in the industry.

(e) Corporate Governance: Corporate governance is the system by which companies are directed and controlled by the management in the best interest of the shareholders and others ensuring greater transparency and better and timely financial reporting. The Board of Directors are responsible for governance of their companies. A number of reports and codes of corporate governance have been published internationally. The Securities and Exchange Board of India (SEBI) had set up a Committee under the Chairmanship of Shri Kumar Manglam Birla to formulate the code of corporate governance. Based on this report, SEBI has by circular in February 2000 directed stock exchanges to amend the Listing Agreement between them and the entities whose securities are listed on such stock exchanges and include a new Clause 49 in such Listing Agreement. Various clauses deal with composition of board, setting-up of audit committee including scope thereof, remuneration of directors, meetings of Board, contents of management discussions and analysis report, etc. Clause 49 also prescribes that there shall be a separate section on Corporate Governance in the annual reports of company, with a detailed compliance report on Corporate Governance. Non compliance of any mandatory requirement i.e. which is part of the listing agreement with reasons there of and the extent to which the non-mandatory requirements have been adopted, should be specifically highlighted. Further, the entity is required to obtain a certificate from the statutory auditor of the entity as regards compliance of conditions of corporate governance as stipulated in that clause.

(f) Responsibility of Joint Auditors: AAS-12 on, “Responsibility of Joint Auditors” deals with the professional responsibilities which the auditors undertake in accepting such appointments as joint auditors. The responsibilities of joint auditors, as a rule are no different from the responsibilities of individual auditors as enumerated in the Companies Act, 1956. Main features of the said AAS are discussed below:

Division of Work: Where joint auditors are appointed, they should, by mutual discussion, divide the audit of identifiable units or specified areas. Certain areas of work, owing to their importance or owing to the nature of work involved would not be divided and would be covered by all the joint auditors. Such a division affected by the joint auditors should be adequately documented and preferably communicated to the auditee. **Coordination:** Where in the course of his work, a joint auditor comes across matters which are relevant to the areas of other joint auditors and which require joint discussion, he should communicate the same to all the other joint auditors in writing before the finalisation of audit and preparation of audit report. In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:

- (a) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
- (b) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors.
- (c) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (d) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and
- (e) for ensuring that the audit report complies with the requirements of the relevant statute.
- (f) It is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit.
- (g) The responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors.
- (h) Each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

Normally, the joint auditors are able to arrive at an agreed report. However where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report. A joint auditor is not bound by the views of majority of joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

Question Nos.1, 2 and 3 are compulsory

Answer any Four from the rest of the questions.

1. Answer any **two** of the following: **(6+6=12 Marks)**

- a) The Board of Directors of M/s ABC Tech Limited, registered in Mumbai, proposes to hold the next board meeting in Oct 2007. They seek your advice in respect of the following matters:
- (i) Can the Board Meeting be held in Bangalore, when all the Directors of the company reside at Mumbai?
 - (ii) Whether the Board Meeting can be called on a public holiday and that too after business hours as the majority of the directors of the Company have gone to Chennai on vacation?
 - (iii) Is it necessary that the notice of the Board Meeting should specify the nature of business to be transacted?
- b) What are the powers to be exercised at the board meeting with unanimous consent of the directors?
- c) Briefly list out the situations and transactions for which the provisions of Section 372A shall not apply.

2. Answer any **two** of the following: **(6+6=12 Marks)**

- a. Draft a resolution proposed to be passed at the General Meeting of a Public Company giving consent for investments in excess of the limits laid down under section 372A of the Companies Act.
- b. Explain in brief the method of disclosure of interest by a Director as per section 299 of the Companies Act, 1956.
- c. Explain the provisions of section 215 of the Companies Act, 1956 with respect to authentication of Balance Sheet and Profit and Loss Account

3 Answer any **two** of the following: **(6+6=12 Marks)**

- a. Examine with reference to the provisions of the Companies Act, 1956, the validity/legality of the following:

A meeting of the Board of Directors of ABC Co.Ltd., due to be held on 31.12.2007 did not take place for want of quorum. As a result, the company did not hold any Board meeting for the quarter ended 31.12.2007 and there is a complaint that the company has violated the provisions of the Act in this regard.

- b. Draft a resolution proposed to be passed at a meeting of the Board of Directors of a public company for the constitution and appointment of remuneration committee in accordance with Schedule XIII to the Companies Act, 1956.

- c. List out in brief the circumstances in which the company may be wound up by the court
4. Explain briefly the procedure for passing of resolution by circulation? **(16 Marks)**
5. X is a Director of a Private Limited Company. Please advise him the procedure for obtaining the Director's Identification Number(DIN) and the mode of intimation of his DIN to the Company. **(16 Marks)**
6. a. Which are the intermediaries involved in an issue?
- b. What are lock in requirements for and also in excess of a minimum specified contribution for promoters in public issues? **(8+8=16 Marks)**
7. a. Briefly enumerate the procedure to be followed by the transferee company to carry out the scheme of amalgamation **(16 Marks)**
8. Explain the provisions of Section 198 with regard to maximum managerial remuneration payable to Directors. **(16 Marks)**
9. Explain the provisions of Section 300 of the Companies Act, 1956. **(16 Marks)**
10. Can majority of shareholders apply to the court for relief against oppression by the minority shareholders? If so, when? **(16 Marks)**
11. Explain the procedure for removal of a Director together with relevant case laws. **(16 Marks)**

PRIME ACADEMY
28th SESSION MODEL EXAM
CORPORATE LAWS AND SECRETARIAL PRACTICE
SUGGESTED ANSWERS

1 a)

- (i) There is no statutory provision restricting the company from holding a board meeting at a place other than the place where the Registered Office is situated. As long as the statutory provisions such as signing of register of contracts in which directors are interested have been complied with the company can hold the meeting anywhere, including Bangalore. The fact that all the Directors reside in Mumbai is not relevant.
- (ii) A Board Meeting can be held even on a public holiday after business hours.
- (iii) It is not necessary to specify the nature of business or the agenda, to be transacted unless the articles stipulate.

1 b)

The following powers are to be exercised at a board meeting only with the consent of all directors present and entitled to vote at the meeting-

- (i) Appointment of a Managing Director who is already a Managing Director or Manager of another Company (Sec.316).
- (ii) Appointment of a Manager who is already a Managing Director or Manager of another Company (Sec.386).
- (iii) To make loans and investments or giving guarantees or provide security in connection with loans to other bodies corporate (Sec.372A)

1 c)

Sub section (8) of section 372A provides that the conditions of section 372A shall not apply in the following situations and the transactions of making of loans or investments, giving of guarantee and providing security which are outside the provisions of section 372A of the Act are as under:—

- (a) any loan made, any guarantee given, or any security provided, or any investment made by:
 - (i) a banking company, or an insurance company, or a housing finance company in the ordinary course of its business, or a company established with the object of financing industrial enterprises, or of providing infrastructure facilities;
 - (ii) a company whose principal business is the acquisition of shares, stocks, debenture or other securities;
 - (iii) a private company unless it is a subsidiary of a public company.
- (b) to investment made in shares allotted in pursuance of clause (a) of sub-section (1) of section 81 of the Companies Act, 1956;
- (c) to any loan made by a holding company to its wholly owned subsidiary;
- (d) to any guarantee given or security provided by a holding company in respect of a loan made to its wholly-owned subsidiary;
- (e) to acquisition by a holding company, by way of subscription, purchase or otherwise, the securities of its wholly owned subsidiary.

2 a)

The special resolution for investments in excess of the limits under section 372A of the Companies Act, 1956 to be passed in a General Meeting is as follows-

RESOLVED THAT pursuant to section 372A and other applicable provisions, if any, of the Companies Act, 1956, the consent of the members of the Company be and is hereby granted to make an investment of a sum not exceeding Rs.100 Lacs in M/s ABC Ltd., notwithstanding that such investment or such investment together with the company's existing investment in all other bodies corporate shall be in excess of the limits prescribed under section 372A of the Act and the Board of directors of the Company be and is hereby authorised to determine the actual sum to be so invested and all matters arising out of or incidental to the proposed investment and to do all such acts and things as may be necessary to implement this resolution.

2 b)

Section 299(3) deals with the mode of disclosure.

A general notice given to the Board by a director, to the effect that he is a director or a member of a specified body corporate or is a member of a specified firm and is to be regarded as concerned or interested in any contract or arrangement which may, after the date of the notice, be entered into with that body corporate or firm, shall be deemed to be a sufficient disclosure of concern or interest in relation to any contract or arrangement so made.

Following are the important aspects in this regard:—

- (i) *Contents of general disclosure.*—The notice shall specify the following details which he furnishes to the Board of directors of the concerned company:—
 - (a) He is a director of a specified body corporate(s).
 - (b) He is a member of a specified body corporate(s).
 - (c) He is a member of a specified firm. This also includes member of HUF, sole proprietary or charitable concern.
 - (d) He has indirect interest as he is interested through his relatives in specified body corporate(s) or firm.
- (ii) *Validity of general notice.*—Any such general notice shall expire at the end of the financial year in which it is given, but may be renewed for further period of one financial year at a time, by a fresh notice given in the last month of the financial year in which it would otherwise expire. [Section 299(3)(b)]
- (iii) *Giving or reading of general notice at Board meeting.*—Section 299(3)(c) provides that no general notice as described under section 299(3)(a), and no renewal thereof, shall be of effect unless either it is given at a meeting of the Board, or the director concerned takes reasonable steps to secure that it is brought upon and read at the first meeting of the Board after it is given.
- (iv) *Include details of relatives' interest.*—It is the responsibility of a director to disclose the nature of interest of his relatives, if any.
- (v) *Form for disclosure.*—It should be made in the prescribed Form 24AA.

2 c)

Provisions of section 215 relating to authentication of balance sheet and profit and loss account applies to all companies.

Section 215(3) stipulates that the balance sheet and profit and loss account shall be approved by the Board of directors before they are signed on behalf of the Board and before they are submitted to the auditors for their report thereon. It has been clarified by the Department *vide* letter No. 8/22/(215)/76-CL-V, dated 27-10-1976 that the Board of directors as a whole must consider the annual accounts and approve them before the same are handed over to the statutory auditors. The powers of the Board cannot be delegated to a committee of directors or to only some of the directors.

In the case of a company other than a banking company, every balance sheet and every profit and loss account of a company shall be signed on behalf of the Board of directors

by its manager or secretary, if any, and

by not less than two directors of the company one of whom shall be a managing director where there is one.

However, in the case of a non-banking company, when only one of its directors is for the time being in India, the balance sheet and the profit and loss account shall be signed by such director; but in such a case there shall be attached to the balance sheet and the profit and loss account, a statement signed by him explaining the reasons for non-compliance with the provisions of section 215(1).

In the case of a banking company, every balance sheet and every profit and loss account of a company shall be signed on behalf of the Board of directors by the persons specified in clause (a) or clause (b), as the case may be, of section 29(2) of the Banking Companies Act, 1949.

3 a)

As per Section 288 (2), if a meeting of the Board called in compliance with section 285 could not be held for want of quorum, the provisions of section 285 shall not be deemed to have been contravened. In view of this, the complaint that M/s ABC Co. Ltd has violated the provisions of the Companies Act, 1956 is not maintainable.

3 b)

The Board resolution for constituting a remuneration committee is as follows:

RESOLVED THAT pursuant to the provisions of Schedule XIII and other applicable provisions, if any, of the Companies Act, 1956, the Board hereby constitute and appoint a Committee of the Board of directors, named as 'REMUNERATION COMMITTEE' consisting of the following directors of the company:

COMMITTEE MEMBERS:

S. No.	Name	Designation	Position in Committee
1.	Shri MNQ	Director	Chairman
2.	Shri ACK	Director	Member
3.	Shri GHI	Director	Member

FURTHER RESOLVED THAT the Remuneration Committee shall have powers to act in accordance with the Schedule XIII to the Companies Act, 1956.

3 c)

Section 433 provides that a company may be wound up by the High Court/Tribunal,—

- (a) if the company has by special resolution resolved that the company be wound up by the Court/Tribunal;
- (b) if default is made in delivering the statutory report to the Registrar or in holding the statutory meeting;
- (c) if the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;
- (d) if the number of members is reduced, in the case of a public company, below seven, and in the case of a private company, below two;
- (e) if the company is unable to pay its debts;
- (f) if the Court/Tribunal is of the opinion that it is just and equitable that the company should be wound up;
- (g) if the company has made a default in filing with the Registrar, its balance sheet and profit and loss account or annual return for any five consecutive financial years;
- (h) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
- (i) if the Court/Tribunal is of the opinion that the company should be wound up under the circumstances specified in section 424G:

Provided that the Court/Tribunal shall make an order for winding up of a company under clause (h) on an application made by the Central Government or State Government.

4

Section 289 of the Companies Act provides for passing of resolution by circulation.

The provisions are as follows:

- a. The draft of the Board resolution is to be circulated, together with the necessary papers, to all the directors or members of the committee in India (not to be less than the quorum for the meeting) and to all other directors at their usual address in India
- b. The resolution is to be approved by
Such of the directors in India
Or
Majority of the directors entitled to vote on the resolution

The words “entitled to vote on the resolution” would imply that the votes of interested directors may not be considered as valid.

- c. The resolution shall be deemed to have been passed by the board or by the committee thereof by circulation.
- d Any resolution other than those required to be passed only at the Board Meetings can be passed by circulation
- e. However, this does not dispense with the need for holding a meeting once in every 3 months
- f. The resolution has to be incorporated in the minutes of the next Board meeting

5 The procedure to be followed by Mr. X, the Director of a private limited company, being the applicant, for obtaining Director's Identification Number (DIN) is as under:

(i) The Director, being the applicant is required to click and open the Form DIN-1 on-line on the portal www.mca.gov.in and fill-up various particulars such as Full name with Surname, father's name and present and permanent residential address. Please ensure that you do not use any abbreviations or initials in the case of name;

(ii) Click on the '**Submit**' function and the system would automatically generate a provisional DIN in the space provided for in this form;

(iii) Thereafter, the applicant is required to take a print-out of the two-page form, affix his photograph in the space provided, manually sign the undertaking at the end, enclose copies of the proof of identity and the proof of residence with the application form and get the requisite certifications from any of the authorities specified therein;

(iv) On completion of Step (iii) above, the applicant is required to send these papers by post to the Central DIN Processing Cell.

(v) The application is examined and processed in the DIN Processing Cell. After it is found to be in order, a DIN approval letter is generated and dispatched under Postal Certificate to the applicant at the address given by him in the application form. The 'provisional' status of DIN is converted into a regular DIN and activated in the system.

The Director shall intimate his approved DIN to the Company/ies in which he is a Director in the following manner-

- (i) The Director, to whom a DIN is allotted, is required to inform the companies, on which one is a Director, about the Director Identification Number allotted to him/her in Form DIN-2 within a period of one month of allotment of the DIN.
- (ii) The companies, thereafter, are required to inform the Director Identification Numbers of the Directors on their Company Board to the Registrar of Companies in Form DIN-3 within a period of seven days after receipt of information to this effect from the Directors. This information is to be sent by the companies to the ROCs on-line in a paperless mode.

6 a)

Intermediaries which are registered with SEBI are Merchant Bankers to the issue (known as Book Running Lead Managers (BRLM) in case of book built public issues), Registrars to the issue, Bankers to the issue & Underwriters to the issue who are associated with the issue for different activities. Their addresses, telephone/fax numbers, registration number, and contact person and email addresses are disclosed in the offer documents.

(i) **Merchant Banker:** Merchant banker does the due diligence to prepare the offer document which contains all the details about the company. They are also responsible for ensuring compliance with the legal formalities in the entire issue process and for marketing of the issue.

(ii) **Registrars to the Issue:** They are involved in finalizing the basis of allotment in an issue and for sending refunds, allotment etc.

(iii) **Bankers to the Issue:** The Bankers to the Issue enable the movement of funds in the issue process and therefore enable the registrars to finalize the basis of allotment by making clear funds status available to the Registrars.

(iv) **Underwriters:** Underwriters are intermediaries who undertake to subscribe to the securities offered by the company in case these are not fully subscribed by the public, in case of an underwritten issue.

6 b)

Lock in of Minimum Specified Promoters' Contribution in Public Issues.

In case of any issue of capital to the public the minimum promoters' contribution shall be locked in for a period of 3 years.

The lock-in shall start from the date of allotment in the proposed public issue and the last date of the lock-in shall be reckoned as three years from the date of commencement of commercial production or the date of allotment in the public issue whichever is later.

The expression "Date of commencement of commercial production" means the last date of the month in which commercial production in a manufacturing company is expected to commence as stated in the offer document

Lock-in of Excess Promoters' Contribution

In case of a public issue by unlisted company, if the promoters' contribution in the proposed issue exceeds the required minimum contribution, such excess contribution shall also be locked in for a period of one year.

In case of a public issue by a listed company, participation by promoters in the proposed public issue in excess of the required minimum percentage shall also be locked-in for a period of one year.

Provided that excess promoters' contribution shall not be subject to lock-in, in the case of listed company, which is listed on a stock exchange for a period of 3 years and has a track record of dividend payment for atleast 3 immediately preceding three years but the same is subject to the clause 4.10 of the SEBI guidelines.

In case shortfall in the firm allotment category is met by the promoter, such subscription shall be locked in for a period of one year.

7

The following is the procedure to be followed by the transferee company to carry out the scheme of amalgamation

- a. Check up whether the Memorandum of Association contains the power to amalgamate in its objects clause. If not, then carry out the proceedings to alter the same.
- b. Prepare the draft scheme including the exchange ratio and get it approved by the Board of Directors.
- c. Apply to the court for directions to convene the General Meeting by way of Judge's Summons supported by an affidavit.
- d. The notice of General Meeting shall also be sent by the company without waiting for the High Court, along with a statement setting forth the terms of the compromise or arrangement and explaining its effect and in particular stating any material interests of the directors, managing director or manager of the company, whether in their capacity as such or as members or creditors of the company or otherwise and the effect on those interests of the amalgamation, if and in so far as it is different from the effect on the like interests of other persons.
- e. In case of debentureholders rights being affected by amalgamation, the said statement to give like information and explanation regarding the trustees under the deed.

- f. Hold the general meeting and pass the resolution approving the draft scheme of amalgamation subject to the confirmation of the high court, resolution to be passed by a majority in number representing 3/4th in value of the members.
- g. Move the High Court for approval of the scheme and for the purpose to supply it with material facts as required by the proviso to section 391(2).
- h. On receipt of the court's order, to file the certified copy thereof with the registrar within 30 days after the making of the order in order to make it effective.
- i. After filing a copy of the order to be annexed to every copy of the Memorandum of Association.
- j. Proceed on effecting the scheme of amalgamation as per the approved scheme and directions given by the High Court by issuing suitable notices to shareholders and to allot shares and take over the business as per the scheme.

8

The provisions of Section 198 of the Companies Act, 1956 with regard to maximum managerial remuneration payable to directors are as follows:

The total managerial remuneration payable by a public company or a private company which is a subsidiary of a public company, to its directors and its manager in respect of any financial year shall not exceed eleven per cent of the net profits of that company for that financial year computed in the manner laid down in sections 349 and 350, except that the remuneration of the directors shall not be deducted from the gross profits.

The percentage aforesaid shall be exclusive of any fees payable to directors under sub-section (2) of section 309.

Within the limits of the maximum remuneration specified in sub-section (1), a company may pay a monthly remuneration to its managing or whole-time director in accordance with the provisions of section 309 or to its manager in accordance with the provisions of section 387.

Notwithstanding anything contained in sub-sections (1) to (3), but subject to the provisions of section 269, read with Schedule XIII, if, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including any managing or whole-time director or manager, by way of remuneration any sum exclusive of any fees payable to directors under sub-section (2) of section 309, except with the previous approval of the Central Government.

For the purposes of this section and sections 309, 310, 311, 381 and 387, "remuneration" shall include,—

- (a) any expenditure incurred by the company in providing any rent-free accommodation, or any other benefit or amenity in respect of accommodation free of charge, to any of the persons specified in sub-section (1);
- (b) any expenditure incurred by the company in providing any other benefit or amenity free of charge or at a concessional rate to any of the persons aforesaid;
- (c) any expenditure incurred by the company in respect of any obligation or service, which, but for such expenditure by the company, would have been incurred by any of the persons aforesaid; and
- (d) any expenditure incurred by the company to effect any insurance on the life of, or to provide any pension, annuity or gratuity for, any of the persons aforesaid or his spouse or child.

9.

The provisions of section 300 of the Companies Act, 1956 are as follows:

As per Section 300 (1) of the Companies Act, 1956, no director of a company shall, as a director, take any part in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, if he is in any way, whether directly or indirectly, concerned or interested in the contract or arrangement; nor shall his presence count for the purpose of forming a quorum at the time of any such discussion or vote; and if he does vote, his vote shall be void.

The above provision shall not apply to—

- (a) a private company which is neither a subsidiary nor a holding company of a public company;
- (b) a private company which is a subsidiary of a public company, in respect of any contract or arrangement entered into, or to be entered into, by the private company with the holding company thereof;
- (c) any contract of indemnity against any loss which the directors, or any one or more of them, may suffer by reason of becoming or being sureties or a surety for the company;
- (d) any contract or arrangement entered into or to be entered into with a public company, or a private company which is a subsidiary of a public company, in which the interest of the director aforesaid⁵⁸ [consists solely—
 - (i) in his being a director of such company and the holder of not more than shares of such number or value therein as is requisite to qualify him for appointment as a director thereof, he having been nominated as such director by the company referred to in sub-section (1), or
 - (ii) in his being a member holding not more than two per cent of its paid-up share capital;]
- (e) a public company, or a private company which is a subsidiary of a public company, in respect of which a notification is issued under sub-section (3), to the extent specified in the notification.

Case Law: Madras Tube Co. Ltd vs Hari Krishan Somani

XY Limited has four directors. At one of its convened Board meeting only two of them attended and they appointed two additional directors who were their relatives.

In the present situation, Madras High Court held that since only two out of four directors had attended the meeting and were related to the two persons who were appointed as additional directors, they will be treated as interested directors, even though the appointment as director does not come within the scope of the expression "contract" because the position of director may be conferred on a person by a method other than contract. Therefore the appointments were a nullity.

In the case of a public company or a private company which is a subsidiary of a public company, if the Central Government is of opinion that having regard to the desirability of establishing or promoting any industry, business or trade, it would not be in the public interest to apply all or any of the prohibitions contained in sub-section (1) to the company, the Central Government may, by notification in the Official Gazette, direct that that sub-section shall not apply to such company, or shall apply thereto subject to such exceptions, modifications and conditions as may be specified in the notification.

Every director who knowingly contravenes the provisions of this section shall be punishable with fine which may extend to fifty thousand rupees

10.

(1) A majority of shareholders can also apply for relief under section 397 as the section uses the words “any members”.

As per section 399(1) of the Companies Act, 1956, the following members of a company shall have the right to apply under section 397 or 398 of the Act:—

- (a) in the case of a company having a share capital, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one-tenth of the issued share capital of the company, provided that the applicant or applicants have paid all calls and other sums due on their shares;
- (b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.

For the purposes of sub-section (1), where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

Where any members of a company are entitled to make an application in virtue of sub-section (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.

The Central Government may, if in its opinion circumstances exist which make it just and equitable so to do, authorise any member or members of the company to apply to the Tribunal under section 397 or 398, notwithstanding that the requirements of clause (a) or clause (b), as the case may be, of sub-section (1) are not fulfilled.

The Central Government may, before authorising any member or members as aforesaid, require such member or members to give security for such amount as the Central Government may deem reasonable, for the payment of any costs which the Tribunal dealing with the application may order such member or members to pay to any other person or persons who are parties to the application

The persons referred above can apply to the Tribunal in the following circumstances

Any members of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members (including any one or more of themselves) may apply to the Tribunal for an order under this section.

(2) If, on any application under sub-section (1), the Tribunal is of opinion—

- (a) that the company's affairs are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members; and
- (b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up;

The Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

11. Procedure for removal of a Director:

A special notice of resolution for removal of a director shall be served on the company at least 14 days before the meeting exclusive of the day on which it is served and the day of the meeting.

When a special notice of resolution is properly served on a company, a copy thereof shall forthwith be sent to the director concerned as required u/s 284(3).

Any omission to serve a special notice on the directors sought to be removed constitutes denial of their statutory right of reply and in the absence of such notice to the directors, any resolution for their removal would be vitiated by such omission. [*S. Varadarajan v Udhayem Leasings & Investments P. Ltd.* (2005) 62 SCL 315 (CLB - Chennai)].

The director concerned shall be entitled to be heard on the resolution at the meeting. Company shall send a copy of representation to every member thereof.

Where the representations could not be sent by the company because it was received too late or because of the company's default, the director may require that the representations shall be read out at the meeting.

The representation need not be sent to members nor read at the meeting, if the Central Government is satisfied that the rights conferred by this section are being abused to secure needless publicity for defamatory matter; and the Central Government may order at the company's costs on the application to be paid by the director concerned.

Where the resolution for the removal of a director is passed at the general meeting, the meeting may appoint another person in place of the director removed if special notice for appointment of some other person has also been served on the company. A director so appointed shall hold office if he had not been removed as aforesaid.

If another person is not appointed at the said meeting, the Board may fill the vacancy as a casual vacancy as per section 262 at a meeting of the Board. However, the director so removed shall not be re-appointed by the Board.

In *Vinod Kumar Mittal V Kaveri Lime Industries Ltd*, the Director concerned made misleading complaints against the company, due to which the company's premises were subject to raids. Once the authorities found that the company was not guilty, the shareholders were entitled to remove the director.