PAPER – 1 : ADVANCED ACCOUNTING

QUESTIONS

Valuation of Shares

1. The balance sheet of Major Ltd. has been given to you for the purpose of valuation of shares:

Balance Sheet of Major Ltd. as on 31st December, 2009

Liabilities	Rs.	Rs.		Rs.
Share Capital:			Fixed Assets:	
Equity Shares of Rs.10 each	5,00,000		Goodwill	50,000
			Machinery	2,30,000
Less: Call in arrear			Factory shed	3,00,000
(Rs.2 on final call)	10,000	4,90,000	Vehicles	60,000
8% preference shares of			Furniture	25,000
Rs.10 each, fully paid		2,00,000	Investments	1,00,000
Reserve and Surplus:			Current Assets:	
General Reserve		2,00,000	Stock in trade	2,10,000
Profit and Loss Account		1,40,000	Sundry Debtors	3,50,000
Current Liabilities:			Cash at Bank	50,000
Bank Loan		1,00,000	Preliminary Expenses	25,000
Sundry Creditors		2,70,000		
		14,00,000		14,00,000

Additional Information:

1. Fixed Assets are worth 20% above their actual book value. Depreciation on appreciated value of fixed assets to be ignored for valuation of goodwill.
2. Of the investments 80% is non-trading and the balance is trading. All trade investments are to be valued at 20% below cost. A uniform rate of dividend of 10% is earned on all investments.
3. For the purpose of valuation of shares, Goodwill is to be considered on the basis of 4 years' purchase of the super-profits based on average profit of the last 3 years. Profits are as follows:

	Rs.
2007	1,90,000
2008	2,00,000
2009	2,10,000

In a similar business return on capital employed is 15%. In 2007 new furniture costing Rs.10,000 was purchased but wrongly charged to revenue. (No effect has been yet been given for rectifying the same). Depreciation is charged on furniture @ 10%. Find out the value of each fully-paid and partly-paid equity share, assuming tax rate of 50%.

Valuation of Goodwill

2. The Balance Sheets of X Ltd. are as follows:

		(Rs. in lakhs)
Liabilities	As at 31.3.2006	As at 31.3.2007
Share Capital	1,000.0	1,000.0
General Reserve	800.0	850.0
Profit and Loss Account	120.0	175.0
Term Loans	370.0	330.0
Sundry Creditors	70.0	90.0
Provision for Tax	22.5	25.0
Proposed Dividend	200.0	250.0
	2,582.5	2,720.0
Assets		
Fixed Assets and Investments (Non-trade)	1,600.0	1,800.0
Stock	550.0	600.0
Debtors	340.0	220.0
Cash and Bank	92.5	100.0
	2,582.5	2,720.0

Other Information:

1. Current cost of fixed assets excluding non-trade investments on 31.3.2006 Rs. 2,200 lakhs and on 31.3.2007 Rs. 2,532.8 lakhs.
2. Current cost of stock on 31.3.2006 Rs. 670 lakhs and on 31.3.2007 Rs. 750 lakhs.
3. Non-trade investments in 10% government securities Rs. 490 lakhs.
4. Debtors include foreign exchange debtors amounting to $ 70,000 recorded at the rate of $ 1 = Rs. 17.50 but the closing exchange rate was $ 1 = Rs. 21.50.
5. Creditors include foreign exchange creditors amounting to $ 1,20,000 recorded at the rate of $ 1 = Rs. 16.50 but the closing exchange rate was $ 1 = Rs. 21.50.
6. Profit included Rs. 120 lakhs being government subsidy which is not likely to recur.
7. Rs. 247 lakhs being the last instalment of R and D cost were written off the profit and loss account. This expenditure is not likely to recur.
8. Tax rate during 2006-07 was 50% effective future tax rate is estimated at 40%.
9. Normal rate of return is expected at 15%.

Based on the information furnished, Mr. Iral, a director contends that the company does not have any goodwill. Examine his contention.

Valuation of Business

3. Xeta Ltd. plans to take over Beta Ltd. Independent Cash Flow forecasts of both companies are as follows:

Year	1	2	3	4	5
Xeta Ltd. (Rs. In lakhs)	2,00	2,25	2,50	2,70	2,85
Beta Ltd. (Rs. In lakhs)	50	65	80	95	110

Year	6	7	8	9	10
Xeta Ltd. (Rs. In lakhs)	3,10	3,50	6,00	6,10	6,50
Beta Ltd. (Rs. In lakhs)	1,20	1,30	1,50	1,70	1,80

Following further information is available from the latest Balance Sheet of Beta Ltd.

Assets:		Rs. in lakhs
Fixed Assets		5,00
Stock		1,15
Debtors		50
		6,65
Less: Liabilities		
Sundry creditors	1,65	
Long term loan	2,00	(3,65)
Net assets		3,00

Xeta Ltd. finds that fixed assets of book value Rs.75 lakhs will not be used which will fetch Rs.50 lakhs on immediate disposal. Moreover, stock will fetch Rs.140 lakhs and debtors Rs.48 lakhs immediately. But Xeta Ltd. has to payoff the liabilities immediately. Also it has to pay Rs.110 lakhs to workers of Beta Ltd. whose service cannot be used. It appears that after merger Xeta Ltd. has to invest Rs.210 lakhs for renovation of the plant and machinery at the end of 1st year and Rs.50 lakhs for modernization at the end of 2nd year after merger.

Forecast of cash flows of Xeta Ltd. after merger.

Year	1	2	3	4	5
Cash flows (Rs. In lakhs)	2,40	2,80	3,50	4,00	4,10

Year	6	7	8	9	10
Cash flows (Rs. In lakhs)	4,80	5,50	8,00	8,80	9,50

Determine the maximum value of Beta Ltd. which its management should ask from Xeta Ltd. You may use 20% discount rate.

Acquisition of Business

4. A company was incorporated on 1st July, 2008 to take over the business of Mr. M as and from 1st April, 2008. Mr. M's Balance Sheet, as at that date was as under:

Liabilities	Rs.	Assets	Rs.
Trade Creditors	36,000	Building	80,000
Capital	1,94,000	Furniture and Fittings	10,000
		Debtors	90,000
		Stock	30,000
		Bank	20,000
	2,30,000		2,30,000

Debtors and Bank balances are to be retained by the vendor and creditors are to be paid off by him. Realisation of debtors will be made by the company on a commission of 5% on cash collected. The company is to issue M with 10,000 equity shares of Rs.10 each, Rs.8 per share paid up and cash of Rs.56,000.

The company issued to the public for cash 20,000 equity shares of Rs.10 each on which by 31st March, 2009 Rs.8 per share was called and paid up except in the case of 1,000 shares on which the third call of Rs.2 per share had not been realized. In the case of 2,000 shares, the entire face value of the shares had been realized. The share issue was underwritten for 2% commission, payable in shares fully paid up.

In addition to the balances arising out of the above, the following were shown by the books of accounts of the company on 31st March, 2009:

	Rs.
Discount (including Rs.1,000 allowed on vendor's debtors)	6,000
Preliminary expenses	10,000
Directors' fees	12,000
Salaries	48,000
Debtors (including vendor's debtors)	1,60,000
Creditors	48,000
Purchases	3,20,000
Sales	4,60,000

Stock on 31st March, 2009 was Rs.52,000. Depreciation at 10% on Furniture and Fittings and at 5% on Building is to be provided. Collections from debtors belonging to the vendor were Rs.60,000 in the period.

Kindly prepare the Trading and Profit & Loss Account for the period ended 31st March, 2009 of the limited company and its Balance Sheet as at that date.

Internal Reconstruction of a Company

5. The following is the Balance Sheet as at 31st December, 2008 of Ginni Ltd.

Liabilities	Rs.	Assets	Rs.
Subscribed capital:		Fixed Assets (including goodwill of Rs.1,00,000)	10,80,000
3,000 Cumulative Preference shares of Rs.100 each fully paid up	3,00,000	Investments	20,000
		Stock in Trade	2,00,000
7,500 Equity share of Rs.100 each fully paid up	7,50,000	Trade Debtors	1,54,500
		Bank Balances	62,500
Securities Premium	12,000		
Preference Shares			
General Reserve	80,000		
Trade Creditors	3,75,000		
	15,17,000		15,17,000

Contingent liability:

Preference Dividends in arrears Rs.66,000.

The Board of Directors of the Company decided upon the following scheme of reconstructions:

(i) The preference shares are to be converted into 13% unsecured debentures of Rs.100 each in regard to 80% of the dues (including arrears of dividends) and for the balance equity shares of Rs.50 paid up would be issued. The authorized capital of the company permitted the issue of additional shares.

(ii) Equity shares would be reduced to share of Rs.50 each paid up.

(iii) All equity holders agree to pay the balance in cash.

(iv) Goodwill has lost its value and is to be written off fully. Investment are to reflect their market value of Rs.30,000. Obsolete items in stock of Rs.50,000 are to be written off. Bad debts to the extent of 5% of the total debtors would be provided for. Fixed assets to be written down by Rs.1,50,000.

The scheme was duly approved and put into effect.

The company carried on trading for six months and after writing off depreciation at 20% p.a. on the revised value of fixed assets, made a net profit of Rs.80,000. The half-yearly working resulted in an increase of Sunday Debtors by Rs.60,000. Stock by Rs.80,000 and cash by Rs.40,000.

Show the journal entries (without narration) necessary in the Company's books to give effect to the scheme and draw the Balance sheet as at 30th June, 2009.

6. Following are the Balance Sheet of companies as at 31.12.2008:

Liabilities	D Ltd.	V Ltd.	Assets	D Ltd.	V Ltd.
	Rs.	Rs.		Rs.	Rs.
Equity share capital			Goodwill	6,00,000	—
(Rs. 100)	8,00,000	6,00,000	Fixed Assets	5,00,000	8,00,000
General Reserve	4,00,000	3,00,000	Investments	2,00,000	4,00,000
Investment Allowance			Current Assets	4,00,000	3,00,000
Reserve	—	4,00,000			
Sundry Creditors	5,00,000	2,00,000			
	17,00,000	15,00,000		17,00,000	15,00,000

D Ltd. took over V Ltd. on the basis of the respective shares value, adjusting wherever necessary, the book values of assets and liabilities on the basis of the following information:

(i) Investment Allowance Reserve was in respect of addition made to fixed assets by V Ltd. in the year 2002- 2007 on which income tax relief has been obtained. In terms of the Income Tax Act, 1961, the company has to carry forward till 2011 reserve of Rs. 2,00,000 for utilization.

(ii) Investments of V Ltd. included 1,000 shares in D Ltd. acquired at cost of Rs. 150 per share. The other investments of V Ltd. have a market value of Rs. 1,92,500.

(iii) The market value of investments of D Ltd. are to be taken at Rs. 1,00,000.

(iv) Goodwill of D Ltd. and V Ltd. are to be taken at Rs. 5,00,000 and Rs. 1,00,000 respectively.

(v) Fixed assets of D Ltd. and V Ltd. are valued at Rs. 6,00,000 and Rs. 8,50,000 respectively.

(vi) Current assets of D Ltd. included Rs. 80,000 of stock in trade received from V Ltd. at cost plus 25%.

The above scheme has been duly adopted. Pass necessary Journal Entries in the books of D Ltd. and prepare Balance Sheet of D Ltd. after taking over the business of V Ltd. Fractional share to be settled in cash, rest in shares of D Ltd. Calculation shall be made to the nearest multiple of a rupee.

7. Astha Ltd. acquired 80% of both classes of shares in Birat Ltd. on 1.4.2007. The draft Balance Sheets of two companies on 31st March, 2008 were as follows:

(Rs. in 000's)

Liabilities	Astha Ltd.	Birat Ltd.	Assets	Astha Ltd.	Birat Ltd.
Share Capital:					
Equity shares of Rs.10 each, full paid up	3,000	600	Plant & machinery	2,060	600
14% Preference shares of Rs.100 each, fully paid up	-	400	Furniture & fixtures	600	540
General reserve	1,900	40	Investments in equity shares of Birat Ltd.	1,920	-
Profit and loss account	1,600	720	in preference shares of Birat Ltd.	320	-
Creditors	300	320	Stock	680	404
			Debtors	560	316
			Cash at bank	660	220
	6,800	2,080		6,800	2,080

Note:

Contingent liability – Astha Ltd.: Claim for damages lodged by a contractor against the company pending in a law-suit – Rs.1,55,000.

Additional Information:

(i) General reserve balance of Birat Ltd. was the same as on 1.4.2007.

(ii) The balance in Profit and Loss A/c of Birat Ltd. on 1.4.2007 was Rs.3,20,000, out of which dividend of 16% p.a. on the Equity capital of Rs.6,00,000 was paid for the year 2006-07.

(iii) The dividend in respect of preference shares of Birat Ltd. for the year 2007-08 was still payable as on 31.3.2008.

(iv) Astha Ltd. credited its Profit and Loss A/c for the dividend received by it from Birat Ltd. for the year 2006-07.

(v) Sundry creditors of Astha Ltd. included an amount of Rs.1,20,000 for purchases from Birat Ltd., on which the later company made a loss of Rs.10,000.

(vi) Half of the above goods were still with the closing stock of Astha Ltd. as at 31.3.2008.

(vii) At the time of acquisition by Astha Ltd., while determining the price to be paid for the shares in Birat Ltd. it was considered that the value of plant and machinery was to be increased by 25% and that of furniture and fixtures reduced to 80%. There was no transaction of purchase or sale of these assets during the year. The directors wish to give effect to these revaluations in the consolidated balance sheet.

(viii) The directors of Astha Ltd. are of opinion that disclosure of its contingent liability will seriously prejudice the company's position in dispute with the contractor.

Prepare consolidated balance sheet as at 31st March, 2008, assuming the rate of depreciation charged as 25% p.a. and 10% p.a. on plant and machinery and furniture and fixtures respectively. Workings should be part of the answer.

Corporate Restructuring

8. The Balance Sheet of Z Ltd. as at 31st March, 2008 is given below. In it, the respective shares of the company's two divisions namely S Division and W Division in the various assets and liabilities have also been shown.

(All amounts in crores of Rupees)

	S Division	W Division	Total
Fixed Assets:			
Cost	875	249	
Less: Depreciation	360	81	
Written-down value	515	168	683
Investments			97
Net Current assets:			
Current Assets	445	585	
Less: Current Liabilities	270	93	
	175	492	667
			1,447
Financed by:			
Loan funds		15	417
Own funds:			
Equity share capital: shares of Rs. 10 each			345
Reserves and surplus			685
			1,447

Loan funds included, inter alia, Bank Loans of Rs. 15 crore specifically taken for W Division and Debentures of the paid up value of Rs. 125 crore redeemable at any time between 1st October, 2007 and 30th September, 2008.

On 1st April, 2008 the company sold all of its investments for Rs. 102 crore and redeemed all the debentures at par, the cash transactions being recorded in the Bank Account pertaining to S Division.

Then a new company named Y Ltd. was incorporated with an authorized capital of Rs. 900 crore divided into shares of Rs. 10 each. All the assets and liabilities pertaining to W Division were transferred to the newly formed company; Y Ltd. allotting to Z Ltd.'s shareholders its two fully paid equity shares of Rs. 10 each at par for every fully paid equity share of Rs. 10 each held in Z Ltd. as discharge of consideration for the division taken over.

Y Ltd. recorded in its books the fixed assets at Rs. 218 crore and all other assets and liabilities at the same values at which they appeared in the books of Z Ltd.

You are required to:

(i) Show the journal entries in the books of Z Ltd.

(ii) Prepare Z Ltd.'s Balance Sheet immediately after the demerger and the initial Balance Sheet of Y Ltd. (Schedules in both cases need not be prepared).

Buy-back of Securities

9. The Balance Sheet of Gunshot Ltd. as on 31.3.2008 is given :

(Rs. in '000)

Liabilities	Amount	Fixed Assets	Amount
Share Capital :		Fixed Assets	2,700
Equity shares of Rs. 10 each	800	Non-trade Investments	300
Securities Premium	100	Stock	600
General Reserve	780	Sundry Debtors	360
Profit and Loss Account	120	Cash and Bank	160
10% Debenture	2,000		
Creditors	320		
	4,120		4,120

Gunshot Ltd. buy back 16,000 shares of Rs. 20 per share. For this purpose, the Company sold its all non-trade investments for Rs. 3,20,000. Give Journal Entries with full narrations affecting the buy back.

Value Added Statement

10. (a) What are the advantages of preparation of Value Added (VA) statements? Explain in brief.

(b) The following are the balances in the accounts statements of Addition Ltd. for the year, 2008:

	Rs. in lakhs		Rs. in lakhs
Turnover	2,300	Printing and Stationery	22
Loss on Sale of Machinery	75	Auditor's Remuneration	28
Depreciation on Plant and Machinery	200	Retained Profits (Opening Balance)	994
Dividend to Ordinary Shareholders	146	Retained Profits for the year	288
Debtors	200	Rent, Rates and Taxes	165
Creditors	127	Other Expenses	85
Total Stock of all materials, W.I.P. and finished goods		Ordinary Share Capital issued	1,500
Opening Stock	160	Interest on Borrowings	40
Closing Stock	200	Income Tax for the year	276
Raw Materials purchased	625	Wages and Salaries	327
PF Contribution	28	Employees State Insurance	35

Prepare a value added statement for the company for 2008.

Economic Value Added

11. (a) What is economic value added and how is it calculated? Discuss.

(b) From the following information of Vinod Ltd., compute the economic value added:

Share capital	Rs.2,000 lakhs
Reserve and surplus	Rs.4,000 lakhs
Long-term debt	Rs.400 lakhs
Tax rate	30%
Risk free rate	9%
Market rate of return	16%
Interest	Rs.40 lakhs
Beta factor	1.05
Profit before interest and tax	Rs.2,000 lakhs

Human Resource Accounting

12. (a) Describe the progress made by India so far in the field of human resource accounting.

(b) Why Human Resources Asset is not recognized in the Balance sheet?

Corporate Social Reporting

13. From the following information taken from the books of Srishti Ltd. relating to staff and community benefits, you are required to prepare a statement classifying the various items under the appropriate heads, required under corporate social reporting:

Particulars	Rs. in lakhs
Environmental improvements	36.18
Medical facilities	9.00
Training programmes	18.45
Generation of job opportunities	109.35
Municipal taxes	19.26
Increase in cost of living in the vicinity due to company's operations	29.79
Concessional transport, water-supply etc.	20.25
Generation of business	45.00
Leave encashment and leave travel benefits	93.60
Education facilities for children of staff members	38.88
Subsidised canteen facilities	25.92
Extra work put in by staff and officers for drought relief	33.30

Financial Reporting of Financial Institutions

14. (a) Explain "Non-Performing Assets" as per NBFC Prudential Norms (RBI) directions.
    (b) What do you mean by "Net asset value" (NAV) in case of mutual fund units?
15. (a) Write short note on Capital adequacy requirements of merchant bankers.
    (b) Write short note on Books of account required to be maintained by a Stock Broker.

Accounting for Not-for-profit Organizations

16. The Annuity fund of Punjab University accepts an annuity – based gift from an alumnus who specifies that he receives a monthly payment of Rs.25,000 for the remainder of his life. The gift consists of cash of Rs.20 lakh and securities having a market value of Rs.15 lakh at the time of the gift. The investment income of annuity fund for a particular month comes to Rs.38,500.

    Draft journal entries in the University's books.

Indian AS, IFRS and US GAAPs

17. State the treatment of the following items with reference to Indian Accounting Standards and IFRS:
    (i) Discontinued operations – definition and measurement
    (ii) Acquired intangible assets.

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

    If XYZ is a partnership firm is there any other exemptions additionally available.

    (b) What criteria is applied for rating an enterprise as Level II enterprise for the purpose of compliance of Accounting Standards in India?

    (c) If a sale and lease back transaction results in an operating lease, what provisions will be applicable? Describe in line with AS 19.

    (d) A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known. Is it a liability?

19. Write short notes on :

    (i) NACAS.

    (ii) Impairment of asset and its application to inventory.

    (iii) Treatment of borrowing costs.

    (iv) Accounting for investment by a holding company in subsidiaries.

    (v) Concept of Cost v/s Fair value with reference to Indian Accounting Standards.

    (vi) Restatement of shares as per AS 20.

    (vii) Provisions of AS 26 relating to retirement and disposal of intangible assets.

    (viii) Change in accounting estimates.

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

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

The company's contentions in this matter are:

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

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

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer.

(iii) Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 2007 for Rs.60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 2007-08 the carrying amount was Rs.41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch Rs.36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of Rs.54 crore per annum and has a carrying amount of Rs.3.46 crore. All such machines put together could fetch a sum of Rs.4.44 crore if disposed. Discuss the applicability of Impairment loss.

(iv) A manufacturing company purchased shares of another company from stock exchange on 1st May, 2007 at a cost of Rs.5,00,000. It also purchased Gold of Rs.2,00,000 and Silver of Rs.1,50,000 on 1st April, 2005. How will you treat these investments as per the applicable AS in the books of the company for the year ended on 31st March, 2008, if the values of these investments are as follows:

	Rs.
Shares	2,00,000
Gold	4,00,000
Silver	2,50,000

21. (i) Rainbow Limited borrowed an amount of Rs.150 crores on 1.4.2008 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized Rs.19.50 crores for the accounting period ending on 31.3.2009. Due to surplus fund out of Rs.150 crores, an income of Rs.3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

(ii) Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2006, 2007 and 2008 for Rs.11,00,000, Rs.16,00,000 and Rs.21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of Rs.7,00,000, Rs.18,00,000 and Rs.23,00,000 for the years 2006, 2007 and 2008 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 2006, 2007 and 2008.

(iii) B Ltd. undertook a construction contract for Rs. 50 crores in April, 2007. the cost of construction was initially estimated at Rs. 35 crores. The contract is to be completed in 3 years. While executing the contract, the company estimated the cost of completion of the contract at Rs. 53 crores.

Can the company provide for the expected loss in the book of account for the year ended 31st March, 2008?

(iv) The Board of Directors of X Ltd. decided on 31.3.2007 to increase sale price of certain items of goods sold retrospectively from 1st January, 2007. As a result of this decision the company has to receive Rs.5 lakhs from its customers in respect of sales made from 1.1.2007 to 31.3.2007. But the Company's Accountant was reluctant to make-up his mind. You are asked to offer your suggestion.

22. From the following information, prepare cash flow statement as at 31st December, 2008 by using indirect method according to AS 3:

Balance Sheets

Liabilities	2007	2008	Assets	2007	2008
Share Capital	5,00,000	5,00,000	Fixed Assets	8,50,000	10,00,000
Profit & Loss A/c	4,25,000	5,00,000	Stock	3,40,000	3,50,000
Long Term Loans	5,00,000	5,30,000	Debtors	3,60,000	3,30,000
Creditors	1,75,000	2,00,000	Cash	30,000	35,000
			Bills Receivable	20,000	15,000
	16,00,000	17,30,000		16,00,000	17,30,000

Income Statement for the year ended 31st December, 2008

Sales		20,40,000
Less:	Cost of Sales	13,60,000
Gross Profit		6,80,000
Less:	Operating Expenses:	
	Administrative Expenses	(2,30,000)
	Depreciation	(1,10,000)

Operating Profit		3,40,000
Add:	Non-Operating Incomes (dividend received)	25,000
		3,65,000
Less:	Interest Paid	(70,000)
		2,95,000
Less:	Income Tax	1,30,000
Profit after Tax		1,65,000

Statement of Retained Earnings

Opening Balance		4,25,000
Add:	Profit	1,65,000
		5,90,000
Less:	Dividend paid	90,000
Closing Balance		5,00,000

23. (i) A Ltd. had 6,00,000 equity shares on April 1, 2007. The company earned a profit of Rs.15,00,000 during the year 2007-08. The average fair value per share during 2007-08 was Rs.25. The company has given share option to its employees of 1,00,000 equity shares at option price of Rs.15. Calculate basic EPS and diluted EPS.

(ii) A Ltd., owns 30% of the equity capital of B Ltd. B Ltd. in turn owns 35% of equity capital C Ltd., and 40% of equity capital in D Ltd. You are required to answer the following questions.

(a) Whether B Ltd. is a related party to A Ltd?

(b) Whether C Ltd., is a related party to A Ltd.?

(c) Whether C Ltd. and D Ltd. are related parties?

(iii) A limited company has set up its business in a designated backward area and is entitled to a capital subsidy of 15% under a scheme in force. Accordingly, it received a subsidy of Rs.30 lakhs on an investment of Rs.200 lakhs in the unit. The accountant would like to treat of Rs.30 lakhs on an investment of Rs.200 lakhs in the unit. The accountant would like to treat it as income and reduce the losses made in the first year of its operations ending with 31st March, 2009. You are asked to advise the accountant, whether his view is in conformity with AS 12.

(iv) Induga Company has at its financial year ended 31st March, 2009 fifteen law suits outstanding none of the which has been settled by the time the accounts are approved by the directors. The directors have estimated that the possible outcomes as below:

Result	Probability	Amount of loss
	0.6	-
For first ten cases:		
Lose-low damages	0.3	90,000
Lose-high damages	0.1	1,60,000
For remaining five cases:		
Win	0.5	-
Lose-low damages	0.3	60,000
Lose-high damages	0.2	95,000

The directors believe that the outcome of each case is independent of the outcome of all the others.

Estimate the amount of contingent loss and state the accounting treatment of such contingent loss

24. (i) Amigo Mutual Fund Ltd. is a SEBI Registered mutual fund. The Company follows the practice of valuing its investments on "mark to market basis". For the financial year ended March, 2009 the investments which were acquired at a cost of Rs.109 crores were reflected in the Balance Sheet at Rs.89 crore. The company insists that the depreciation in value of the investments need not be disclosed separately in its financial statements since its investment valuation policy is disclosed as part of its accounting policies. Discuss the validity of this argument.

(ii) A company has given counter guarantees of Rs. 2.25 crores to various banks in respect of the guarantees given by the said banks in favour of Government authorities. Outstanding counter guarantees as at the end of financial year 2007-2008 were Rs. 1.95 crores. How should this information be shown in the Financial Statements of the Company.

25. (i) Choice Ltd. grants 100 stock options to each of its 1,000 employees on 1.4.2005 for Rs.20 depending upon the employees at the time of vesting of options. The market price of the share is Rs.50. The options will vest at the end of year 1 if the earning of Choice Ltd. increases 16% or it will vest at the end of the year 2 if the average earning of two years increases by 13% or lastly it will vest at the end of the third year if the average earning of 3 years will increase by 10%. 5,000 unvested options lapsed on 31.3.2006, 4,000 unvested options lapsed on 31.3.2007 and finally 3,500 unvested options lapsed on 31.3.2008.

Following is the earning of Choice Ltd. :

Year	Earning (in %)
Year 1	14%
Year 2	10%
Year 3	7%

850 employees exercised their vested options within a year and remaining options were unexercised at the end of the contractual life. Pass Journal entries for the above.

(ii) Parikshit Ltd. holds Rs.1,00,000 of loans yielding 18 per cent interest per annum for their estimated lives of 9 years. The fair value of these loans, after considering the interest yield, is estimated at Rs.1,10,000.

The company securitises the principal component of the loan plus the right to receive interest at 14% to Susovana Corporation, a special purpose vehicle, for Rs.1,00,000.

Out of the balance interest of 4 percent, it is stipulated that half of such balance interest, namely 2 per cent, will be due to Parikshit Ltd. as fees for continuing to service the loans. The fair value of the servicing asset so created is estimated at Rs.3,500. the remaining half of the interest is due to Parikshit Ltd. as an interest strip receivable, the fair value of which is estimated at Rs.6,500.

Give the accounting treatment of the above transactions in the form of journal entries in the books of originator.

SUGGESTED ANSWERS/HINTS

1.

(i)

Capital Employed on 31.12.2009	Rs.	Rs.
Machinery		2,30,000
Factory Shed		3,00,000
Vehicles		60,000
Furniture (25,000+7,290)		32,290
		6,22,290
Add: 20%		1,24,458
		7,46,748
Trade Investments		16,000
Stock in Trade		2,10,000
Sundry Debtors		3,50,000
Cash at Bank		50,000
		13,72,748
Less:		
Bank Loan	1,00,000	
Sundry Creditors	2,70,000	3,70,000
		10,02,748

(ii) Average profits for the last three years

	2007	2008	2009
	Rs.	Rs.	Rs.
Reported Profit (taking the figures given in the question as profit after tax)	1,90,000	2,00,000	2,10,000
Add: furniture purchased charged to revenue (net of tax)	5,000	-	-
	1,95,000	2,00,000	2,10,000
Less: Depreciation on furniture purchased (net of tax)	500	450	405
	1,94,500	1,99,550	2,09,595
Less: Dividend on non-trading investments less tax	4,000	4,000	4,000
	1,90,500	1,95,550	2,05,595
Average Profit			1,97,215

(iii) Calculation of Super Profits

		Rs.
Capital employed		10,02,748
Average profit		1,97,215
Normal profit @ 15% on capital employed		1,50,412
Super profit		46,803
Goodwill at four years' purchase		1,87,212
Valuation of Equity Shares		Rs.
Value of Net Tangible Assets [Refer (i)]		10,02,748
Add Goodwill [Refer (iii)]		1,87,212
Add Non-trade investments		80,000
Add Notional Calls		10,000
		12,79,960
Less: Preference Share Capital		2,00,000
		10,79,960
No. of shares	50,000	
Intrinsic value of fully paid share		Rs.21.60
Intrinsic value of partly paid share (Rs.21.60-2.00)		Rs.19.60

2.

(Rs. in lakhs)

(1) Average Capital employed

	As at 31.3.2006	As at 31.3.2007
Current cost of fixed assets other than non trade investments	2,200.0	2,532.8
Current cost of stock	670.0	750.0
Debtors	340.0	222.8
Cash and Bank	92.5	100.0
	3,302.5	3,605.6
Less: Outside Liabilities:		
Term loans	370.0	330.0
Sundry creditors	70.0	96.0
Tax provision	22.5	25.0
	462.5	451.0
Capital Employed	2,840.0	3,154.6
Average Capital Employed at current value = $\frac{2,840.0+3,154.6}{2}=$		2,997.3

(2) Future maintainable profit

Increase in General Reserve		50
Increase in Profit and Loss Account		55
Proposed Dividend		250
Profit after tax		355
Pre-tax profit = $\frac{355}{1-0.5}$		710.00
Less: Non-trading income	49.00	
Exchange loss on creditors [1.2 lakhs × (21.5 – 16.5)]	6.00	
Subsidy	120.00	175.00
		535.00
Add: Exchange gain on debtors [0.7 lakhs × (21.5 – 17.5)]	2.80	
R & D costs	247.00	
Stock adjustment	30.00	279.80
Adjusted pre-tax profit		814.80
Less: Tax @ 40%		325.92
Future maintainable profit		488.88

Valuation of Goodwill

		(Rs. in lakhs)
(1)	Capitalisation Method	
	Capitalised value of future maintainable profit $\left(\frac{488.88}{0.15}\right)$	3,259.20
	Less: Average Capital Employed	2,997.30
	Goodwill	261.90
(2)	Super Profit Method	
	Future Maintainable Profit	488.88
	Normal Profit @ 15% on average capital employed	449.60
	Goodwill	39.28

Under capitalisation method, the amount of goodwill is larger than the amount of goodwill computed under super profit method. In either case, the existence of Goodwill cannot be doubted. The director's view cannot, therefore, be upheld.

Working Notes:

		(Rs. in lakhs)
(1)	Stock adjustment	
	Difference between current cost and historical cost of closing stock	150.00
	Difference between current cost and historical cost of opening stock	120.00
		30.00
(2)	Debtors' adjustment	
	Value of foreign exchange debtors at the closing exchange rate ($ 70,000 × 21.5)	15.05
	Value of foreign exchange debtors at the original exchange rate ($ 70,000 × 17.5)	12.25
		2.80
(3)	Creditors' adjustment	
	Foreign exchange creditors at the closing exchange rate ($ 1,20,000 × 21.5)	25.80
	Foreign exchange creditors at the original exchange rate ($ 1,20,000 × 16.5)	19.80
		6.00

3. Maximum value to be quoted

	Particulars		Rs. in Lakhs	Rs. in Lakhs
a.	Value of merged entities as per discounted cashflows (W.N.1)			502.38
b.	Add: Cash to be collected immediately on disposal of assets			
	i.	Fixed assets	50.00	
	ii.	Stock	140.00	

	iii.	Debtors	48.00	238.00
c.	Less:			
	i.	Sundry creditors	165.00	
	ii.	Long term loan	200.00	
	iii.	Compensation to workers	110.00	
	iv.	Renovation of plant and machinery (210×0.8333) [PV]	174.99	
	v.	Modernisation of Plant and machinery (50 x 0.6944)	34.72	(684.71)
d.	Maximum value to be quoted (a+b-c)			55.67

So, Beta Ltd. can quote as high as Rs.55,67,000 for take over.

Working Note:

Valuation of Xeta Ltd. in case of merger

Year	Cash flow after merger	Cash flow of Xeta Ltd. before merger	Incremental cash flow	Discount factor @ 20%	Discounted cash flow
(1)	(2)	(3)	(4)= (2)-(3)	(5)	(6) = (4) ×(5)
1	240	200	40	0.8333	33.33
2	280	225	55	0.6944	38.19
3	350	250	100	0.5787	57.87
4	400	270	130	0.4823	62.70
5	410	285	125	0.4019	50.24
6	480	310	170	0.3349	56.93
7	550	350	200	0.2791	55.82
8	800	600	200	0.2326	46.52
9	880	610	270	0.1938	52.33
10	950	650	300	0.1615	48.45
					502.38

4. Trading and Profit and Loss Account for the year ended 31.03.09

Dr.					Cr.
		Rs.			Rs.
To	Opening Stock	30,000	By	Sales	4,60,000
To	Purchases	3.20.000	By	Closing Stock	52,000
To	Gross Profit c/d	1,62,000			
		5,12,000			5,12,000

		Pre-Incorporation Rs.	Post-Incorporation Rs.			Pre-Incorporation Rs.	Post-Incorporation Rs.
To	Salaries	12,000	36,000	By	Gross Profit c/d	40,500	1,21,500
To	Directors' fee	-	12,000	By	Commission	-	3,000
To	Discount	1,250	3,750				
To	Depreciation:						
	Building	1,000	3,000				
	Furniture	250	750				
To	Pre-incorporation Profit transferred to Capital Reserve Account	26,000	-				
To	Net Profit	-	69,000				
		40,500	1,24,500			40,500	1,24,500

Note: Apportionment has been made in the Profit and Loss Account between pre-incorporation and post-incorporation period using the following basis.

Item	Base	Ratio
Gross Profit	Time	1 : 3
Salaries	Time	1 : 3
Discount	Time	1 : 3
Directors' Fees		100% to post-incorporation period
Commission		100% to post-incorporation period

Balance Sheet as on 31.3.2009

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital:			Fixed Assets		
30,000 equity shares of Rs.10 each Rs.8 called up	2,40,000		Building	80,000	
			Less: Depreciation	4,000	76,000

Less: Calls in Arrear (of the above 10,000 shares are allotted pursuant to a contract without payments being received in cash)	2,000	2,38,000			
Share Suspense A/c (400 shares to be issued to the underwriter in consideration of under-writing commission on completion of share issue)		4,000	Furniture & Fittings	10,000	
			Less: Depreciation	1,000	9,000
			Investments		Nil
Reserves and Surplus			Current Assets, Loans and Advances		
Capital Reserve	26,000		(A) Current Assets:		
Less: Goodwill w/o	16,000	10,000	Stock	52,000	
Profit & Loss A/c		69,000	Debtors	1,31,000	
Secured Loans		Nil	Cash	91,000	2,74,000
Unsecured loans		Nil	(B) Loans and Advances		Nil
Current Liabilities and Provisions			Miscellaneous Expenditure		
(A) Current Liabilities:			Preliminary Expenses	10,000	
Sundry Creditors	48,000		Underwriting Commission	4,000	14,000
Calls in Advance	4,000	52,000			
(B) Provisions		Nil			
		3,73,000			3,73,000

Working Notes:

(1) Goodwill on acquisition

		Rs.	Rs.
Purchase consideration:			
10,000 equity shares of Rs.10 Rs.8 paid up			80,000
Cash			56,000
			1,36,000
Less:	Assets taken over		
	Building	80,000	
	Furniture and Fittings	10,000	
	Stock	30,000	1,20,000
Goodwill			16,000

(2) Cash Inflows from public issue of equity shares

		Rs.
20,000 equity shares of Rs.10 each Rs.8 called up		1,60,000
Less:	Calls in arrear on 1,000 shares @ Rs.2 per share	2,000
		1,58,000
Add:	Calls-in-advance on 2000 shares @ Rs.2	4,000
		1,62,000

(3) Underwriting Commission 2% on face value Rs.2,00,000 4,000

Underwriting Commission becomes due on completion of the job relating to shares underwritten. It appears that the job relating to public issue was not finished till 31st March, 2009. So a Share Suspense Account should be created showing the amount of shares to be issued to the underwriter in discharge of his claim for commission

(4) Cash collection from Company's debtors

Total Debtors Account

Dr.		Vendor's Debtors	Company's Debtors			Vendor's Debtors	Company's Debtors
		Rs.	Rs.			Rs.	Rs.
To	Balance b/d	90,000	-	By	Discount	1,000	5,000

To	Sales		4,60,000	By	Cash	60,000	[1]3,24,000
				By	Balance c/d	29,000	[2]1,31,000
		90,000	4,60,000			90,000	4,60,000

Note: Assumed that all sales were on credit.

(5) Cash payment for purchases

Dr.					Cr.
		Rs.			Rs.
To	Cash (Balancing figure)	2,72,000	By	Purchases	3,20,000
To	Balance c/d	48,000			
		3,20,000			3,20,000

Note: Assumed that all purchases were on credit

(6) Summary Cash Book

Dr.					Cr.
		Rs.			Rs.
To	Share Capital A/c	1,62,000	By	Total Creditors A/c:	
To	Total Debtors A/c:			Payment to creditors	2,72,000
	Collection from company's debtors	3,24,000	By	Vendor's A/c:	
	Collection from vendor's debtors	60,000		Purchase consideration	56,000
			By	Preliminary Expenses	10,000
			By	Directors' Fees	12,000
			By	Salaries	48,000
			By	Vendor's A/c (Collection less commission Rs.3,000)	57,000
			By	Balance c/d	91,000
		5,46,000			5,46,000

[1] Balancing figure.

[2] Total Debtors Rs.1,60,000 minus Vendor's Debtors Rs.29,000

5. In the books of Ginni Ltd.

Journal Entries

		Debit Rs.	Credit Rs.
Cumulative Preference Share Capital A/c	Dr.	3,00,000	
Capital Reduction A/c	Dr.	66,000	
To Cumulative Preference Shareholders A/c			3,66,000
(Being the cumulative preference shares & arrear dividend transferred to cumulative preference shareholders account in accordance with the resolution of the Board dated……..)			
Cumulative Preference Shareholders A/c	Dr.	3,66,000	
To 13% unsecured debentures A/c			2,92,800
To Equity Share Capital A/c			73,200
(Being the issue of 13% unsecured debentures and 1,464 Equity shares of Rs.100 each issued as Rs.50 paid up as per the Board's resolution dated….)			
Equity Share Capital A/c	Dr.	3,75,000	
To Capital Reduction A/c			3,75,000
(Being the entry for reducing every share of Rs.100 each as Rs.50 paid up 7,500 Equity shares @ 50 per share as per the Board resolution dated….)			
Cash A/c	Dr.	4,48,200	
To Equity Share Capital A/c			4,48,200
(Being the receipt of Cash of Rs.50 each for 8964 being the call made as per Boards resolution dated…..)			
Investments A/c	Dr.	10,000	
Capital Reduction (Balancing figure)	Dr.	2,97,725	
To Goodwill A/c			1,00,000
To Stock A/c			50,000
To Fixed Assets A/c			1,50,000
To Provision for doubtful Debts A/c			7,725
(Being the change in value of assets as per the resolution of the Board dated…..)			
Capital Reduction A/c	Dr.	11,275	
To Capital Reserve A/c			11,275
(Being the transfer of Capital Reduction A/c balance to Capital Reserve)			

Ginni Ltd.

Balance Sheet as at 30th June, 2009

Liabilities	Rs.	Assets	Rs.	Rs.
Subscribed Capital		Fixed Assets	8,30,000	
8,964 Equity Shares of Rs.100 each	8,96,400	Less: depreciation	83,000	7,47,000
		Investments		30,000
Securities premium	12,000			
Capital Reserve	11,275	Stock in Trade		2,30,000
General Reserve	80,000	Trade Debtors	2,14,500	
Profit and Loss A/c	80,000	Less: Provision for Doubtful debts	7,725	2,06,775
13% unsecured debentures	2,92,800	Bank Balance		5,50,700
Trade Creditors	3,92,000			
	17,64,475			17,64,475

Working Notes:

1.	No. of equity shares issued to cumulative preference shareholders	1,464
	No. of shares held by Equity shareholders	7,500
	Total	8,964

		Rs.
2.	Opening Balance on 31.12.2008	62,500
	Add: Calls on shares @ 50 per share (8,964 × Rs.50 per share)	4,48,200
	Balance on implementation of the scheme	5,10,700
	Add: Change in cash balance (as given in the question)	(+)40,000
		5,50,700
3.	Creditors Balance = Balancing figure	
	Alternative approach: Profit & Loss upto 30.6.2009	80,000
	Add: Depreciation (non cash item)	83,000
	Cash from operations	(A)1,63,000
	Change in Current Assets:	
	Debtors	(+)60,000
	Stock	(+)80,000

Cash Balance	(+)40,000
Cash Outflow	(B)1,80,000
Increase in creditors	
Excess of (B) over (A)	17,000
Add: Opening Balance	3,75,000
	3,92,000

6. Journal Entries in the Books of D Ltd.

		Dr. Amount Rs.	Cr. Amount Rs.
Business Purchase Account	Dr.	12,42,500	
To Liquidator of V Ltd.			12,42,500
(For purchase consideration due)			
Investments Account	Dr.	1,92,500	
Goodwill Account (Balancing figure)	Dr.	1,00,000	
Fixed Assets Account	Dr.	8,50,000	
Current Assets Account	Dr.	3,00,000	
To Sundry Creditors Account			2,00,000
To Business Purchase Account			12,42,500
(For assets and liabilities taken over at agreed value)			
Liquidator of V Ltd.	Dr.	12,42,500	
To Equity Share Capital Account (Rs. 100)			9,03,600
To Securities Premium Account (Rs. 37.50)			3,38,850
To Cash Account			50
(For purchase consideration discharged)			
Goodwill Account	Dr.	16,000	
To Current Assets (Stock) Account			16,000
(For elimination of unrealized profit on unsold stock)			
Amalgamation Adjustment Account	Dr.	2,00,000	
To Investment Allowance Reserve Account			2,00,000
(For incorporation of statutory reserve)			

Balance Sheet of D Ltd. as on 31st December, 2008

Liabilities	Amount Rs.	Assets	Amount Rs.
Equity Share Capital:		Fixed Assets	
17,036 shares of Rs. 100 each (out of which 9036 shares are issued in favour of vendor for consideration other than cash)	17,03,600	(5,00,000 + 8,50,000)	13,50,000
		Goodwill (6,00,000 + 1,00,000 + 16,000)	7,16,000
		Investments	
General Reserve	4,00,000	(2,00,000 + 1,92,500)	3,92,500
Securities Premium	3,38,850	Current Assets	
Investment Allowance Reserve	2,00,000	(7,00,000 – 50 – 16,000)	6,83,950
Sundry Creditors	7,00,000	Amalgamation Adjustment Account	2,00,000
	33,42,450		33,42,450

Working Notes:

1. Calculation of net asset value of shares

	D Ltd. Rs.	V Ltd. Rs.
Goodwill	5,00,000	1,00,000
Fixed Assets	6,00,000	8,50,000
Investments	1,00,000	3,30,000*
Current Assets	4,00,000	3,00,000
	16,00,000	15,80,000
Less: Sundry Creditors	5,00,000	2,00,000
Net assets	11,00,000	13,80,000
Number of shares	8,000	6,000
Value per equity share	137.50	230

*Investments of V Ltd. are calculated as follows:	Rs.
Shares in D Ltd. (1,000 × 137.50)	1,37,500
Market value of remaining investments (given)	1,92,500
	3,30,000

2. Calculation of Purchase Consideration

	Rs.
Net assets of V Ltd.	13,80,000
Value of Shares of D Ltd.	137.50
Number of shares to be issued in D Ltd. to V Ltd. (13,80,000 ÷ 137.50)	10,036.36
Less: Shares already held by V Ltd.	1,000
Additional shares to be issued	9,036.36
Total value of shares to be issued (9036 × 137.50)	12,42,450
Cash payment for fractional share (.36 × 137.50)	50
	12,42,500

7. Consolidated Balance Sheet of Astha Ltd. and its subsidiary Birat Ltd. as at 31st March 2008

(Rs. in '000s)

Liabilities		Amount	Assets		Amount
Share capital:			Goodwill (W.N.5)		1,088.0
3,00,000 Equity shares of			Plant and machinery		
Rs. 10 each fully paid up		3,000.0	Astha Ltd.	2,060.0	
Minority interest (W.N.4)		360.4	Birat Ltd. (W.N.7)	750.0	2,810.0
General reserves		1,900.0	Furniture and fixtures		
Profit and loss A/c (W.N.6)		1,894.6	Astha Ltd.	600.0	
Creditors			Birat Ltd. (W.N. 8)	432.0	1,032.0
Astha Ltd.	300.0		Stock		
Birat Ltd.	320.0		Astha Ltd.	680.0	
	620.0		Birat Ltd.	404.0	
Less: Mutual owings	120.0	500.0		1,084.0	
			Add: Unrealised loss	5.0	1,089.0
			Debtors		
			Astha Ltd.	560.0	
			Birat Ltd.	316.0	
				876.0	
			Less: Mutual owings	120.0	756.0
			Cash at Bank		
			Astha Ltd.	660.0	
			Birat Ltd.	220.0	880.0
		7,655.0			7,655.0

Contingent liability: Claim against damages lodged by a contractor against Astha Ltd. is pending in a law suit Rs. 155 thousands (W.N. 9).

Working Notes:

1. Calculation of capital profits (pre-acquisition)

		(Rs. in '000s)
General reserve balance as on 1-04-2007		40.0
Profit and loss account balance as on 1-04-2007	320.0	
Less: Dividend at 16% p.a. on Rs. 6,00,000 for the year 2006-07	96.0	224.0
		264.0
Add: Profit on revaluation of plant and machinery (W.N.7)		200.0
		464.0
Less: Loss on revaluation of furniture and fixtures (W.N.8)		120.0
		344.0
Share of Astha Ltd. (80%)		275.2
Share of Minority Interest (20%)		68.8

2. Calculation of revenue profits (post-acquisition)

	(Rs. in '000s)
Profits during the year 2007-08 (720.0 – 224.0)	496.0
Less: Preference dividend for the year 2007-08 @ 14% on Rs.4,00,000	56.0
	440.0
Less: Under charging of depreciation on plant and machinery due to upward revaluation (Rs.2,00,000 x 25%)	50.0
	390.0
Add: Overcharging of depreciation on furniture and fixtures due to downward revaluation (Rs.1,20,000 x 10%)	12.0
	402.0
Share of Astha Ltd. (80%)	321.6
Share of Minority Interest (20%)	80.4

3. Calculation of dividend on preference shares of Birat Ltd.

		(Rs. in '000s)
Dividend on preference shares (Rs. 4,00,000 x 14%)		56.0
Share of Astha Ltd.	(80%)	44.8
Share of Minority Interest	(20%)	11.2
		56.0

4. Calculation of Minority Interest

	(Rs. in '000s)
Equity share capital (20%)	120.0
Preference share capital (20%)	80.0
Share of capital profits (W.N. 1)	68.8
Share of Revenue profit (W.N.2)	80.4
Share of preference dividend (W.N.3)	11.2
	360.4

5. Calculation of Cost of Control - Goodwill

		(Rs. in '000s)
Investment by Astha Ltd. in		
Equity shares of Birat Ltd.	1,920.0	
Less: Dividend received for 2006-07 (600 x 80% 16%)	76.8	1,843.2
Preference shares		320.0
		2,163.2
Less:Paid up value of		
Equity shares (80%)	480.0	
Preference shares (80%)	320.0	
Share in Capital Profit (W.N. 1)	275.2	1,075.2
Goodwill		1,088.0

6. Calculation of Consolidated Profit and Loss Account

	(Rs. in '000s)
Balance in Profit and loss A/c of Astha Ltd. as on 1-04-2007	1,600.0
Add: Revenue profit from Birat Ltd (W.N. 2)	321.6
Preference dividend of Birat Ltd. (W.N. 3)	44.8
Share of unrealised loss on stock (Rs. 10,000 x 50%)	5.0
	1,971.4
Less:Dividend wrongly credited	76.8
	1,894.6

7. Value of Plant and Machinery of Birat Ltd.

	(Rs. in '000s)
Value as on 1.04.07 (600 x 100/75)	800.0
Add: Appreciation on revaluation (25%)	200.0
Revalued figure	1,000.00

Less: Depreciation			
Already charged (800-600)	200.0		
Due to upward revaluation (200 x 25%)	50.0		(250.0)
			750.0

8. Value of Furniture and Fixtures of Birat Ltd.

		(Rs. in '000s)
Value as on 1.4.2007 (540 x 100/90)		600.00
Less: Diminution on revaluation (20%)		(120.00)
Revalued Figure		480.0
Less: Depreciation already charged (600 - 540)	60.0	
Less: Depreciation written back due to downward revaluation (120 x 10%)	(12.0)	(48.0)
		432.0

9. Contingent liability:

As per para 68 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', "unless the possibility of any outflow in settlement is remote, an enterprise should disclose contingent liability at the balance sheet date along with a brief description of the nature of such contingent liability." Therefore, it would not be correct to ignore the contingent liability.

8. (i) In Z Ltd.'s Books

Journal Entries

(Rs. in crores)

		Dr. Amount Rs.	Cr. Amount Rs.
Bank Account (Current Assets)	Dr.	102	
To Investments			97
To Profit and Loss Account (Reserves and Surplus)			5
(Sale of investments at a profit of Rs. 5 crore)			
Debentures (Loan Funds)	Dr.	125	
To Bank Account (Current Assets)			125
(Redemption of debentures at par)			
Current Liabilities	Dr.	93	
Bank Loan (Loan Funds)	Dr.	15	

Provision for Depreciation	Dr.	81	
Reserves and Surplus (Loss on Demerger)	Dr.	645	
To Fixed Assets			249
To Current Assets			585
(Assets and liabilities pertaining to W Division taken out of the books on transfer of the division to Y Ltd.)			

(ii) (a) Z Ltd.'s Balance Sheet after demerger

	Rs. in crores	Rs. in crores
Fixed Assets		
Gross Block	875	
Less: Depreciation	360	515
Net Current Assets		
Current Assets	422	
Less: Current Liabilities	270	152
		667
Financed by		
Shareholders' Funds		
Equity Share Capital	345	
Reserves and Surplus	45	390
Loan Funds		277
		667

Working Notes:

		Rs. in crores	Rs. in crores
1.	Reserves and Surplus		
	Balance as on 31st March, 2008		685
	Add: Profit on sale of investments		5
			690
	Less: Loss on demerger		645
	Balance shown in balance sheet after demerger		45
2.	Loan Funds		
	Balance as on 31st March, 2008		417
	Less: Bank Loan transferred to Y Ltd.	15	
	Debentures redeemed	125	140
	Balance shown in balance sheet after demerger		277

3. Current Assets	
Balance as on 31st March, 2008	445
Add: Cash received from sale of investments	102
	547
Less: Cash paid to redeem debentures	125
Balance shown in balance sheet after demerger	422

(b) **Initial Balance Sheet of Y Ltd.**

	Rs. in crores	Rs. in crores
Fixed Assets		218
Net Current Assets		
Current Assets	585	
Less: Current Liabilities	93	492
		710
Financed by		
Shareholders' funds:		
Capital (Issued for acquisition of business)		690
Capital Reserve*		5
Loan Funds		15
		710

9. **Journal Entries for Buy-back of shares of Gun Shot Ltd.**

			Rs.	Rs.
(i)	Bank A/c	Dr.	3,20,000	
	To Non-trade Investments			3,00,000
	To Profit & Loss A/c			20,000
	(Being the entry for sale of Non-trade Investments)			
(ii)	Shares Buy back A/c (16,000 x Rs. 20)	Dr.	3,20,000	
	To Bank A/c			3,20,000
	(Being purchase of 16,000 shares @ Rs.20 per share)			

* Capital Reserve has been calculated as

		Rs. in crores
Purchase consideration		690
Less: Assets transferred	710	
Loan funds transferred	(-15)	695
Capital reserve		5

(iii)	Equity Share Capital A/c (16,000 x Rs.10)	Dr.	1,60,000	
	Buy-back Premium (16,000 x Rs.10)	Dr.	1,60,000	
	To Shares Buy-back A/c			3,20,000
	(Being cancellation of shares bought back)			
(iv)	Securities Premium A/c	Dr.	1,00,000	
	General Reserve	Dr.	60,000	
	To Buy-back Premium			1,60,000
	(Being adjustment of buy-back premium)			
(v)	General Reserve	Dr.	1,60,000	
	To Capital Redemption Reserve			1,60,000
	(Being the entry for transfer of General Reserve to Capital Redemption Reserve to the extent of face value of equity shares bought back)			

10. (a) Various advantages of preparation of Value Added (VA) Statements are as under:

1. Reporting on VA improves the attitude of employees towards their employing companies. This is because the VA statement reflects a broader view of the company's objectives and responsibilities.
2. VA statement makes it easier for the company to introduce a productivity linked bonus scheme for employees based on VA. The employees may be given productivity bonus on the basis of VA / Payroll Ratio.
3. VA based ratios (e.g. VA / Payroll, taxation / VA, VA / Sales etc.) are useful diagnostic and predictive tools. Trends in VA ratios, comparisons with other companies and international comparisons may be useful.
4. VA provides a very good measure of the size and importance of a company. To use sales figure or capital employed figures as a basis for company's rankings can cause distortion. This is because sales may be inflated by large bought-in expenses or a capital-intensive company with a few employees may appear to be more important than a highly skilled labour–intensive company.
5. VA statement links a company's financial accounts to national income. A company's VA indicates the company's contribution to national income.
6. VA statement is built on the basic conceptual foundations which are currently accepted in balance sheets and income statements. Concepts such as going concern, matching, consistency and substance over form are equally applicable to VA statement.

(b) Value Added Statement

			(Rs. in lakhs)
Turnover			2,300
Add:	Change in Finished Stock		
	(Closing Stock 200 – Opening Stock 160)		40
			2,340
Less:	Bought in Materials and Services:		
	Raw Materials Purchased	625	
	Printing and Stationery	22	
	Auditor's Remuneration	28	
	Rent, Rates and Taxes	165	
	Other Expenses	85	925
	Value Added		1,415
Disposals as follows:			
To	Employees:		
	Wages and Salaries	327	
	Employees State Insurance	35	
	PF Contribution	28	390
To	Providers of Capital:		
	Interest	40	
	Dividend	146	186
To	Government: Income Tax		276
To	Provide for Maintenance:		
	Loss on Sale of Machinery	75	
	Depreciation	200	
	Retained Earnings	288	563
			1,415

11. (a) Economic Value Added (EVA) is primarily a benchmark to measure earnings efficiency. EVA as a residual income measure of financial performance is simply the operating profit after tax less a charge for the capital employed, equity as well as debt, used in the business.

Mathematically EVA= OPBT – Tax – (TCE × COC)

Where:

OPBT = Opening Profit Before Tax

TCE = Total Capital Employed

COC = Cost of Control

Because EVA includes both profit and loss as well as balance sheet efficiency as well as the opportunity cost of investor capital - it is better linked to changes in shareholders wealth and is superior to traditional financial measures such as PAT or percentage of return measures such as ROCE or ROE.

EVA, additionally, is a tool for management to focus on the impact of their decisions in increasing shareholders wealth. These include both strategic decisions such as what investments to make, which business to exit, what financing structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make inhouse or outsource, repair or replace an equipment, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholders wealth is to integrate EVA framework in four key areas, viz., to measure business performance, to guide managerial decision making, to align managerial incentives with the shareholders' interests and to improve the financial and business literacy throughout the organisation.

(b) Vinod Limited

Computation of Economic Value Added

Economic Value Added	Rs. in Lakhs
Net Operating Profit after Tax (Refer Working Note 5)	1,372.00
Add: Interest on Long-term Fund (Refer Working Note 2)	28.00
	1,400.00
Less:Cost of Capital Rs. 6,400 lakhs × 15.77% (Refer working notes 3 and 4)	1,009. 28
Economic Value Added	390. 72

Working Notes:

1. Cost of Equity = Risk free Rate + Beta Factor (Market Rate – Risk Free Rate)

   9% + 1.05 (16 – 9) = 9% + 7.35% = 16.35%

2. Cost of Debt

Interest	Rs.40 lakhs
Less: Tax (30%)	Rs.12 lakhs
Interest after Tax	Rs.28 lakhs

   Cost of Debt = $\frac{28}{400} \times 100 = 7\%$

3. Weighted Average Cost of Capital

Cost of Equity	Rs. 6,000 lakhs × 16.35% (W.N.1)	Rs. 981 lakhs
Cost of Debt	Rs. 400 lakhs × 7% (W.N.2)	Rs. 28 lakhs
		Rs. 1009 lakhs

$$\text{WACC} = \frac{1,009}{6,400} = 15.77\% \qquad \text{(approx.)}$$

4. Capital Employed

	Rs. in Lakhs
Share Capital	2,000
Reserves + Surplus	4,000
Long-term Debts	400
	6,400

5. Net operating Profit after Tax

Profit before Interest + Tax	2,000
Interest	40
	1,960
Tax 30% on 1,960 Lakhs	588
Operating Profit after Tax	1,372

12. (a) Human resource accounting can be defined as the process of identifying, measuring and communicating 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). Indian Companies focused their attention on the present value of employee earning as a measure of their human capital. However the Indian Companies have suitably modified the Lev and Schwartz model to suit their individual circumstances.

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

13. Srishti Ltd.

Statement relating to Staff and Community Benefits

I.		Social benefits and cost to staff		Rs. In lakhs
	A.	Social Benefits to Staff		
		1.	Medical Facilities	9.00
		2.	Training Programmes	18.45
		3.	Concessional Transport and Later Supply	20.25
		4.	Leave Enchashments and Leave Travel Benefits	93.60
		5.	Educational Facilities for children of staff members	38.88
		6.	Subsidized canteen facilities	25.92
		Total		206.10
	B. Less:	Social costs to staff		
		Extra work put in by staff and officers for drought relief		33.30
		Net Social benefits to staff (A-B)		172.80
II.		Social benefits for cost to community		
	A.	Social Benefits to Community		
		1.	Environmental Improvements	36.18
		2.	Generation of Job Opportunities	109.35
		3.	Municipal Taxes	19.26
		4.	Generation of Business	45.00
		Total		209.79
	B. Less:	Social costs to community increase in cost of living in the vicinity due to company's operations		29.79
				180.00
		Total Net Social Benefits to staff and community (I +II)		352.80

14. (a) "Non–Performing Asset" as per NBFC Prudential Norms (RBI) directions means:

(i) An asset, in respect of which, interest has remained past due for six months;

(ii) A term loan inclusive of unpaid interest, when the instalment is overdue for more than six months of which interest amount remained past due for six months;

(iii) A bill which remained overdue for six months;

(iv) The interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/advances that remained overdue for a period of six months;

(v) Any dues on account of sales of assets or services rendered or reimbursement expenses made, which remained overdue for a period of six months;

(vi) The lease rental and hire purchase instalment, which has become overdue for a period of more than twelve months;

(vii) In respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities made available to borrower /beneficiary when anyone of the credit facilities becomes NPA.

However, an NBFC may classify each such account on the basis of record of recovery as regards hire purchase and lease transactions.

(b) Mutual funds sell their shares to public and redeem them at current net Assets Value (NAV) which is calculated as under:–

$$\frac{\text{Total market value of all Mutual Fund holdings - All Mutual Fund liabilities}}{\text{Unit size}}$$

The net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme. Simply stated, NAV is the value of the assets of each unit of the scheme, or even simpler value of one unit of the scheme. Thus, if the NAV is more than the face value (Rs. 10), it means your money has appreciated and vice versa. NAV also includes dividends, interest accruals and reduction of liabilities and expenses, besides market value of investments. NAV is the value of net assets under a mutual fund scheme. The NAV per unit is NAV of the scheme divided by number of units outstanding. NAV of a scheme keeps on changing with change in market value of portfolio under the scheme.

15. (a) Capital adequacy requirements have been specified by SEBI under the SEBI (Merchant Bankers) Regulations, 1992.

Regulation 7 specifies that the requirement of capital adequacy shall not be less than the net worth of the person making the application for grant of registration.

The specified net worth in this connection will be computed as under:

	Minimum requirement
Category I: Merchant bankers who carry on activity of the issue management, which will inter alia, consist of preparation of prospectus and other information relating to the issue, determining the financial structure, tie-up of financiers and final allotment and refund of subscriptions and act as advisor, consultant, manager, underwriter,	

portfolio manager etc.	Rs. 5 crores
Category II – Merchant bankers who act as advisor, consultant, co-manager, underwriter, portfolio manager	Rs.50 lakhs
Category III – Merchant bankers who act as underwriter, adviser, consultant to the issue.	Rs.20 lakhs
Category IV – Merchant bankers who act only as an advisor or consultant to the issue.	Nil

For the purposes of the regulation, a merchant banker has been defined as any person engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities is as manager, consultant, advisory or rendering corporate advising more in relation to issue management.

(b) Every stock broker is required to maintain the following books of account and records as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992:

(a) Register of transactions (Sauda book)/Daily transaction list;

(b) Clients ledger;

(c) General ledger;

(d) Journals;

(e) Cash book;

(f) Bank Pass Book;

(g) Documents register/Inward-outward register showing full particulars of shares and securities received and delivered;

(h) Members' contract book showing details of all contracts entered into by him with other members of the stock exchange or counterfoils or duplicates of memos of confirmation issued to such other members;

(i) Counterfoils or duplicates of contract notes issued to clients;

(j) Written consent of clients in respect of contracts entered into as principals;

(k) Margin deposit book;

(l) Register of accounts of sub-brokers;

(m) An agreement with a sub-broker specifying the scope of authority and responsibilities of the stock broker and such sub-brokers.

In addition to the above statutory requirements, stock brokers are also required to maintain scrip wise client wise list in respect of scripts of specified group, client upla statement, duplicate copies of self-certificates submitted on monthly basis, copies of margin statements downloaded by the stock exchange, copies of valan balance sheet (Form 31), details of spot delivery transactions, client data base and broker client agreement, copy of registration certificate of each sub-broker issued by SEBI, copies of the power of attorney/board resolution authorising directors and employees and copies of pool account statements.

16. Journal Entries

Particulars		L.F.	Debit Rs.	Credit Rs.
Bank A/c	Dr.		20,00,000	
Investments A/c	Dr.		15,00,000	
To Annuity Fund A/c				35,00,000
(Being receipt of annuity based gift in the form of cash and marketable securities)				
Bank A/c	Dr.		38,500	
To Annuities Payable A/c				25,000
To Annuity Fund A/c				13,500
(Being monthly investment income received from the fund and surplus accruing after meeting the annuity payable, transferred to the fund)				
Annuities Payable A/c	Dr.		25,000	
To Bank A/c				25,000
(Being monthly annuity payment made)				

17. Treatment under Indian Accounting Standard and IFRS

		Indian Accounting Standards	IFRS
(i)	Discontinuing operations - definition and measurement	Operations and cash flows that can be clearly distinguished for financial reporting and represent major line of business or geographical area of operations are discontinued operations. Measurement of discontinued operations is based on AS 24.	Definition of discontinued operations under IFRS is similar to Indian Accounting Standards. However, it also includes a subsidiary acquired exclusively with a view to resale. Discontinued operations are measured at lower of carrying amount and fair value less cost to sell.

(ii)	Acquired intangible assets	If recognition criteria are satisfied then it can be capitalized. All intangibles are amortized over useful life with rebuttable presumption of not exceeding 10 years. Revaluations are not permitted.	If recognition criteria are satisfied then it can be capitalized. It is amortized over useful life. Intangibles assigned an indefinite useful life are not amortized but reviewed at least annually for impairment. Revaluations are permitted in rare circumstances.

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

1. AS 3 “Cash Flow Statements” is not mandatory.
2. AS 17 “Segment Reporting” is not mandatory.
3. SMEs are exempt from some paragraphs of AS 19 “Leases”.
4. SMEs are exempt from disclosures of diluted EPS (both including and excluding extraordinary items).
5. SMEs are allowed to measure the ‘value in use’ on the basis of reasonable estimate thereof instead of computing the value in use by present value technique under AS 28 “Impairment of Assets”.
6. SMEs are exempt from disclosure requirements of paragraphs 66 and 67of AS 29 “Provisions , Contingent Liabilities and Contingent Assets”.
7. SMEs are exempt from certain requirements of AS 15 “Employee Benefits”.
8. Accounting Standards 21, 23, 27 are not applicable to SMEs.

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

(b) Enterprises which are not Level I enterprises but fall in any one or more of the following categories are classified as Level II enterprises:

(i) All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 40 lakhs but does not exceed Rs. 50 crores. Turnover does not include ‘other income’.

(ii) All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 1 crore but not in excess of Rs. 10 crores at any time during the accounting period.

(iii) Holding and subsidiary enterprises of any one of the above at any time during the accounting period.

(c) As per para 50 and 52 of AS 19, ‘if a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognized immediately.

(d) It is a present obligation as a result of past obligating event. The obligating event is the sale of the product which gives rise to an obligation because obligations also arise from normal business practices. An outflow of resources, embodying economic benefits in settlement is probable because a proportion of goods are returned for refund. For the best estimate of the cost of refunds, a provision should be recognized as per AS 29.

19. (i) NACAS: Under Section 210 A of the Companies Act 1956, the Central Government, by notification, has constituted a committee to advise the Central Government on the formulation of accounting policies and accounting standards for adoption by companies or class of companies specified under the Act. Based on the recommendations of NACAS, the Central Government has notified AS 1 to AS 7 and AS 9 to AS 29 in Dec. 2006 in the form of Companies (Accounting Standards) Rules, 2006. Presently, these rules are called as Companies (Accounting Standards) Amendment Rules, 2008.

(ii) The objective of AS 28 ‘Impairment of Assets’ is to prescribe the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Statement requires the enterprise to recognize an impairment loss. This standard should be applied in accounting for the impairment of all assets, other than (i) inventories (AS 2, Valuation of Inventories); (ii) assets arising from construction contracts (AS 7, Accounting for Construction Contracts); (iii) financial assets, including investments that are included in the scope of AS 13, Accounting for Investments; and (iv) deferred tax assets (AS 22, Accounting for Taxes on Income). AS 28 does not apply to inventories, assets arising from construction contracts, deferred tax assets or investments because other accounting standards applicable to these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

(iii) According to AS 16, borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds. Borrowing costs may include: (i) interest and commitment charges on bank borrowings and other short-term and long-term borrowings; (ii) amortization of discounts or premiums relating to borrowings; (iii) amortization of ancillary costs incurred in connection with the arrangement of borrowings; (iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and (v) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset• should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when the conditions specified in AS 16 are satisfied.

(iv) Investments by a holding company in the shares of its subsidiary company are normally considered as long term investments. Indian holding companies show investment in subsidiary just like any other investment and generally classify it as trade investment. As per AS 13 'Accounting for Investments', investments are classified as long term and current investments. A current investment is an investment that by its nature is readily realizable and is intended to be held for more than one year from the date of acquisition. A long term investment is one that is not a current one.

Costs of investment include besides acquisition charges, expenses such as brokerage, fees and duties. If an investment is acquired wholly or partly by an issue of shares or other securities, the acquisition cost is determined by taking the fair value of the shares/securities issued. If an investment were to be acquired in exchange – part or whole – for another asset, the acquisition cost of the investment is determined with reference to the value of the other asset exchanged. Dividends received out of incomes earned by a subsidiary before the acquisition of the shares by the holding company and not treated as income but treated as recovery of cost of the assets (investment made in the subsidiary). The carrying cost for current investment is the lower of cost or fair/market value whereas investment in the shares of the subsidiary (treated as long term) is carried normally at cost.

(v) Cost vs. Fair value

Cost basis: The term cost refers to cost of purchase, costs of conversion on other costs incurred in bringing the goods to its present condition and location. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or

• A qualifying asset is an asset that necessarily takes a substantial period of time[1] to get ready for its intended use or sale.

in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

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

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

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

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

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

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

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

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

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

(vi) According to para 44 of AS 20, 'If the number of equity or potential equity shares outstanding increases as a result of a bonus issue or share split or decreases as a result of a reverse share split (consolidation of shares), the calculation of basic and diluted earnings per share should be adjusted for all the periods presented. If these changes occur after the balance sheet date but before the date on which the financial statements are approved by the board of directors, the per share calculations for those financial statements and any prior period financial statements presented should be based on the new number of shares. When per share calculations reflect such changes in the number of shares, that fact should be disclosed.

(vii) Para 87, 88 and 89 of AS 26 states that an intangible asset should be derecognised (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the statement of profit and loss.

An intangible asset that is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use. At least at each financial year end, an enterprise tests the asset for impairment under Accounting Standard on Impairment of Assets, and recognises any impairment loss accordingly.

(viii) The effect of a change in an accounting estimate should be included in the determination of net profit or loss in:

(a) the period of the change, if the change affects the period only; or

(b) the period of the change and future periods, if the change affects both.

The effect of a change in an accounting estimate should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.

The nature and amount of a change in an accounting estimate which has a material effect in the current period, or which is expected to have a material effect in subsequent periods, should be disclosed. If it is impracticable to quantify the amount, this fact should be disclosed.

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

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

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

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

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

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

(iii) As per provisions of Para 91(b) of AS 28 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

(iv) As per para 32 of AS 13 on 'Accounting for Investments', any investment of long term period is shown at cost. Hence, the investment in Gold and Silver (purchased on 1st April 2005) shall continue to be shown at cost i.e., Rs.2,00,000 and Rs.1,50,000 respectively as their value have increased.

Also as per AS 13, for investment in shares - if the investment is for short-term period then the loss of Rs.3,00,000 is to be charged to profit & loss account for the year ended 31st March, 2008. If investment is of long term period then it will continue to be shown at cost in the Balance Sheet of the company. However, provision for diminution shall be made to recognize a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.

21. (i) Para 10 of AS 16 'Borrowing Costs' states "To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings." The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case, treatment of accountant of Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2008-09 should be calculated as follows:

Actual interest for 2008-09 (11% of Rs.150 crores)	Rs.16.50 crores
Less:Income on temporary investment from specific borrowings	Rs. 3.50 crores
Borrowing costs to be capitalized during year 2008-09	Rs. 13.00 crores

(ii) Omega Limited.

Calculation of Deferred Tax Asset/Liability

Year	Accounting Income	Taxable Income	Timing Difference (balance)	Deferred Tax Liability (balance)
2006	11,00,000	7,00,000	4,00,000	1,40,000
2007	16,00,000	18,00,000	2,00,000	70,000
2008	21,00,000	23,00,000	NIL	NIL
	48,00,000	48,00,000		

(iii) As per para 35 of AS 7 "Construction Contracts", when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately. Therefore, The foreseeable loss of Rs.3 crores (Rs. 53 crores less Rs. 50 crores) should be recognised as an expense immediately in the year ended 31st march, 2008. The amount of loss is determined irrespective of

(i) Whether or not work has commenced on the contract;

(ii) Stage of completion of contract activity; or

(iii) The amount of profits expected to arise on other contracts which are not treated as a single construction contract in accordance with para 8 of AS 7.

(iv) As per para 10 of AS 9 'Revenue Recognition', the additional revenue on account of increase in sales price with retrospective effect, as decided by Board of Directors of X Ltd., of Rs.5 lakhs to be recognised as income for financial year 2006-07, only if the company is able to assess the ultimate collection with reasonable certainty. If at the time of raising of any claim it is unreasonable to expect ultimate collection, revenue recognition should be postponed.

22. Cash Flow Statement for the year ended December 31, 2008

Cash Flows from Operating Activities	
Profit before Tax	2.95,000
Add: Depreciation (Non-Cash expense)	1,10,000
Interest (Non-operating expense)	70,000
Less:Non-operating Income	(25,000)
Operating Profit	4,50,000
Add: Decrease in Bills Receivable	5,000
Decrease in Debtors	30,000
Increase in Creditors	25,000
Less: Increase in Stock	(10,000)

Cash flow from operation before tax	5,00,000	
Less: Tax paid	(1,30,000)	
Cash provided by Operating Activities		3,70,000
Cash Flows from Investing Activities		
Purchase of Fixed Assets (10,00,000 + 1,10,000 – 8,50,000)	(2,60,000)	
Dividend on Investments	25,000	
Cash used in Investing Activities		(2,35,000)
Cash Flows from Financing Activities		
Long term loan taken	30,000	
Interest paid	(70,000)	
Dividend Paid	(90,000)	
Income from Financing Activities		(1,30,000)
Net Increase in Cash during the year		5,000
Add: Opening Cash Balance		30,000
Closing Cash Balance		35,000

23. (i) Computation of earnings per share

	Earnings	Shares	Earnings per share
Net profit for the year 2007-08	Rs.15,00,000		
Weighted average number of shares outstanding during year 2007-08		6,00,000	
Basic earnings per share			Rs. 2.50
Number of shares under option		1,00,000	
Number of shares that would have been issued at fair value: (100,000 x 15.00)/25.00	*	(60,000)	
Diluted earnings per share	Rs. 15,00,000	6,40,000	Rs. 2.34 (approx.)

* The earnings have not been increased as the total number of shares has been increased only by the number of shares (40,000) deemed for the purpose of the computation to have been issued for no consideration.

(ii) (a) As per AS 18, associates and joint ventures of the reporting enterprise are related parties. Since A Ltd. holds more than 20% of the voting power in B Ltd. by virtue of this it has substantial interest and significant influence in B Ltd. Therefore B Ltd. is an associate and is related party to A Ltd.

(b) An associate of an associate is not a related party. Only in the case of a holding company a subsidiary of a subsidiary (sub-subsidiary) also becomes a related party.

(c) C Ltd. and D Ltd. are co-associates. Co-subsidiaries become related parties because of common control. In the case of this common control is missing and therefore they are not related parties.

(iii) According to AS 12 states "where the Government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income".

In the given case the subsidy is given with reference to the total investment in the unit located in the backward area by way of promoter's contribution, the amount should be treated as capital reserve and not income.

(iv) As per AS 29, Contingent liability should be disclosed in financial statements if following conditions are satisfied:-

- There should be present obligation arising out of past event but not recognized as provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an outflow of resources embodying economic benefits is not remote.
- The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first 10 cases is 60% and for remaining, five cases 50%. In other words, the probability of losing is 40% or 50% respectively. As per the AS-29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note amount may be calculated as under:

Expected loss in first ten cases	=	Rs.90,000 $\times$ 0.3 + Rs.1,60,000 $\times$ 0.1
	=	Rs.43,000 $\times$ 10
	=	Rs.4,30,000
Expected loss in remaining five cases	=	Rs.60,000 $\times$ 0.3 + Rs.95,000 $\times$ 0.2

	=	Rs.37,000 $\times$ 5
	=	Rs.1,85,000
Total Contingent Liability	=	Rs.4,30,000 + Rs.1,85,000= Rs.6,15,000

24. (i) The Guidance note on "Accounting for Investments in Financial Statements of Mutual Funds" provides that Investments should be marked to market on balance sheet date with provision for depreciation, if any, in the value of investments debited to revenue account. The provision so created should be shown as a deduction from the value of investments in the Balance Sheet. The Guidance notes further states that the depreciation or appreciation should be worked out on individual basis or by category of investment but not on an overall basis. Keeping in view 'prudence' as a factor for preparation of financial statements and correct disclosure of the amount of depreciation on investments, the Guidance Note states that the gross value of depreciation on investments should be reflected in the revenue account rather than the same being netted off with the appreciation in the value of other investments. Thus the claim of Amigo Mutual Fund Ltd. is not correct.

(ii) The counter guarantee given by the company is, infact, an undertaking to perform what is, in any event, the obligation of the company itself. In any case, this is a matter which is in the control of the company itself and the mere possibility of a default by the company in the future cannot be said to involve the existence of a contingent liability on the balance sheet date.

Thus, as per 'Guidance Note on Guarantees and Counter-Guarantees given by Companies', no separate disclosure is required in respect of counter guarantees.

25. (i) Journal Entries

Date	Particulars		Rs.	Rs.
31.3.2006	Employees compensation Expenses A/c	Dr.	14,25,000	
	To ESOS outstanding A/c			14,25,000
	(Being compensation expense recognized in respect of the ESOP i.e. 100 options each granted to 1,000 employees at a discount of Rs. 30 each, amortised on straight line basis over vesting years- Refer W.N.)			
	Profit and Loss A/c	Dr.	14,25,000	
	To Employees compensation expenses A/c			14,25,000
	(Being compensation expenses charged to P & L A/c)			

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
31.3.2007	Employees compensation expenses A/c	Dr.	3,95,000	
	To ESOS outstanding A/c			3,95,000
	(Being compensation expense recognized in respect of the ESOP)			
31.3.2007	Profit and Loss A/c	Dr.	3,95,000	
	To Employees compensation expenses A/c			3,95,000
	(Being compensation expense charged to P & L A/c)			
30.3.2008	Employees compensation expenses A/c	Dr.	8,05,000	
	To ESOS outstanding A/c			8,05,000
	(Being compensation expense recognized in respect of the ESOP)			
30.3.2008	Bank A/c (85,000 X Rs.20)	Dr.	17,00,000	
	ESOS outstanding A/c [(26,25,000/87,500)x85,000]	Dr.	25,50,000	
	To Equity share capital 600XRs. 10			8,50,000
	To Securities premium A/c (85,000 X Rs.40)			34,00,000
	(Being 85,000 options exercised at an exercise price of Rs. 50 each)			
	Profit and Loss A/c	Dr.	8,05,000	
	To Employees compensation expenses A/c			8,05,000
	(Being compensation expenses charged to P & L A/c)			
	ESOS outstanding A/c	Dr.	75,000	
	To General Reserve A/c			75,000
	(Being ESOS outstanding A/c on lapse of 2,500 options at the end of exercise of option period transferred to General Reserve A/c)			

Working Note:

Particulars	Year 1 (31.3.2006)	Year 2 (31.3.2007)	Year 3 (31.3.2008)
Length of the expected vesting period (at the end of the year)	2 years	3 years	3 years
Number of options expected to vest	95,000 options	91,000 options	87,500 options
Total compensation expenses accrued @ Rs.30 (50-20)	Rs. 28,50,000	Rs. 27,30,000	Rs.26,25,000
Compensation expenses of the year	28,50,000 x 1/2 = Rs.14,25,000	27,30,000 x 2/3 = Rs.18,20,000	
Compensation expenses recognized previously	Nil	Rs.14,25,000	Rs. 18,20,000
Compensation expenses to be recognized for the year	Rs.14,25,000	Rs. 3,95,000	Rs. 8,05,000

(ii) Journal Entries in the Books of Originator

S.No.	Particulars		L.F.	Debit Rs.	Credit Rs.
1.	Bank A/c	Dr.		1,00,000	
	To Loans (Cost of Securitised Component)				90,910
	To Profit on Securitisation				9,090
	(Being securitization of principal amount and right to receive interest at 14% interest rate)				
2.	Servicing Asset A/c	Dr.		3,180	
	Interest Strip A/c	Dr.		5,910	
	To Loans				9,090
	(Being creation of servicing asset and interest strip receivable)				

Working Notes:

1. Fair value of securitized component of loan

Fair value of Loan		1,10,000
Less: Fair value of servicing asset	3,500	
Fair value of interest strip	6,500	10,000
		1,00,000

2. Appropriation of carrying amount based on Fair Value

Particulars	Fair Value	% to Fair Value	Proportionate Carrying Amount
	Rs.	Rs.	Rs.
Fair value of securities component of the loan	1,00,000	90.91%	90,910
Fair value of servicing asset	3,500	3.18%	3,180
Fair value of interest strip	6,500	5.91%	5,910
	1,10,000	100.00%	1,00,000

3. Profit on Securitisation

	Rs.
Net proceeds from securitisation	1,00,000
Less: Apportioned carrying amount	90,910
	9,090

Annexure

LIST OF INSTITUTE'S PUBLICATIONS RELEVANT FOR NOVEMBER, 2009 EXAMINATIONS

The following List of Institute's Publications is relevant for the forthcoming examination i.e. November, 2009. Students may kindly take it into consideration while preparing for the examinations.

Final Examination

Paper 1: Advanced Accounting

I. Statements and Standards

1. Framework for the Preparation and Presentation of Financial Statements
2. Accounting Standards – AS 1 to AS 29.

II. Guidance Notes on Accounting Aspects

1. Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets.
2. Guarantees and Counter-Guarantees Given by Companies.
3. Guidance Note on Accrual Basis of Accounting.
4. Guidance Note on Accounting Treatment for Excise Duty.
5. Guidance Note on Accounting for Depreciation in Companies.
6. Guidance Note on Availability of Revaluation Reserve for Issue of Bonus shares.
7. Guidance Note on Accounting Treatment for MODVAT/CENVAT.
8. Guidance Note on Accounting for Securitisation.
9. Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options (2003).
10. Guidance Note on Accounting for Corporate Dividend Tax.
11. Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds.
12. Guidance Note on Accounting for Employee Share-based Payments.
13. Guidance Note on Accounting for Fringe Benefits Tax.
14. Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961.
15. Guidance Note on Measurement of Income Tax for Interim Financial Reporting in the context of AS 25.

PAPER –2 : MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS

QUESTIONS

Swap

1. Suppose you are a treasurer of XYZ plc in the UK. XYZ have two overseas subsidiaries, one based in Amsterdam and one in Switzerland. The Dutch subsidiary has surplus Euros in the amount of 7,25,000 which it does not need for the next three months but which will be needed at the end of that period (91 days). The Swiss subsidiary has a surplus of Swiss Francs in the amount of 9,98,077 that, again, it will need on day 91. The XYZ plc in UK has a net balance of £75,000 that is not needed for the foreseeable future.

   Given the rates below, what is the advantage of swapping Euros and Swiss Francs into Sterling?

   Spot Rate €/£ 0.6858- 0.6869

   91 day Pts 0.0037 0.0040

   Spot Rate £/CHF 2.3295- 2.3326

   91 day Pts 0.0242 0.0228

   Interest rates for the Deposits

	91 day Interest Rate % pa		
Amount of Currency			
	£	€	CHF
0 – 100,000	1	¼	0
100,001 – 500,000	2	1 ½	¼
500,001 – 1,000,000	4	2	½
Over 1,000,000	5.375	3	1

Merger and Acquisition

2. Cool-cool Ltd.. makes thermal clothing for winter sports and outdoor work, and is considering acquiring Sking Shell Ltd. which manufactures and sells ski clothing. Sking Shell is about one quarter of Frozen's size and manufactures its entire product line in a small rented factory on a mountaintop in Manali. It costs about Rs.10,00,000 a year in overhead to operate in the factory. Cool-cool Ltd. produces its output in a less popular in North but more popular north-east locations. Its factory has at least 50% excess capacity. Cool-cool's plan is to acquire Sking Shell, and combine production operations in its north-eastern factory, but otherwise run the companies separately.

   Sking Shell's beta is 2.0, Treasury bills currently yield 5% and the Nifty Index is yielding 9%. The corpoarte income tax rate for both firms is 40%. Because Sking Shell will no longer be maintaining its own production facilities, it can be assumed that only a minimal amount of cash will have to be reinvested to keep its equipment current and for future growth. This amount is estimated at Rs. 1,00,000 per year. Selected financial information for Sking Shell is as follows:

Revenue	Rs. 1,25,00,000
EAT	Rs. 13,00,000
Depreciation	Rs. 6,00,000

(a) Calculate the appropriate discount rate for evaluating the Sking Shell acquisition.

(b) Determine the annual cash flow expected by Cool-cool Ltd.from Sking Shell if the acquisition is made (don't forget to include the synergy).

(c) Calculate the value of the acquisition to Cool-cool Ltd.assuming the benefits last for (1) five years, (2) 10 years, and (3) 15 years.

(d) Sking Shell has 2,50,000 shares of stock outstanding. Calculate the maximum price Cool-cool Ltd. should be willing to pay per share to acquire the firm under the three assumptions in part c.

(e) If Cool-cool Ltd. is willing to assume the benefits of the Sking Shell acquisition will last indefinitely but not grow, what should it be willing to pay per share?

3. In above question , assume that the cash flow from the Sking Shell acquisition grows at 10% from its initial value for one year and then grows at 5% indefinitely (starting in the third year). Calculate the value of the firm and the implied stock price under these conditions. Use a terminal value at the beginning of the period of 5% growth. What price premium is implied in dollars and as a percent of market price if Sking Shell's stock is currently selling at Rs. 62?

Corpoarte Restructing

4. The Nishan Ltd. has 35,000 shares of equity stock outstanding with a book value of Rs.20 per share. It owes debt Rs.15,00,000 at an interest rate of 12%. Selected financial results are as follows.

Income and Cash Flow		Capital	
EBIT	Rs. 80,000	Debt	Rs.1,500,000
Interest	1,80,000	Equity	7,00,000
EBT	(Rs.1,00,000)		Rs.2,200,000
Tax	0		
EAT	(Rs.1,00,000)		
Depreciation	Rs. 50,000		
Principal repayment	(Rs. 75,000)		
Cash Flow	(Rs.1,25,000)		

Restructure the financial line items shown assuming a composition in which creditors agree to convert two thirds of their debt into equity at book value. Assume Nishan will pay tax at a rate of 15% on income after the restructuring, and that principal repayments are reduced proportionately with debt. Who will control the company and by how big a margin after the restructuring?

Bond Valuation

5. Given a five-year, 8% coupon bond with a face value of Rs.1,000 and coupon payments made annually, determine its values given it is trading at the following yields: 8%, 6%, and 10%. Comment on the price and yield relation you observe. What are the percentage changes in value when the yield goes from 8% to 6% and when it goes from 8% to 10%?

6. Given a two-year, 8% annual coupon bond with a face value of Rs. 1,000 and with annual coupon payments that is fully taxable and selling at par, and an identical bond that is tax free, what would the yield and price on the tax-free bond have to be for an investor in a 35% tax bracket to be indifferent between the two bonds?

Lease Evaluation

7. Mr. Lee wants to acquire a mechanized feed spreader that cost €80,000. He intends to operate the equipment for 5 years, at which time it will need to be replaced. However, it is expected to have a salvage value of €10,000 at the end of the fifth year. The asset will be depreciated on a straight-line basis (€16,000 per year) over the 5 years, and Lee is in a 30 percent tax bracket. Two means for financing the feed spreader are available. A lease arrangement calls for lease payments of €19,000 annually, payable in advance. A debt alternative carries an interest of €19,000 annually, payable in advance. A debt alternative carries an interest cost of 10 percent. Debt payments will be at the start of each of the 5 years using mortgage type of debt amortization.

   (a) Using the present-value method, determine the best alternative.

   (b) Using the internal-rate-of-return method, which is the best alternative? Does your answer differ from that to part a ?

Right Issue

8. The stock of the Soni plc is selling for £50 per common stock. The company then issues rights to subscribe to one new share at £40 for each five rights held.

   (a) What is the theoretical value of a right when the stock is selling rights-on?

   (b) What is the theoretical value of one share of stock when it goes ex-rights?

   (c) What is the theoretical value of a right when the stock sells ex-rights at £50?

   (d) John Speculator has £1,000 at the time Soni plc goes ex-rights at £50 per common stock. He feels that the price of the stock will rise to £60 by the time the rights expire. Compute his return on his £1,000 if he (1) buys Soni plc stock at £50, or (2) buys the rights as the price computed in part c, assuming his price expectations are valid.

9. PQR Ltd. is a management consultancy firm in the industry for the last 10 year. It got listed its equity share 4 years ago at a Recognized Stock Exchange. The company has pursued a policy of aggressive growth and specializes in providing services to the entities in high technology and high growth sectors. The company has no leverage element in their capital structure and financed by equity shares of Rs.50 Crores of Rs.2 per share (par value).

   The company's result for the year ending 31 March 2009, have just announced. Profit before tax were Rs.12.66 Crores. As per Chairman cum Managing Director's statement (included in the forecast column of company's Annual Report for the year ending 31 March 2009) earnings might be expected to rise by 4% which is lower than annual rate than in the recent years. This is due to global recession especially in US Economy.

   XYZ Ltd. is another company, in the same business but has been established much longer. It sources more to traditional business sectors and its earning track record has been erratic. In most of the daily newspaper poor management have been blamed for poor performance of company and due to this stock of the company in market had lost its value for sometimes. The current earning forecast of XYZ Ltd is also 4% for the foreseeable future. The capital structure of the company consists of Rs.18 crores equity share capital of Rs.1 (par value). The Profit before tax of the company for the year ending 31 March 2009 is Rs.11.25 Crores.

   PQR Ltd. has recently approached the shareholders of XYZ Ltd with a bid of five new share in PQR Ltd for every six shares in XYZ Ltd. Otherwise shareholders can accept a cash payment @Rs.3.45 per share.

   Following the announcement of this bid, the market price of PQR Ltd. shares fell by 10% whereas the price of Shares of XYZ Ltd. rose up by 14%. The P/E ratio and dividend yield of these two companies and other two companies in same industry immediately prior to bid announcement is as follows:

Company	Share Price (Rs.)		P/E Ratio	Dividend yield (%)
	High	Low		
PQR Ltd	4.25	3.25	11	2.4
XYZ Ltd	3.50	2.85	7	3.1
LMN Ltd.	1.87	1.22	9	5.2
DEF Ltd.	2.30	1.59	16	2.4

   The Corporate Tax Rate is 30%. PQR Ltd is post tax cost of equity is 13% and XYZ Ltd's cost of equity is 11%.

   Evaluate, whether the proposed share-for-share offer's likely to be beneficial to shareholders in both PQR Ltd and XYZ Ltd. Please use the information and merger terms available above.

   You may make appropriate assumption to forecast post merger values.

Dividend Theory

10. Zumo & Co. is a watch manufacturing company and is all equity financed and has paid up capital Rs.10,00,000 (Rs.10 per shares)

The other data related to the company is as follows:

Year	EPS (Rs.)	Net Dividend per share (Rs.)	Share Price (Rs.)
2004	4.20	1.70	25.20
2005	4.60	1.80	18.40
2006	5.10	2.00	25.50
2007	5.50	2.20	27.50
2008	6.20	2.50	37.20

Zumo & Co. has hired one management consultant, Vidal Consultants to analyze the future earnings and other related item for the forthcoming years.

As per Vidal Consultants's report

(1) The earnings and dividend will grow at 25% for the next two years.

(2) Earnings are likely at rate of 10% from 3rd year and onwards.

(3) Further if there is reduction in earnings growth occurs dividend payout ratio will increase to 50%

Assuming the tax rate as 33% (not expected to change in the foreseeable future) calculate the estimated share price and P/E Ratio which analysts now expect for Zumo & Co., using the dividend valuation model.

You may further assume that post tax cost of capital is 18%.

Financial Services

11. The following financial information related to Norwason India Ltd.:

	2008	2007
	Rs. 000	Rs. 000
Sales (all on credit)	37,400	26,720
Cost of sales	34,408	23,781
Operating profit	2,992	2,939
Finance costs (interest payments)	355	274
Profit before taxation	2,637	2,665

	2008		2007	
	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Non-current assets		13,632		12,750

Current assets				
Inventory	4,600		2,400	
Trade receivables	4,600		2,200	
	9,200		4,600	
Current liabilities				
Trade payables	4,750		2,000	
Overdraft	3,225		1,600	
	7,975		3,600	
Net current assets		1,225		1,000
		14,857		13,750
8% Bonds		2,425		2,425
		12,432		11,325
Capital and reserves				
Share capital		6,000		6,000
Reserves		6,432		5,325
		12,432		11,325

The average variable overdraft interest rate in each year was 5%. The 8% bonds are redeemable in ten years' time.

A factor has offered to take over the administration of trade receivables on a non-recourse basis for an annual fee of 3% of credit sales. The factor will maintain a trade receivables collection period of 30 days and Norwason India Ltd will save Rs.1,00,000 per year in administration costs and Rs. 3,50,000 per year in bad debts. A condition of the factoring agreement is that the factor would advance 80% of the face value of receivables at an annual interest rate of 7%.

Evaluate whether the proposal to factor trade receivables is financially acceptable.

Foreign Exchange Management

12. On 30th June 2009 when a forward contract matured for execution you are asked by an importer customer to extend the validity of the forward sale contract for US$ 10,000 for a further period of three months.

Contracted Rate US$1 = Rs.41.87

The US Dollar quoted on 30.6.2009

Spot	40.4800/40.4900
Premium July	0.1100/0.1300
Premium August	0.2300/0.2500
Premium September	0.3500/0.3750

Calculate the cost for your customer in respect of the extension of the forward contract. Rupee values to be rounded off to the nearest Rupee.

Margin 0.080% for Buying Rate

Margin 0.25% for Selling Rate

13. You sold € 1 million value spot to your customer at € 1= Rs.54.60 and covered yourself in Singapore market on the same day when the exchange rate were as under:

    Spot US$ 1 = € 0.7373/0.7375

    Local inter bank US$ 1 = Rs.40.1850/40.1950

    (Brokerage paid Rs.2,000)

    Calculate the cross rate nearest to the fourth decimal and ascertain profit or loss in the transaction to the nearest Rupee.

Decision Tree

14. MCL Technologies is evaluating new software for ERP. The software will have a 3-year life and cost €1,000 thousands. Its impact on cash flows is subject to risk . Management estimates that there is a 50-50 chance that the software will either save the company €1,000 thousands in the first year or save it nothing at all. If nothing at all, savings in the last 2 years would be zero. Even worse, in the second year an additional outlay of €300 thousands may be required to convert back to the original process, for the new software may result in less efficiency. Management attaches a 40 percent probability to this occurrence, given the fact that the new software " failed" in the first year. If the software proves itself, second-year cash flows may be either €1,800 thousands, €1,400 thousands, or €1,000 thousands, with probabilities of 0.20, 0.60, and 0.20, respectively. In the third year, cash, inflows are expected to be €200 thousands greater or €200 thousands less than the cash flow in period 2, with an equal chance of occurrence. (Again, these cash flows depend on the cash flow in period 1 being €1,000 thousands.) All the cash flows are after taxes.

    (a) Set up a probability tree to depict the foregoing cash-flow possibilities.

    (b) Calculate a net present value for each three-year possibility, using a risk-free rate of 5 percent.

    (c) What is the risk of the project?

Derivatives

15. From the following data compute value of call option using the Black-Scholes Option Pricing Model (OPM).

    Stock Price = Rs. 27.00.

    Strike Price = Rs. 25.00

Time to expiration = 6 Months.

Risk-Free Rate = 6.0%.

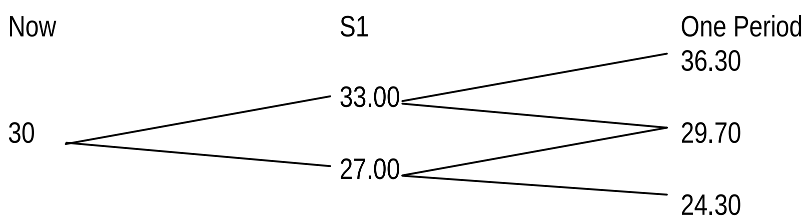
Stock Return Variance = 0.11.

16. The following information is available for a call option:

Time to expiration (months)	3
Risk free rate	8%
Exercise price	€60
Stock price	€70
Call price	€14

What is the value of a put option if the time to expiration is 3 months, risk free rate is 8%, exercise price is €60 and the stock price is €70?

17. Following is a two-period tree for a share of stock in CAB Ltd.:



Using the Binomial model, calculate the current fair value of a regular call option on CAB Stock with the following characteristics : X = Rs. 28, Risk Free Rate = 5 percent (per sub period). You should also indicate the composition of the implied riskless hedge portfolio at the valuation date.

18. In March, a derivatives dealer offers you the following quotes for June British pound option contracts (expressed in U.S. dollars per GBP):

Contract	Strike Price	MARKET PRICE OF Bid	CONTRACT Offer
Call	USD 1.40	0.0642	0.0647
Put		0.0255	0.0260
Call	1.44	0.0417	0.0422
Put		0.0422	0.0427
Call	1.48	0.0255	0.0260
Put		0.0642	0.0647

(a) Assuming each of these contracts specifies the delivery of GBP 31,250 and expires in exactly three months, complete a table similar to the following (expressed in dollars) for a portfolio consisting of the following positions:

(1) Long a 1.44 call

(2) Short a 1.48 call

(3) Long a 1.40 put

(4) Short a 1.44 put

June USD/GBP	Net Initial Cost	Call 1.44 Profit	Call 1.48 Profit	Put 1.40 Profit	Put 1.44 Profit	Net Profit
1.36	—	—	—	—	—	—
1.40	—	—	—	—	—	—
1.44	—	—	—	—	—	—
1.48	—	—	—	—	—	—
1.52	—	—	—	—	—	—

(b) Graph the total net profit (i.e., cumulative profit less net initial cost, ignoring time value considerations) relationship using the June USD/GBP rate on the horizontal axis (be sure to label the breakeven point(s)). Also, comment briefly on the nature of the currency speculation represented by this portfolio.

(c) If in exactly one month (i.e., in April) the spot USD/GBP rate falls to 1.385 and the effective annual risk-free rates in the United States and England are 5 percent and 7 percent, respectively, calculate the equilibrium price differential that should exist between a long 1.44 call and a short 1.44 put position.

19. In mid-May, there are two outstanding call option contracts available on the stock of MGH Co.:

Call #	Exercise Price	Expiration Date	Market Price
1	€50	August 19	€8.40
2	€60	August 19	€3.34

(a) Assuming that you form a portfolio consisting of one Call #1 held long and two Calls #2 held short, complete the following table showing your intermediate steps. In calculating net profit, be sure to include the net initial cost of the options.

Price of MGH Stock at Expiration	Profit on Call #1 Position	Profit on Call #2 Position	Net Profit on Total Position
€40	—	—	—
€45	—	—	—
€50	—	—	—
€55	—	—	—
€60	—	—	—

€65	—	—	—
€70	—	—	—
€75	—	—	—

(b) Graph the net profit relationship in Part a, using stock price on the horizontal axis. What is (are) the breakeven stock price(s)? What is the point of maximum profit?

(c) Under what market conditions will this strategy (which is known as a call ratio spread) generally make sense? Does the holder of this position have limited or unlimited liability?

Futures

20. The following information about copper scrap is given:

- Spot price : $10,000 per ton
- Futures price : $10,800 for a one year contract
- Interest rate : 12 %
- PV (storage costs) : $500 per year

What is the PV (convenience yield) of copper scrap?

Portfolio Management

21. The following data are available to you as a portfolio manager.

Security	Expected Return	Beta	Standard Deviation
O	0.32	1.70	0.50
P	0.30	1.40	0.35
Q	0.25	1.10	0.40
R	0.22	0.95	0.24
S	0.20	1.05	0.28
T	0.14	0.70	0.18
Composite Index	0.12	1.000	0.20
T-bills	0.08	0.00	0.00

(a) In terms of a security market line (SML) , which of the securities listed above are undervalued? Why?

(b) Assume that a portfolio is constructed using equal portions of the six stocks listed above.

(i) Why is the expected return of such a portfolio?

(ii) What would the expected return if this portfolio was increased by 40% through borrowed funds with the cost of borrowing at 12%?

22. Mr. Nirmal Kumar has categorized all the available stock in the market into the following types:

(i) Small cap growth stocks

(ii) Small cap value stocks

(iii) Large cap growth stocks

(iv) Large cap value stocks

Mr. Nirmal Kumar also estimated the weights of the above categories of stocks in the market index. Further more, the sensitivity of returns on these categories of stocks to the three important factor are estimated to be:

Category of Stocks	Weight in the Market Index	Factor I (Beta)	Factor II (Price Book)	Factor III (Inflation)
Small cap growth	25%	0.80	1.39	1.35
Small cap value	10%	0.90	0.75	1.25
Large cap growth	50%	1.165	2.75	8.65
Large cap value	15%	0.85	2.05	6.75
Risk Premium		6.85%	-3.5%	0.65%

The rate of return on treasury bonds is 4.5%

Required:

(a) Using Arbitrage Pricing Theory, determine the expected return on the market index.

(b) Using Capital Asset Pricing Model (CAPM), determine the expected return on the market index.

(c) Mr. Nirmal Kumar wants to construct a portfolio constituting only the 'small cap value' and 'large cap growth' stocks. If the target beta for the desired portfolio is 1, determine the composition of his portfolio.

Mutual Fund

23. Consider the following information about the return on Classic Mutual Fund, the market return and the T-bill returns:

Year	Classic Mutual Fund	Market Index	T-bills
1994	17.1	10.8	5.4
1995	-14.6	-8.5	6.7
1996	1.7	3.5	6.5
1997	8.0	14.1	4.3
1998	11.5	18.7	4.1
1999	-5.8	-14.5	7.0
2000	-15.6	-26.0	7.9
2001	38.5	36.9	5.8
2002	33.2	23.6	5.0
2003	-7.0	-7.2	5.3
2004	2.9	7.4	6.2
2005	27.4	18.2	10.0

2006	23.0	31.5	11.4
2007	-0.6	-4.9	14.1
2008	21.4	20.4	10.7

The following additional information is available regarding the comparative performance of five mutual funds:

	Return (%)	Standard Deviation (%)	Beta	
Alpha	1.95	20.03	0.983	0.819
Beta	11.57	18.33	0.971	0.881
Gama	8.41	22.92	1.169	0.816
Rho	9.05	24.04	1.226	0.816
Theta	7.86	15.46	0.666	0.582

From the above information, calculate all the inputs required for determining the Sharpe's Ratio, Treynor's ratio and Jensen's ratio.

24. Risk appetite, risk aversion and risk premium are sometimes used interchangeably. Explain this statement. How investor's expectation vary with the variation in the level of risk appetite.

25. Write Short Notes on

    (i) What is relationship between EVA and MVA?

    (ii) Explain the term "Balance Transfer".

    (iii) 'Stack hedging' and 'Strip hedging'

SUGGESTED ANSWERS/HINTS

1. Individual Basis

Holland	Total	
€ 7,25,000 x 0.02 x 91/360 = € 3,665.28	€ 7,28,665.28	= £ 5,03,434.84
	(728,665.28x0.6909)	
Switzerland		
CHF 9,98,077x 0.005x91/360 = CHF 1,261.46	CHF 9,99,338.46	= £ 4,33,496.05
	(9,99,338.46÷2.3053)	
UK		
£ 75,000 x 0.01 x 91/365 = £ 186.99		£ 75,186.99
Total GBP at 91 days		£ 10,12,117.88

Swap to Sterling

Sell € 7,25,000 (Spot at 0.6869) buy £	£ 4,98,002.50
Sell CHF 9,98,077(Spot at 2.3295) buy £	£ 4,28,451.16
Independent GBP amount	£ 75,000.00
	£ 1,001,453.66
Interest (1,001,453.66 x 0.05375 x 91/365)	£ 13,420.16
Total GBP at 91 days	£ 1,014,873.82
Less: Total GBP at 91 days as per individual basis	£ 1,012,117.88
Net Gain	£ 2,755.94

2. (a) $k_{SS} = k_{RF} + (k_M - k_{RF})\, ß_{SS}$

$= 5\% + (9\% - 5\%)\ 2.0$

$= 13\%$

(b)

Cash Flow:	(Rs.000)
EAT	1,300
Depreciation	600
Operating cash flow	1,900
Savings on factory operation after tax	600
Less reinvested cash	(100)
	2,400

(c) Value of Sking Shell Acquisition

Planning Horizon

	5 yrs	10 yrs	(Rs.000) 15 yrs
Yearly cash flow	Rs.2,400	Rs.2,400	Rs.2,400
$\times$ $PVFA_{13,n}$	3.5172	5.4262	6.4624
Value of acquisition	Rs.8,441	Rs.13,023	Rs.15,510
(d) Divide by # shares	250,000	250,000	250,000
Offer price	Rs. 33.76	Rs. 52.09	Rs. 62.04

(e) Rs.24,00,000/0.13 = Rs.1,84,62,000

Rs.1,84,62,000/2,50,000 = Rs.73.85

3. (Rs. 000)

Year	1	2	3
Cash flow	Rs. 2,400	Rs. 2,640	Rs. 2,772

Value at end of year 2 = $\frac{\text{Rs.}2{,}772}{0.13-0.05}$ =Rs. 34,650

(Rs. 000)

PV = Rs. 2,400[$PVF_{13,1}$] + Rs. 2,640[$PVF_{13,2}$] + Rs. 34,650[$PVF_{13,2}$]

= Rs. 2,400(0.8850) + Rs. 2,640(0.7831) + Rs. 34,650(0.7831)

= Rs. 2,124 + Rs. 2,067 + Rs. 27,134

= Rs. 31,325

Price per share = $\frac{\text{Rs.}3{,}13{,}25{,}000}{\text{Rs.}2{,}50{,}000}$ = Rs. 125.30

Premium = Rs. 125.30 – Rs. 62 = Rs. 63.30,

Premium is (Rs. 63.30/Rs. 62) = 102.10% of market price.

4. Creditors would convert Rs.10,00,000 in debt to equity by accepting

Rs.1,000,000/Rs.20= 50,000 shares of stock.

The remaining Rs.500,000 of debt would generate interest of

Rs.500,000 × 0.12 = Rs.60,000

Repayment of principal would be reduced by two thirds to Rs.25,000 per year.

The result is as follows

Income and Cash Flow		Capital	
EBIT	Rs. 80,000	Debt	Rs. 500,000
Interest	60,000	Equity	Rs. 1,700,000
EBT	Rs. 20,000		Rs .2,200,000
Tax	3,000		
EAT	Rs. 17,000		
Depreciation	50,000		
Principal repayment	(25,000)		
Cash Flow	Rs. 42,000		

After the restructuring there will be a total of (35,000+50,000) 85,000 shares of equity stock outstanding. The original shareholders will still own 35,000 shares (approximately 41%), while the creditors will own 50,000 shares (59%). Hence the creditors will control the company by a substantial majority.

5.

$$V_0 = \sum_{t=1}^{5} \frac{80}{(1.08)^t} + \frac{1000}{(1.08)^5} = 80\left[\frac{1-(1/1.08)^5}{0.08}\right] + \frac{1000}{(1.08)^5} = \text{Rs}.1{,}000$$

$$V_0 = \sum_{t=1}^{5} \frac{80}{(1.06)^t} + \frac{1000}{(1.06)^5} = 80\left[\frac{1-(1/1.06)^5}{0.06}\right] + \frac{1000}{(1.06)^5} = \text{Rs}.1{,}084.25$$

$$V_0 = \sum_{t=1}^{5} \frac{80}{(1.10)^t} + \frac{1000}{(1.10)^5} = 80\left[\frac{1-(1/1.10)^5}{0.10}\right] + \frac{1000}{(1.10)^5} = \text{Rs}.924.18$$

The answer shows the inverse relationship that exists between the price of a bond and its rate of return.

From 8% to 6%, the percentage change in value is 8.425%; from 8% to 10%, the percentage change in value is –7.582%.

6. For the investor to be indifferent, the tax-free bond's yield would have to be equal to the taxable bond's after-tax yield. Given a 35% tax rate, the taxable bond's after-tax yield is 5.2%:

ATY = (1-0.35)0.08 = 0.052

Thus, the tax-free bond would have to yield 5.2% for the investor to be indifferent. Given a 5.2% discount rate, the price of the tax-free bond would have to be Rs. 1,051.92:

$$P_0 = \frac{80}{(1.052)} + \frac{80+1000}{(1.052)^2} = 1051.92$$

7. (a) Lease Alternative:

End of Year	(1) Lease Payment (€)	(2) Tax Shield (1) x 0.30 (€)	(3) Cash Out Flow (1) - (2) (€)	PVF @ 7 %*	(4) PV of Cash Outflows (€)
0	19,000	0	19,000	1	19,000
1-4	19,000	5,700	13,300	3.3872	45,050
5		5,700	(5,700)	0.713	(4,064)
					€59,986

* 10% (1-0.30)

The present value of cash outflows is €59,986.

(b) Debt Alternative:

Annual debt repayments are:

Let X be the annual installment for loan repayment

Then €80,000 = X + 3.1699X (3.1699 = PV factor for 4-year annuity at 10%)

X = €80,000/4.1699

X = €19,185

End of Year	Debt Payment (€)	Principal Amount Owing (€)	Annual Interest (€)
0	19,185	60,815	0
1	19,185	47,712	6,082
2	19,185	33,298	4,771
3	19,185	17,443	3,330
4	19,187	0	1,774

The principal amount of €80,000 is reduced by the amount of the first payment of €19,185 to give €60,815 at time 0. The last debt payment is slightly higher due to rounding.

Statement showing the Cash Outflows (Debt Alternative)

End of Year	(1) Debt Repayment (€)	(2) Interest (€)	(3) Depreciation (€)	(4) Tax Shield 0.30x [(2)+(3)] (€)	(5) Out-flows (1) - (4) (€)	PV @ 7%	(6) PV Cash of Out flows (€)
0	19,185	0	0	0	19,185	1	19,185
1	19,185	6,082	16,000	6,625	12,560	0.9346	11,738
2	19,185	4,771	16,000	6,231	12,954	0.8734	11,315
3	19,185	3,330	16,000	5,799	13,386	0.8163	10,927
4	19,187	1,774	16,000	5,332	13,855	0.7629	10,570
5	0	0	16,000	4,800	(4,800)	0.7130	(3,422)
5					(7,000)†	0.7130	(4,991)
							55,322

†Residual value x (1 - 0.30)

Conclusion: As the present value of cash outflows under the debt alternative is lower i.e. €55,322 versus €59,986, hence debt option would be preferred.

(b) Schedule of Cash Flows: IRR Analysis of Lease

End of Year	(1) Cost (€)	(2) Lease Payment (€)	(3) Depreciation (€)	(4) Excess Tax Shield 0.30x (L-D) (€)	(5) Post tax Residual Value (€)	(6) Net cash Flows (€)
0	80,000	19,000	0	0		61,000
1		19,000	16,000	900		(18,100)
2		19,000	16,000	900		(18,100)
3		19,000	16,000	900		(18,100)
4		19,000	16,000	900		(18,100)
5		0	16,000	900	7,000	(6,100)

Solving for the internal rate of return for the last column, we find it to 10.11 percent. The after tax cost of borrowing of 7 percent is lower, and it dominates. The answer is the same as in the present value method of analysis, as we would expect.

8. (a) $R_0 = \frac{P_0 - S}{N+1} = \frac{£50 - £40}{5+1} = £1.67$

(b) $P_x = \frac{(P_0 \times N) + S}{N+1} = \frac{(£50 \times 5) + £40}{6} = £48.33$

(c) $R_x = \frac{P_x - S}{N} = \frac{£50 - £40}{5} = £2.00$

(d) (1) £1,000/£50 =20 shares x £60 = £1,200

£1,200 - £1,000 = £200

(2) £1,000 / £2 = 500 rights X £4* = £2,000

£2,000-£1,000 = £1,000

*R_x = (£60 - £40)/5 = £4

9. Working Notes:

	PQR Ltd.	XYZ Ltd	Total
Profit before tax (Rs.crore)	12.66	11.25	23.91
Tax @ 30%	3.80	3.38	7.18
Profit After tax	8.86	7.87	16.73
No. of Shares (Crores)	25	18	40
Earning Per share (Rs.)	0.3544	0.437	0.4183
PE Ratio before Bid	11	7	

Pre Bid Price of share (Rs.)	3.90	3.06	
Market value of company (Rs. Crore)	97.50	55.08	152.058
No. of new shares (Post Bid) (Crores)	25	15	40
% of Combined Entity owned (%)	62.50	37.50	100
Value of original shareholders	95.36	57.22	152.58
Price Per share/Post Bid Price announcement	3.81	3.18	
	(95.36/25)	(57.22/18)	

Thus from above it can be said that in absence of any synergy benefit arising from such merger there will be a transfer of wealth from PQR Ltd. to XYZ Ltd. based on the terms of this offers.

In reality, the price of XYZ Ltd 5 shares is likely to be influenced by the value of cash alternative and the price that will be observed in the market is likely to be below Rs.3.45 per share.

The major question here is what will be P/E Ratio after the merger. If director of PQR Ltd. expect there own pre-bid P/E ratio to be applied to the combind earnings. In such case the market value and share price would be.

Market Value. Rs. 16.73Crores × 11 = Rs. 184.03 Crores.

$$\text{Share Price} = \frac{\text{Rs.184.03}}{\text{40 crores}} = \text{Rs.4.60 Per share}$$

Calculation of Gain/Loss

(a) As PQR Ltd. Shareholder's have exactly the same number of shares as they did before the merger. There share would have rise by 18% as calculated below.

$$\frac{\text{Rs.4.60} - \text{Rs.3.90}}{\text{Rs.3.90}} \times 100$$

(b) XYZ Ltd's shareholders have five-sixth the number of their old shares. Their share value might therefore be expected to rise by 25% as calculated below.

$$\frac{\text{Rs.3.83}^* - \text{Rs.3.06}}{\text{Rs.3.06}} \times 100$$

$$^*\ 4.60 \times \frac{5}{6}$$

The shareholders of XYZ Ltd are taking more gain from merger in share exchange because cash alternative is lower and unlikely to be accepted, although it is an assured amount. The cash offer the premium only to 12.7% calculated as follows.

$$\left(\frac{\text{Rs.3.45} - \text{Rs.3.06}}{\text{Rs.3.06}}\right) \times 100 = 12.7\%$$

Alternative Method.

We can also use the Dividend Valuation Model by using Gordon's Model the price of Share of PQR Ltd. will be

$$= \frac{EPS}{Ke - g} = \frac{0.3544 \times 1.04}{13\% - 4\%} = \text{Rs. } 4.09$$

Using the same assumption the value of XYZ Ltd. would be:

$$= \frac{EPS}{Ke - g} = \frac{0.437 \times 1.04}{11\% - 4\%} = \text{Rs.} 6.49$$

On the basis of above alternative model share of PQR Ltd is under valued slightly. Whereas the share of XYZ Ltd is substantially undervalued, may be market is doubtful about growth prospects due to previous disappointments. If we believe PQR Ltd.'s forecast the PQR Ltd. are getting XYZ Ltd's share cheap and especially so if any XYZ's share holders accept the cash offer Rs. 3.45 per share

10. (a) The formula for the Dividend valuation Model is

$$P_0 = \frac{D_1}{K_e - g}$$

K_e = Cost of Capital

g = Growth rate

D_1= Dividend at the end of year 1

On the basis of the information given, the following projection can be made:

Year	DPS (Rs.)	PVF @18%	PV of DPS (Rs.)
2009	3.13	0.847	2.65
2010	3.91	0.718	2.81
2011	5.33*	0.609	3.25
			8.71

*Payout Ratio changed to 50%.

After 2011, the perpetuity value assuming 10% constant annual growth, is:

D_1= Rs. 5.33 × 110% = Rs. 5.863

Therefore P_0 from the end of 2011

$$\frac{\text{Rs. } 5.863}{0.18 - 0.10} = \text{Rs.} 73.29$$

This must be discounted back to the present value, using the 3 year discount factor after 18%.

	Rs.
Present Value of P_0 (Rs. 73.29 × 0.609)	44.63
Add: Dividends 2009 to 2011	8.71
Expected Market Price of Share	53.34

(b) P/E Ratio

$$\text{P E Ratio} = \frac{\text{Expected Market Price of Share } (P_1)}{\text{Earning Per Share}}$$

$$= \frac{\text{Rs. } 53.34}{\text{Rs. } 6.20} = 8.60$$

11.

Current receivables	Rs.46,00,000
Receivables under factor (Rs. 3,74,00,000 x 30/365)	Rs.30,74,000
Reduction in receivables (Rs. 46,00,000 – Rs. 30,74, 000)	Rs.15,26,000

Computation of Net Cost of Factoring

	(Rs.)
Reduction in finance cost (Rs. 15,26,000 x 0.05) per year	(76,300)
Administration cost savings per year	(1,00,000)
Bad debt savings per year	(3,50,000)
Factor's annual fee (3,74,00,000 x 0.03) per year	11,22,000
Extra interest cost on advance	
Rs. 30,74,000 x 80% x (7% – 5%) per year	49,184
Net cost of factoring	6,44,884

The factor's offer cannot be recommended, since the evaluation shows no financial benefit arising.

12. This extension of forward Contract involves following steps

1. Cancel the contract at TT buying rate.
2. Rebook the contract for three months at the current rate of exchange.

Accordingly

Step 1: Cancel the contract at TT buying rate on 30.6.2009

	Rs.
Spot US$ 1	40.4800
Less: Margin 0.080%	0.0324
	40.4476

Hence TT buying rate Rs.40.45 (Rounded off)

US$ 10,000 @ Rs.40.45	Rs.4,04,500/-
US$ 10,000 @ Rs.41.87	Rs.4,18,700/-

Difference in favour of the bank Rs. 14,200/-.

Step 2: New contract to be booked at the appropriate forward rate.

Three months forward rate is as under:

US$ 1	Rs.40.4900	Spot Selling
Add: September Premium	Rs. 0.3750	
	Rs. 40.8650	
Add: Margin (0.25%)	Rs. 0.1022	
	Rs. 40.9672	

Forward rate to be quoted to the customer is US$ 1 = Rs. 40.97

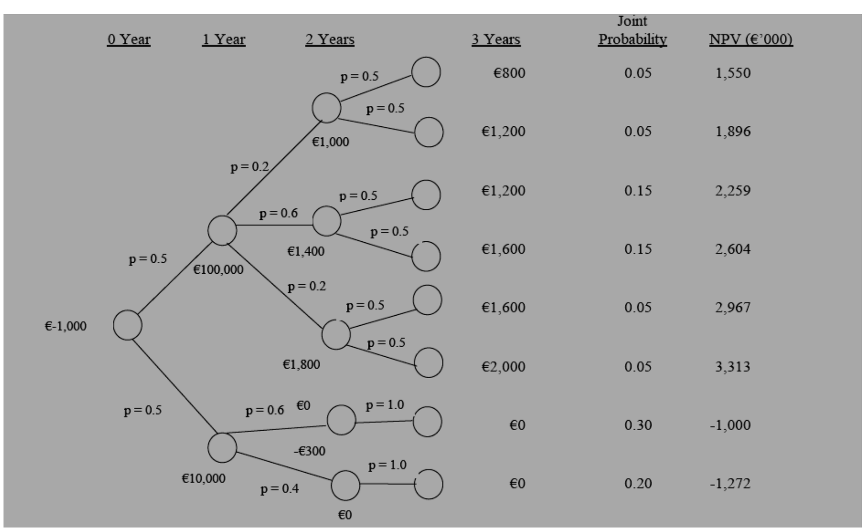
Thus cost to customer Rs. 14,200/-.

13. Our cost of 1 million €

Cross rate Rs. 40.1950/0.7373 = Rs. 54.5165

1 Million € @ 54.5165	Rs. 5,45,16,500
Brokerage	Rs. 2,000
	Rs. 5,45,18,500
Proceeds of sale to customer @ Rs.54.6000	Rs. 5,46,00,000
Profit	Rs. 81,500

14. (a)



Tabular Presentation

Period 0	Period 1		Period 2		Period 3		Overall	
Cash Flow Thousands €	Prob.	Cash Flow Thousands €	Cond. Prob.	Cash Flow Thousands €	Cond. Prob.	Cash Flow Thousands €	Joint Prob	Present Value Thousands €
-1,000	0.5	0	0.4	-€300	1.0	0	0.2	-€1,272
			0.6	0	1.0	0	0.3	-€1,000
	0.5	€1,000	0.2	€1,000	0.5	€800	0.05	€1,550
					0.5	€1,200	0.05	€1,896
			0.6	€1,400	0.5	€1,200	0.15	€2,259
					0.5	€1,600	0.15	€2,604
			0.2	€1,800	0.5	€1,600	0.05	€2,967
					0.5	€2,000	0.05	€3,313

(b) The expected value of net present value of the project is found by multiplying together the last two columns above and totaling them as follows.

(c) The standard deviation is :

$[0.2(-1,272-661)^2 + 0.3(-1,000-661)^2 +0.05(1,550-661)^2 + 0.05(1,896 -661)^2 +0.15(2,259-661)^2 +0.15(2,604-661)^2 +0.05(2,967-661)^2 +0.05(3,313-661)^2]^{1/2}$ = €1,805 thousands

Thus, the dispersion of the probability distribution of possible net present values is very wide. In turn, this is due to 50 percent probability of a zero outcome or less.

15. The input variables are:

S = Rs.27.00; X = Rs. 25.00; r_{RF} = 6.0%; t = 6 months = 0.5 years; and $\sigma^2 = 0.11$

Now, we proceed to use the OPM:

$V = Rs.27[N(d_1)] - Rs.25e^{-(0.06)(0.5)}[N(d_2)]$

$$d_1 = \frac{\ln\left(\frac{s}{x}\right) + \left(r + \frac{\sigma^2}{2}\right)T}{\sigma\sqrt{T}} \text{ and } d_2 = d_1 - \sigma\sqrt{T}$$

$$d_1 = \frac{\ln(\text{Rs. }27/\text{Rs. }25) + [(0.06 + 0.11/2)](0.5)}{(0.3317)(0.7071)}$$

$$= \frac{0.0770 + 0.0575}{0.2345} = 0.5736.$$

$d_2 = d_1 - (0.3317)(0.7071) = d_1 - 0.2345$

$= 0.5736 - 0.2345 = 0.3391.$

$N(d_1) = N(0.5736) = 0.5000 + 0.2168 = 0.7168.$

$N(d_2) = N(0.3391) = 0.5000 + 0.1327 = 0.6327.$

Therefore,

V = Rs. 27(0.7168) - Rs.25$e^{-0.03}$(0.6327) = Rs. 19.3536 - Rs. 25(0.97045)(0.6327)

= Rs. 19.3536 - Rs. 15.3500 = Rs. 4.0036 ≈ Rs. 4.00.

Thus, under the OPM, the value of the call option is about Rs. 4.00.

16. According to put-call parity theorem

$$P_0 = C_0 + \frac{E}{e^{rt}} - S_0$$

$$= €14 + \frac{60}{e^{.08\times.25}} - €70$$

$$= €14 + \frac{60}{1.0202} - €70 = €2.812$$

17. u = 33.00/30.00 = 36.30/33.00 = 1.10 d = 27.00/30.00 = 24.30/27.00 = 0.90

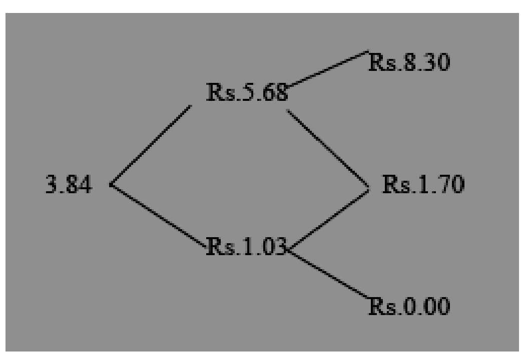
$r = (1 + .05)^{1/2} = 1.0247$

$p = \frac{r-d}{u-d} = \frac{1.0247-0.90}{1.10-0.90}$ = 0.1247/0.20 = 0.6235

C_{uu} = Max [0, 36.30 – 28] = 8.30

C_{ud} = Max [0, 29.70 – 28] = 1.70

C_{dd} = Max [0, 24.30 – 28] = 0



$C_U = \frac{(0.6235)(8.30)+(0.3765)(1.70)}{1.025} = \frac{5.175+0.64}{1.025}$ = 5.815/1.025 = Rs. 5.675

$$C_U = \frac{(0.6235)(1.70)+(0.3765)(0.00)}{1.025} = \frac{1.05995}{1.025} = \text{Rs. } 1.0340$$

$$C_U = \frac{(0.6235)(5.675)+(0.3765)(1.0340)}{1.025} = \frac{3.538+0.3895}{1.025} = \text{Rs. } 3.83$$

h = (33.00 – 27.00)/(5.68 –1.03) = 6.00/4.65 = 1.29

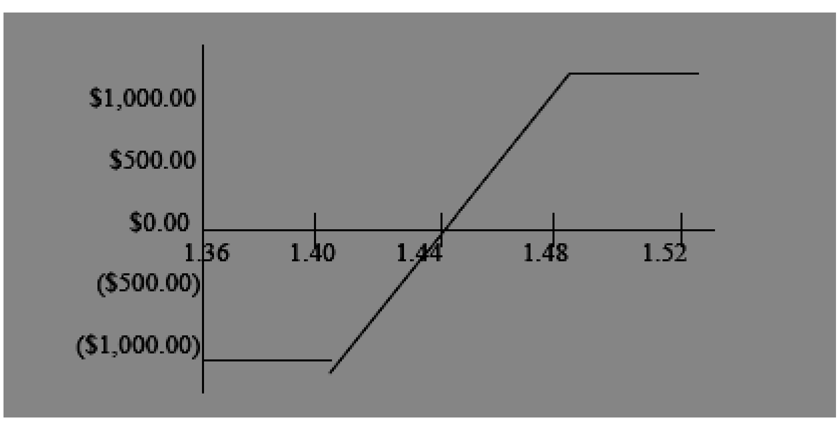
18. (a) Initial Cost

	Cost/Contract	x 31,250
long 1.44 Call	0.0422	($1,318.75)
short 1.48 Call	0.0255	$ 796.88
long 1.40 Put	0.0260	($ 812.50)
short 1.44 Put	0.0422	$1,318.75
		($ 15.62)

June USD/GBP	Net Initial Cost	Long Call 1.44 Profit	Short Call 1.48 Profit	Long Put 1.40 Profit	Short Put 1.44 Profit	Total Net Profit
1.36	($15.62)	0	0	1250	-2500	($1,265.62)
1.40	($15.62)	0	0	0	-1250	($1,265.62)
1.44	($15.62)	0	0	0	0	($15.62)
1.48	($15.62)	1250	0	0	0	$1,234.38
1.52	($15.62)	2500	-1250	0	0	$1,234.38

Example: Long Call 1.44 profit = (1.48 – 1.44) x 31,250 = $1250

(b)



This position resembles a bull vertical spread. The purchaser of this portfolio is probably moderately bullish on the exchange rate. We see this from the willingness to give up the extreme upside in exchange for limiting the downside.

(c) This is a simple application of put-call parity

C - P = R * exp(-rf * dt) - X *exp(-rd *dt)

where R is the exchange rate (1.385), X is the exercise price (1.44)

rd (rf) is the domestic (foreign) risk-free rate,

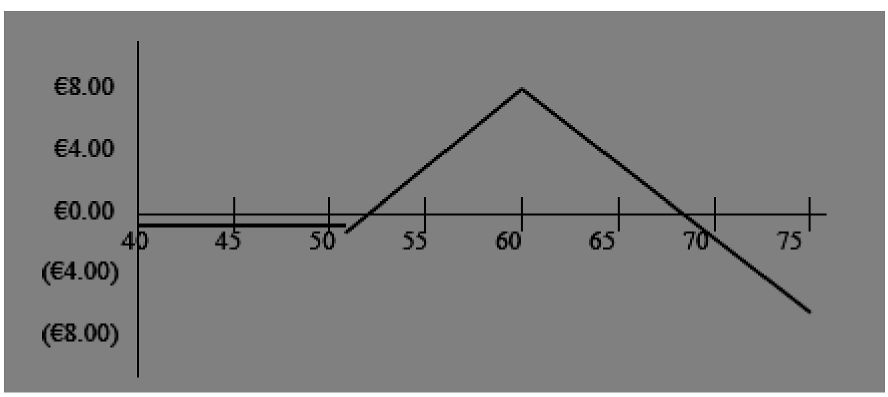
dt is the time to expiration.

C - P = 1.385*exp(-.07*.1667) - 1.44*exp(-.05*.1667) = ($0.0591)

19. (a)

Price of MGH Stock at Expiration	Initial Cost	Profit on Call #1 Position	Profit on Call #2 Position	Net Profit on Total Position
40	(€1.72)	€0.00	€0.00	(€1.72)
45	(€1.72)	€0.00	€0.00	(€1.72)
50	(€1.72)	€0.00	€0.00	(€1.72)
55	(€1.72)	€5.00	€0.00	€3.28
60	(€1.72)	€10.00	€0.00	€8.28
65	(€1.72)	€15.00	(€10.00)	€3.28
70	(€1.72)	€20.00	(€20.00)	(€1.72)
75	(€1.72)	€25.00	(€30.00)	(€6.72)

(b)



Breakeven points are $51.72 and $68.28. Maximum profit occurs at $60.

Maximum profit occurs when the short calls are at-the-money; at prices above $60, the losses on the short calls reduce profit.

Breakeven on the low side occurs at the long call strike price ($50) plus sufficient stock price increase to cover the position's cost ($1.72). This equals $51.72.

Breakeven on the high side occurs with the position's cost ($1.72), profit on the call (P-$50), and loss of the short calls 2($60-P) equal zero: (P-$50) + 2($60-P) - $1.72 = 0 which occurs when price = $68.28

(c) The user of this position is betting on low volatility (that prices will stay between breakeven points). The holder has limited liability for substantial price declines and unlimited liability for substantial price increases.

20. $$\frac{\text{Futures price}}{(1+\text{Risk - free rate})^1} = \text{Spot price} + \text{Present value of storage costs} - \text{Present value of convenience yield}$$

$$\frac{10{,}800}{(1.12)^1} = 10{,}000 + 500 - \text{Present value of convenience yield}$$

Hence the present value of convenience yield is $857.14 per ton.

21. (a)

Security	Expected Return	Beta (β)	Required Return =0.08 + 0.04β	Under Valued Security
O	0.32	1.70	0.148	UVS
P	0.30	1.40	0.136	UVS
Q	0.25	1.10	0.124	UVS
R	0.22	0.95	0.118	UVS
S	0.20	1.05	0.122	UVS
T	0.14	0.70	0.108	UVS

UVS = Under Valued Security

All the securities listed above are undervalued because their expected returns plot above the SML.

(b) (i) Expected return on the portfolio

$$= \frac{1}{6}\ (0.32 + 0.30 + 0.25 + 0.22 + 0.20 + 0.14) = 0.2383$$

(ii) Expected return on the portfolio

R_P $= XR_M – (X – 1)\ R_P$

$= (1.4)\ (0.2383) – (0.4)\ (0.12) = 0.33362 – 0.048 = 0.28562$

22. (a) Method I

Portfolio's return

Small cap growth = 4.5 + 0.80 x 6.85 + 1.39 x (-3.5) + 1.35 x 0.65 = 5.9925%

Small cap value = 4.5 + 0.90 x 6.85 + 0.75 x (-3.5) + 1.25 x 0.65 = 8.8525%

Large cap growth = 4.5 + 1.165 x 6.85 + 2.75 x (-3.5) + 8.65 x 0.65 = 8.478%

Large cap value = 4.5 + 0.85 x 6.85 + 2.05 x (-3.5) + 6.75 x 0.65 = 7.535%

Expected return on market index

0.10 x 8.8525 + 0.25 x 5.9925 + 0.15 x 7.535 + 0.50 x 8.478 = 7.7526%

Method II

Expected return on the market index

= 4.5% + [0.1x0.9 + 0.25x0.8 + 0.15x0.85 + 0.50x1.165] x 6.85 + [(0.75 x 0.10 + 1.39 x 0.25 + 2.05 x 0.15 + 2.75 x 0.5)] x (-3.5) + [{1.25 x 0.10 + 1.35 x 0.25 + 6.75 x 0.15 + 8.65 x 0.50)] x 0.65

= 4.5 + 6.85 + (-7.3675) + 3.77 = 7.7525%.

(b) Using CAPM,

Small cap growth = 4.5 + 6.85 x 0.80 = 9.98%

Small cap value = 4.5 + 6.85 x 0.90 = 10.665%

Large cap growth = 4.5 + 6.85 x 1.165 = 12.48%

Large cap value = 4.5 + 6.85 x 0.85 = 10.3225%

Expected return on market index

= 0.10 x 10.665 + 0.25 x 9.98 + 0.15 x 10.3225 + 0.50 x 12.45 = 11.33%

(c) Let us assume that Mr. Nirmal will invest X_1% in small cap value stock and X_2% in large cap growth stock

$X_1 + X_2 = 1$

$0.90\, X_1 + 1.165\, X_2 = 1$

$0.90\, X_1 + 1.165(1 – X_1) = 1$

$0.90\, X_1 + 1.165 – 1.165\, X_1 = 1$

$0.165 = 0.265\, X_1$

$$\frac{0.165}{0.265} = X_1$$

$0.623 = X_1$, $X_2 = 0.377$

62.3% in small cap value

37.7% in large cap growth.

23.

Classic (R_i)	Market Index (R_m)	T-bills (R_p)	$R_i – R_p$	$R_m – R_p$
17.1	10.8	5.4	11.70	5.4
-14.6	-8.5	6.7	-21.30	-15.20
1.7	3.5	6.5	-4.8	-3.00
8.0	14.1	4.3	3.7	9.8
11.5	18.7	4.1	7.4	14.6
-5.8	-14.5	7.0	-12.8	-21.5
-15.6	-26.0	7.9	-23.5	-33.9

38.5	36.9	5.8	32.7	31.1
33.2	23.6	5.0	28.2	18.6
-7.0	-7.2	5.3	-12.3	-12.5
2.9	7.4	6.2	-3.3	1.2
27.4	18.2	10.0	17.4	8.2
23.0	31.5	11.4	11.6	20.1
-0.6	-4.9	14.1	-14.7	-19.0
21.4	20.4	10.7	10.7	9.7
Average 9.406	Average 8.267	Average 7.36		
Standard Deviation 16.40	Standard Deviation 17.126	Standard Deviation 2.815		

Sharpe's measure index

$S = R_p – R_p/\sigma_p$

Where,

R_p = Average Return on portfolio

R_f = Risk-free rate of return

σ_p = Standard deviation of portfolio

Classic Mutual Fund- $S_p = R_p - R_f/\sigma_p$ = 9.407 – 7.360/16.4 = 0.125

Market Index- $S_p = R_m – R_f/\sigma_m$ = 8.267 – 7.360/17.126 = 0.053

Classic Mutual Fund is better on the basis of the Sharpe's measure.

Treynor's measure

$T = R_p – R_f/\beta_p$

β_p = Beta value of portfolio.

Using regression technique to fine Beta

$$b = \frac{\sum xy - n\bar{x}\bar{y}}{\sum x^2 - n\bar{x}^2}$$

After making calculation by taking Market Index as (x) and Classic Mutual Fund as (y) the values are

Market Index (x)	$(x)^2$	Classic (y)	$(y)^2$	(xy)
10.8	116.64	17.1	292.41	184.68
-8.5	72.25	-14.6	213.16	124.1
3.5	12.25	1.7	2.89	5.95
14.1	198.81	8.0	64.00	112.8
18.7	349.69	11.5	132.25	215.05
-14.5	210.25	-5.8	33.64	84.1

-26.0	676.00	-15.6	243.36	405.6
36.9	1361.61	38.5	1482.25	1420.65
23.6	556.96	33.2	1102.24	783.52
-7.2	51.84	-7.0	49.00	50.4
7.4	54.76	2.9	8.41	21.46
18.2	331.24	27.4	750.76	498.68
31.5	992.25	23.0	529.00	724.5
-4.9	24.01	-0.6	0.36	2.94
20.4	416.16	21.4	457.96	436.56

$\Sigma x^2 = 5424.72$	$\bar{y} = 9.406$
$\Sigma y = 141.1$	$\bar{x} = 8.267$
$\Sigma y^2 = 5361.69$	n=15
$\Sigma xy = 5070.99$.	

Substituting values in the above equation

$$b = \frac{5070.99 - 15X9.406X8.267}{5424.72 - 15X(8.267)^2} = \frac{3904.59}{4399.57} = 0.88$$

$a = \bar{y} - b\bar{x} = 9.406 - 0.88 \times 8.267 = 2.13.$

From above calculation Beta value of security = 0.88

Treynor's measure of Classic Mutual Fund - $T_1 = 9.407 - 7.360/0.88 = 2.32$

Treynor's measure of Market Index- $T_m = 8.267 - 7.360/1.00 = 0.907$

Jensen's performance measure

$\bar{R}_{jt} - R_{ij} = \alpha_j + \beta_j (\bar{R}_{mt} - R_{ft})$

Where,

$\bar{R}_{jt}$ = Average return on portfolio j for period t

R_{ft} = Risk less rate of interest for period t

α_j = Intercept that measures the forecasting ability of the portfolio manager

β_j = A measure of systematic risk

$\bar{R}_{mt}$ = Average return of a market portfolio for period t.

Substituting values in the above equation = $9.406 - 7.360 = \alpha_j + 0.88\ (8.267 - 7.360)$

$\alpha_i = 2.046 - 0.798 = 1.248$

24. Risk appetite, risk aversion and risk premium are sometimes used interchangeably. They are, however, distinctly different. Risk aversion is an intrinsic attribute of investors that leads to the tendency to avoid risk unless adequately compensated. In simple terms, it is the degree to which investors abhor uncertainty surrounding their investment.

Risk appetite is the willingness to bear risk. It consists of two components. One is the degree to which investors dislike the associated uncertainty and the other component is the level of that uncertainty.

Risk premium is the reward for holding a risky investment rather than a risk-free one. It measures the additional returns that investors require to hold assets whose returns are more variable than those of low risk ones.

When investors are unwilling to tolerate risk, they require higher returns for bearing risk. An uncontrollable surge in investor risk appetite can plunge the financial markets into crisis. On the other hand, collapse of investor appetite for risk will dampen the markets. When investor risk appetite increases and shifts towards riskier assets, their prices shoot up, as compared to the less risky ones. One can observe a price rise in low risk assets relative to riskier investments when sentiments across the market are of diminishing risk appetite.

Investors with a high risk appetite will invest in aggressive equity instruments in high risk/high reward sectors. The probability of losing money is as high as is the probability of reaping rewards. Those with a low risk appetite opt for debt instruments. Between the two extremes is the category of investors who take moderate risk. Balanced funds or a mix of equity and debt in their portfolio is best-suited for them.

Sharpe ratio characterises how well the returns of an asset compensates the investor for the risk he takes. It is the ratio of a portfolio's total returns minus the risk-free rate divided by standard deviation of the portfolio. It is a measure of performance of the portfolio in return for bearing risk. Hence, a higher Sharpe ratio implies greater rewards for taking additional risks. The ratio measures a portfolio's risk-return trade-off, and helps the investor decide if the investment is worth the risk.

25. (i) Although EVA is used primarily for evaluating management performance, it also is being used by external analysts to evaluate management with the belief that superior internal performance should be reflected in a company's stock performance. Several studies have attempted to determine the relationship between the two variables (EVA and MVA), and the results have not been encouraging. Although the stock of firms with positive EVAs has tended to outperform the stocks of negative EVA firms, the differences are typically insignificant and the relationship does not occur every year. This poor relationship may be due to the timing of the analysis (how fast EVA is reflected in stocks) or because the market values (MVAs) are affected by factors other than EVA—for example, MVA can be impacted by market interest rates and by changes in future expectations for a firm not considered by EVA—that is, it appears that EVA does an outstanding job of evaluating management's past performance in terms of adding value. While one would certainly hope that superior past performance will continue, there is nothing certain about this relationship.

(ii) Home loan repayments are huge commitments that most families face. Sometimes, there is a huge difference in interest rate between what the borrower currently pays his bank and what another lender offers. In such a scenario, people consider either prepaying their loan or switching the lender. Switching to another lender offering better rates is called balance transfer.

Expenses involved

A balance transfer of the outstanding loan from one bank to another can result in savings of a few thousand rupees, month after month in your EMIs. Borrowers must exert due diligence before exploring the balance transfer option. The existing lender charges a penalty for prepayment and the new lender may seek processing fees. These expenses must be taken into account while weighing the benefits of a balance transfer. Some lenders may levy additional switching charges that must be taken into account as well.

When it works well for you

It makes sense to go ahead with a balance transfer if your net gain is more than one percent. This is after factoring in the prepayment penalty of two percent and loan processing charge of 0.5 to one percent. Since lower rates are applicable for a new borrower (rather than existing borrowers) shop for competitive rates and a good lender. After the switching exercise, you shouldn't get a rude jolt that the new lender has increased the rates. So find out if any rate hike is on the cards before switching.

(iii) For longer –term hedging programmes, such as a two-year loan with three-monthly rollover dates, more complicated strategies can be adopted, such as 'stack hedging' and 'strip hedging'.

With a stack hedge, the total number of contract needed to hedge the loan are purchased for the month of the first rollover date. At that date, the remaining, number of contracts necessary are purchased for the next rollover date, and so on.

A strip hedge, on the other hand, treats each three-month segment of the loan as separate entity, and futures contracts are purchased for each rollover date at the outset of the loan.

PAPER – 3 : ADVANCED AUDITING

QUESTION

1. Comment – "Generally an audit is not concerned with the propriety of business conduct".

2. What are the sources of information for acquiring knowledge of client's business?

3. Distinguish with suitable examples between a case where an auditor is obliged to state in his report to the members of a company that the accounts do not show a true and fair view, and a case where he states that he is unable to form an opinion as to whether or not the accounts give a true and fair view.

4. Discuss the design & control procedures which the auditor should adopt in applying CAAT in an audit under EDP environment.

5. Your client is contemplating taking over a manufacturing concern and desires that in the course of due diligence review, you should look specifically for any hidden liabilities and overvalued assets. State the major areas you would examine for the above.

6. What are the methods an auditor may employ in the performance of statistical sampling tests ?

7. The auditor's assessment of materiality and audit risk may be different at the time of initial Planning and while evaluating the results - Comment

8. What are the special issues involved in Investigation?

9. As a Statutory Auditor, how would you deal with the following?

   (a) Mr. Satish is appointed as the auditor of Greenwood Travels Ltd. with audit fees of Rs. 35,000. He purchased air ticket from Delhi to Kolkata and back for Rs. 18,000 from the client for his personal work and the amount remains unpaid at the end of the year as it is a general practice of the client to give credit to all. Mr. Satish claims that he does not incur any disqualification as contained in Section 226(3)(d) of the Companies Act.

   (b) Anjana Ltd., a well reputed manufacturing public limited company has made a contribution of Rs. 2.5 lacs during the financial year ended 31.3.08 to a political party for running a school, situated in the village, where most of the workers of the company reside. It is admitted that the benefit of the school is mostly for the children of the workers of the company. The company has not made any profits in the last four years.

10. Comment on the following:

    (a) The Company auditor became aware of a matter, only after he had issued his audit opinion. Had he become aware of the same prior to his issuing the audit report, he would have issued a different opinion. What are his responsibilities in such a case?

    (b) Rajan and Co., Chartered Accountants, were appointed as statutory auditor of Sonia Ltd. in the annual general meeting in August 2007. They resigned in June, 2008 without auditing the financial statements and submitting an audit report thereon. In the next annual general meeting in August, 2008 S and Co., Chartered

Accountants, have been appointed as the statutory auditor. It has been decided that the accounts for year 2007-08 would be discussed in the next AGM along with the accounts of 2008-09. Is S and Co. responsible for examining and reporting on the annual accounts pertaining to year 2007-08.

11. Your firm has been appointed as auditor of XYZ Co. State your opinion on the following matter:

    The company has also appointed a cost auditor and, therefore, the management had requested your firm not to review cost records.

12. The Chairman of System International Limited, a large trading company with extensive overseas interests, has asked you to accept the nomination to replace the present auditors at the next annual general meeting of the company.

    (a) Before acceptance of any new audit assignment, there are a number of reasons for non-acceptance that have to be considered. List the circumstances in which acceptance of the nomination would be inappropriate under the following:

        (i) Legal aspect

        (ii) Ethical aspect

        (iii) Practical aspect

13. You have just been appointed as auditor of Escort Engineering Ltd., to fill a casual vacancy created by the death of the previous auditor, Mr. Hemanth, a sole practitioner. He has died after carrying out the audit of the company's accounts, but without having signed the audit report of the members for the accounting period.

    Set out the considerations, which apply, and the steps, which you would take in these circumstances.

14. (a) Mr. Ramesh, a chartered accountant, was appointed by Ajeem & Co. to prepare the statement of accounts and income tax returns. He examined the books of accounts and signed a few statements including the trading and profit and loss account and the balance sheet. He also forwarded the statements of account of the firm to the income tax department stating that the accounts were verified by him. But the income tax department late discovered that the profits shown in the above statements were incorrect and false. The department, therefore, brought legal action against the auditor for his negligence in duty.

    (b) Mr. Rakesh, a chartered accountant, was employed by the complainant for the purpose of income tax appeal before the Income Tax Appellate Tribunal. The remuneration for this purpose to be paid had been fixed on certain parentage of the relief of tax.

        The complainant submitted a complaint to the Institute of Chartered Accountants of India on the following grounds:

        1. That the respondent failed to appear at the hearing of the appeal before the tribunal in spite of agreement between them.

2. That a large sum of money were wrongfully taken by him by false representation of the case.

15. How will you conduct -

    (i) Audit of receipts

    (ii) Audit of stores and stock

16. Write a short note on - Solvency margin in case of an insurer carrying on general insurance business.

17. As an auditor comment on the following:

    RST& Co., a firm of Chartered Accounts has three partners, R, S & T; T is also in whole time employment elsewhere. The firm is offered the audit of XYZ Ltd. and its twenty branches. The firm already holds audit of 40 companies including audit of one foreign company.

18. Is there any misconduct on the part of a Chartered Accountant in the following circumstances:

    (i) Mr. L, a Chartered Accountant in practice as a sole proprietor has an office in Bangalore near Trinity Circle. Due to increase in professional work, he opens another office in a suburb of Bangalore which is approximately 60 kilometers away from his existing office. For running the new office he employs three retired Income-tax Officers.

    (ii) Mr. X, a chartered accountant in practice, enters into a partnership with a non-chartered accountant. However, the firm does not undertake any professional assignment and is dissolved after a few months.

19. (a) 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

    (b) The superannuation-cum-pension fund for the employees of a company was under a separate 'trust'.

    Both the company and the trust were under the same management. The auditor, who was auditing the accounts of the company as well as the trust noted some irregularities in the operation of the trust and commented upon these irregularities in the confidential report given to the trustees, but did not mention about these irregularities in his report on the Annual accounts of the Trust.

20. You have been appointed Management Auditor of a large manufacturing company suffering from working capital crunch. Enlist and discuss the related areas which you would probe into to overcome the company's problem.

21. As a Statutory Auditor, how would you deal with the following?

    (a) S Ltd., a listed company, was incurring heavy losses since the last several years and the industry in which it was functioning was not expected to perform better in the next few years. While finalising the accounts for the year ended 31st March 2007, the CFO of the company decided to create a Deferred Tax Asset for the tax benefits that would arise in future years from the earlier years losses that had remained unabsorbed in Income tax.

(b) A father and son are controlling 34% of voting power in AB Company Limited. They are having a separate partnership firm, which supplies mainly the raw material to the Company. The Management says that the above transaction need not be disclosed.

22. Under CARO, 2003 how, as a statutory auditor would you comment on the following:

    (i) Fixed assets comprising 1/3rd of the total assets have been disposed off during the year.

    (ii) A Term Loan was obtained from a bank for Rs.75 lakhs for acquiring R&D equipment, out of which Rs.12 lakhs was used to buy a car for use of the concerned director, who was overlooking the R&D activities.

23. As an internal auditor of a Cement Manufacturing Company, draft an audit programme for verification of transportation charges for despatches from the factory.

24. Write short notes on - Recognition of Deferred Tax Assets.

SUGGESTED ANSWERS/HINTS

1. The objective of an audit of financial statements of an enterprise, according to SA 200A* entitled 'Objective and Scope of the Audit of Financial Statements', is to enable an auditor to express an opinion as to the truthfulness and fairness of financial statements. The auditor's opinion helps to establish reliability of the financial statements.

   The auditors, however, does not give opinion on the propriety of business conduct or its future prospects. SA 200A has specifically pointed out that the user of the "financial statements should not assume that the auditor's opinion is an assurance as to future viability of the enterprise or the efficiency or effectiveness with which the management has conducted the affairs of the enterprise".

   In pursuance of the role of the auditor in lending credibility to the financial statements the Companies Act, 1956, has provided that he should be concerned about propriety of some specific transactions.

   Section 227(1A) of the Act requires the auditor to enquire into six specified matters and report by exception. This section has been inserted into the Act to ensure that the funds of the company have not been siphoned off by the directors. Also under CARO, 2003 issued by the Central Government in pursuance of powers given to it by Section 227 (4A) of the Companies Act, 1956, the company auditor is required to examine the financial propriety of some transactions.

   Further, SA 570, 'Going concern' requires the auditors to evaluate whether the going concern concept is applicable to the circumstances of the entity and whether it will continue for a foreseeable future i.e., a period not exceeding one year after balance sheet. In other words, future viability for one year is to be assessed.

To conclude, we can say that though, generally, an audit is neither concerned with propriety of business conduct nor its future viability yet the auditor would be required to examine the former for the purposes of Section 227(1A) and Section 227(4A) of the Act and the latter for assessing applicability of going concern assumption as per the requirements of SA 570.

(Note: Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (erstwhile AAS 1) and SA 200A (erstwhile AAS 2) will be merged into one Standard, i.e. SA 200.)

2. Sources of information: The sources of information vary according to the nature, size and complexity of each business. Standard on Auditing (SA) 300, Audit Planning, has identified sources from which knowledge of business can be acquired. These are – internal and external reports and other publications; discussions with management / client and visit to premises and plants :

Sources	
Internal reports	• Client's annual report to shareholders • Minutes of board, shareholders' and important committee meetings • Internal financial management reports such as budgets, forecasts and projections • The previous years' working papers • Policy and procedure manuals • Internal audit reports, etc.
External reports	• Trade journal, magazines and newspapers • Text books • Relevant publications of the ICAI and other professional bodies • Industry publications
Discussions with management/client	• The auditor should meet the client or senior management of the enterprise under audit to obtain information, which is not otherwise available, and to gain understanding on certain key issues affecting the business. Such discussions with the client might include subjects such as • changes in organizational structure, • new or closed plant facilities, • scope and timing of examination and other similar issues.

Visit to client's premises and plant facilities	The visit to client's premises and plant facilities is important to gain understanding of plant layout, manufacturing process, physical safeguards surrounding inventories and internal documents generated within the organization to record transactions. For example, receiving reports indicating receipt of materials, goods outward notes indicating dispatch of goods to customers etc. Some potential problems might be noticed by the auditor during such visit, for example, rust on equipment may indicate a potential problem of obsolescence.

3. Adverse Report and Disclaimer of Opinion: SA 200 " Basic Principles Governing an Audit" states that the audit report should contain a clear written expression of opinion on the financial information. In order to express such an opinion, the auditor should review and assess the conclusions drawn from the audit evidence obtained by him. This review and assessment involves forming an overall conclusion as to whether:

   (a) the financial information has been prepared using acceptable accounting policies, which have been consistently applied;

   (b) the financial information complies with relevant regulations and statutory requirements;

   (c) the view presented by the financial information as a whole is consistent with the auditor's knowledge of business environment; and

   (d) there is adequate disclosure of all matters relevant to the proper presentation of financial information.

   The opinion expressed by an auditor may be unqualified, adverse, qualified or a disclaimer of opinion depending upon the degree of satisfaction of the auditor about the overall truth and fairness of the financial statements.

   An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements. Such an opinion is issued when the effect of disagreement is so material and pervasive to financial statements that the auditor concludes that a qualification of his report is not adequate to disclose the misleading or incomplete picture of the financial statements. This conclusion can be reached by the auditor in an extreme case where there had been flagrant violation of the accounting principles or evidence is not available for material transactions or within the knowledge of the auditor there exists material concealment or misstatement about financial affairs. He must have strong and convincing evidence in favour of his conclusion. It should be appreciated that this opinion is also an overall opinion and owes direct relationship to the portrayal of the financial position in the accounting statements. If one or two illegal transactions of not much significance have taken place and they have been fairly presented and disclosed in the accounting statements, it can not be held that the accounting statements are not true and fair. They are true and fair subject to the illegality already disclosed. The audit report stating that the accounts do not show a true and fair view is indeed an extreme and rare case. In case an auditor has to report to that effect, there must exist reservations on the accounts affecting materially the accounts taken as a whole. The reservation should not be such that it only partially affects the accounts. Also, mere reservation in the mind of the auditor is not enough, he must have convincing and definite evidence to state that the accounts are so materially irregular that they do not show a true and fair view.

SA 700, "The Auditor's Report on Financial Statements" requires that a disclaimer of opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and is, accordingly, unable to express an opinion on the financial statements. A limitation may be imposed by circumstances, for example, when the timing of the auditor's appointment is such that the auditor is unable to observe the counting of physical inventories. It may also arise when, in the opinion of the auditor, the entity's accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed to be desirable. In these circumstances, the auditor would attempt to carry out reasonable alternative procedures to obtain sufficient appropriate audit evidence to support an unqualified opinion. This would also be the case when internal control is so weak as to prevent the auditor from putting any reliance on the accounts. Therefore, to be fair and just, he should state that he is unable to form an opinion as to whether or not accounts give a true and fair view, for example, when the auditor was not able to examine a substantial part of the books of accounts because they were in police custody. In both the situations, the auditor should give also his reasons for the report he makes. Instances in which the auditor faces limitations on the scope of his work, it is appropriate for him to state that he has not been able to form an opinion.

4. The different design and procedural aspects of EDP systems are as follows:

   (i) Consistency of Performance: EDP systems perform functions exactly as programmed and are potentially more reliable than manual systems, provided that all transactions type and conditions that could occur are anticipated and incorporated into the system.

   (ii) Programmed Control Procedures: The nature of computer processing allows the design of internal control procedures in computer programs. These procedures can be designed to provide controls with limited visibility (e.g., protection of data against unauthorized access may be provided by passwords) Other procedures can be designed for use with manual intervention, such as review of reports printed for exception and error reporting and reasonableness and limit checks of data.

   (iii) Single Transaction Update of Multiple or Data Base Computer Files: A single input to the accounting system may automatically update all records associated with the transaction (e.g., shipment of goods documents may update the sales and customers' accounts receivable files as well as the inventory file). Thus, an erroneous entry in such a system may create errors in various financial accounts.

   (iv) System Generated Transactions: Certain transactions may be initiated by the EDP system itself without the need for an input document. The authorisation of such transactions may neither be supported by visible input documentation nor documented in the same way as transactions which are initiated outside the EDP system (e.g., interest may be calculated and charged automatically to customers' account balances on the basis of pre-authorised terms contained in a computer program).

(v) Vulnerability of Data and Programme Storage Media: Large volumes data and the computer programs used to process such data may be stored on portable or fixed storage media, such as magnetic discs and tapes. These media are vulnerable to theft, or international or accidental destruction.

5. The objective of the Due Diligence exercise will be to look specifically for any hidden liabilities or over valued assets.

   Certain examples of hidden liabilities are:

   - The company may not show any show cause notices which have not matured into demands, as contingent liabilities. These may be material and important.
   - The company may have given "Letters of Comfort" to banks and Financial Institutions. Since these are not "guarantees", these may not be disclosed in the Balance sheet of the target company.
   - The Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnify all liabilities and contingent liabilities of the same prior to the date of transfer. These may not be reflected in the books of accounts of the company.
   - Product and other liability claims; warranty liabilities; product returns/discounts; liquidated damages for late deliveries etc. and all litigation
   - Tax liabilities under direct and indirect taxes
   - Long pending sales tax assessments
   - Pending final assessments of customs duty where provisional assessment only has been completed.
   - Agreement to buy back shares sold at a stated price.
   - Future lease liabilities
   - Environmental problems/claims/third party claims
   - Unfunded gratuity/superannuation/leave salary liabilities; incorrect gratuity valuations.
   - Huge labour claims under negotiation when the labour wage agreement has already expired.

   Examples of over valued assets could be:

   - Uncollected/uncollectable receivables
   - Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company

- Underused or obsolete Plant and Machinery and their spares; asset values which have been impaired due to sudden fall in market value etc.
- Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue
- Litigated assets and property
- Investments carried at cost though realizable value is much lower
- Investments carrying a very low rate of income / return
- Infructuous project expenditure/deferred revenue expenditure etc.
- Group Company balances under reconciliation etc.
- Intangibles of no value.

6. The auditor may use a computer to render considerable assistance in the performance of statistical sampling tests, employing the following methods:

   (a) Interval sampling: The computer is programmed to select every nth item stored on magnetic tape, and the items so selected can be copied on to a separate tape and printed out in the form required by the auditor.

   (b) Random number selection: The technique of random number selection can be computerised, the random numbers being stored on tape or generated by the computer separately for each application.

   (c) Random Interval selection: The dangers of selecting a biased example by the use of a uniform interval can be avoided through the use of random variation of the interval between successive items. Random intervals are selected from random number tables maintained on magnetic tape, or produced by means of a random number generator program.

   While applying statistical sampling, it should be remembered that materiality is one of the major considerations to decide whether or not a sample should be selected. For instance in case of certain enterprises like real estate builders, agents, merchant houses, etc. the total number of transactions may be relatively very small and hence are not appropriate for the selection of a sample. Even in case of major enterprises, there are certain items which are so significant that the records relating to them should be scrutinized by the auditor at new item by item basis. For example, the year end closing entries in the journal may be manipulated and, therefore, each entry must be carefully examined and authenticated by the auditor. In actual practice many firms of Chartered Accountants have found limited use of statistical sampling than anticipated by them. The various reasons which may be attributed to this state of affairs are as under:

   (i) Audit has never been a mathematical discipline,

   (ii) Designing and sampling schemes properly take unduly long time.

   (iii) To draw valid conclusions on the basis of statistical sampling, all members of the audit team should have an excellent grasp of the statistical principles involved,

7. Materiality and Audit Risk in Evaluating Audit Evidence: The auditor's assessment of materiality and audit risk may be different at the time of initially planning the engagement from that at the time of evaluating the results of his audit procedures. This could be because of a change in circumstances or a change in the auditor's knowledge as a result of the audit. For example, if the audit is planned prior to period end, the auditor will anticipate the results of operations and the financial position. If actual results of operations and financial position are substantially different, the assessment of materiality and audit risk may also change. Additionally, the auditor may, in planning the audit work, intentionally set the acceptable cut off level for verifying individual transactions at a lower level than is intended to be used to evaluate the results of the audit. This may be done to cover a larger number of items and thereby reduce the likelihood of undiscovered misstatements and to provide the auditor with the margin of safety when evaluating the effect of misstatements discovered during the audit.

   In forming his opinion on the financial information, the auditor should consider whether the effect of aggregate uncorrected misstatements on the financial information is material. Qualitative considerations also influence an auditor in reaching a conclusion as to whether the misstatements are material.

   The aggregate of uncorrected misstatements comprises:

   (a) specific misstatements identified by the auditor, including the net effect of uncorrected misstatements identified during the audit of previous periods; and

   (b) the auditor's best estimate of other misstatements which cannot be specifically identified (that is, projected errors).

   When the auditor tests an account balance or class of transactions by an analytical procedure, he ordinarily would not specifically identify misstatements but would only obtain an indication of whether misstatements might exist in the balance or class and possibly its approximate magnitude. If the analytical procedure indicates that misstatements might exist, but not its approximate amount, the auditor ordinarily would have to employ other procedures to enable him to estimate the aggregate misstatement in the balance or class.

   When an auditor uses audit sampling to test an account balance or class of transactions, he projects the amount of known misstatements identified by him in his sample to the items in the balance or class from which his sample was selected. That projected misstatement, along with the results of other substantive tests, contributes to the auditor's assessment of aggregate misstatement in the balance or class.

   If the aggregate of the uncorrected misstatements that the auditor has identified approaches the materiality level, or if auditor determines that the aggregate of uncorrected misstatements causes the financial information to be materially misstated, he should consider requesting the management to adjust the financial information or extending his audit procedures. In any event, the management may want to adjust the financial information for known misstatements. The adjustment of financial information may involve, for example, application of appropriate accounting principles, other adjustments in amounts, or the addition of appropriate disclosure of inadequately disclosed matters. If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should express a qualified or adverse opinion, as appropriate.

8. Investigation broadly range between two extremes – on one hand there are those in respect of which complete accounts, documents, records and other information are available, and on the other hand, those in respect of which little information, besides published accounts and statistical data, is available. Further, investigation may cover the whole of accounting or may relate to only a part or parts of accounting as may be specified. Some of the issues that may arise in investigations are as follows:

   (i) Verification: Whether an investigator is require to undertake a cent percent verification approach or whether he can adopt selective verification;

   (ii) Reliance on Audited Statements: Whether the investigator can put reliance on the already audited statements of accounts will depend on assignment to assignment. While in Short & Compton v Brackert, it was held that reliance can be so put in case of incoming partner, in Mead v Ball Backer & Co., it was held that the investigator cannot put such reliance when advising a proposed investor in a limited company.

   (iii) Experts Opinion: Whether the investigation requires views or opinions of experts in various fields;

   (iv) Independence: The investigator should keep himself scrupulously professional and should keep the interests of all the involved parties in view;

   (v) Investigator's Opinion: The investigator should refrain from issuing speculative opinion and should confine his opinion to the established facts only;

   (vi) Working Papers: The investigator should retain, on his files full notes of the work carried out, copies of schedules and all the working papers. This will help him support his explanations when called up in the court to give evidence of the work performed.

9. (a) Disqualification of auditors: The guidance note on "Independence of Auditors" issued by the ICAI in this context recommends that "a question of indebtedness may also be raised where an auditor of a company purchases goods or services from the company audited by him. In such a case, if the amount outstanding exceeds Rs. 1000, irrespective of the nature of the purchase or period of credit allowed to other customers, the provisions concerning disqualification of auditor as contained in Section 226 (3) (d) will be attracted. This is applicable in the case of purchase of air tickets for personal work by the auditor of a company on normal terms and conditions of the business of the company as the amount outstanding at the end of the year exceeded Rs. 1000. Therefore, the contention of Mr. Satish that he does not incur disqualification is not correct as he has purchased a ticket of the value of Rs. 18,000. The provisions concerning disqualifications of auditor as contained in Section 226 (3) (d) will be attracted.

   (b) Restrictions regarding political contribution: Section 293A of the Companies Act 1956 deals with prohibitions and restrictions regarding political contribution. A non-Government company which has been in existence for not less than three years may contribute any amount or amounts directly or indirectly to any political party or for any political purpose to any person provided that the aggregate of the amounts which may be so contributed by a company in any financial year shall not exceed 5% of its average net profits determined in accordance with the provisions of Sections 349 and 350 during the three immediately preceding financial years. In the given case, the company has not made any profit in last four years and contributed Rs. 2.5 lacs during the year to a political party for running a school. This is violation of the provisions of Section 293-A of the Companies Act although the children of its workers are benefited. The auditor would have to qualify his report stating the contravention of the provisions of the Companies Act.

10. (a) Legal and professional perspective

(i) Right to receive notice and to attend general meeting

- According to section 231, the auditor has a right to receive all notices of and other communications relating to any general meeting of a company as are sent to the members of the company.
- He can attend any general meeting like a member.
- However, he can speak only on the matters which concern him as an auditor.

(ii) SA 560 – As per SA 560, the auditor before issuing the audit report should consider subsequent events i.e. events occurring from date of balance sheet to the date on which audit report is issued.

(iii) Events subsequent to the date of audit report – The auditor, in case he becomes aware of a matter subsequent to his audit report and such a discovery would cause the revision of the audit report, he may bring this to the notice of shareholders.

Present case

Based on the above perspective, can say, in the given situation, the auditor may attend the general meeting and bring to the notice of shareholders the matter concerned and should communicate to them the change in his opinion.

(b) Duty to report

(i) Section 227(2) requires the auditor to make a report to the members of the company on the accounts examined by him and on every balance sheet and profit and loss account and on every document declared to a part of or annexed to the balance sheet or profit and loss account laid before the company in the general meeting during his tenure of office.

(ii) The auditor holds his office from the conclusion of the AGM to the factual conclusion of the next AGM. Thus, he could examine and report on the annual accounts pertaining to all financial years falling during the tenure of his office.

Given situation – On the basis of above arguments, we can say in the present case S and Co. can examine and report on the annual accounts pertaining to both year 2007-08 as well as 2008-09.

11. (i) Legal requirements

    (a) Section 233(B) empowers the Central Government to order audit of cost accounts in certain cases. However, it points out that the audit conducted by cost auditor under this section shall be in addition to the audit conducted by an auditor under section 224 of the Companies Act, 1956.

    (b) Section 227(3) requires the statutory auditor to report whether in his opinion, proper books of account as required by law have been kept by the company, so far it appears from his examination of those books. Proper books of account include cost records. Thus, it is the statutory duty of the auditor to review cost records maintenance.

    (c) CARO, 2003 has laid down similar responsibility on the statutory auditor.

    (ii) In the given situation, based on the provisions of Sections 233B and 227 of the Act we can say, the auditor should not accept management's contention.

12. It would be inappropriate for a person to accept a nomination as auditor under the following circumstances:

    (i) Legal aspect

    Section 226 (3) of the Companies Act, 1956 provides the disqualifications. According to it, the following persons are not qualified to be appointed as auditor of a company:

    - An officer or employee of the company
    - A person who is a partner or who is in employment of an officer or employee of the company.
    - A person who is indebted to the company for an amount exceeding Rs.1,000 or who has given any guarantee or provided any security in connection with indebtedness of any third person

    (ii) Ethical aspect

    Following are the circumstances where a person cannot accept a nomination as auditor on ethical ground:

    - A potential conflict of interest between the company and an existing client might arise.
    - The person has a personal relationship with a senior member of the company's staff.
    - The person is financially involved with the company and wishes to remain so.
    - The person might not wish to be professionally associated with this firm for some reason arising out of the need to change auditors.

(iii) Practical aspect

Following are circumstances where a person cannot accept a nomination as auditor on practical ground:

- The job might be beyond the capacity of the audit firm, because it requires too many staff or expertise not available within the firm.
- The client may have location, which the audit firm cannot visit or arrange to have audited.
- The client may not be willing to pay the fee that the audit firm would need to charge.
- The following steps should be taken when a change of auditors takes place:
  - (i) The proposed auditor should request permission from the company to contact the previous auditors and if permission is refused, the nomination should be declined.
  - (ii) The proposed auditor should contact the previous auditor and ensure that there are no professional reasons why he should not accept the appointment.
  - (iii) The existing auditor must obtain the company's permission to discuss its affairs with the proposed auditor. If refused, the proposed auditor should be informed of this and should then decline the nomination.
  - (iv) The existing auditor should give the proposed auditor all information relevant to the decision of accepting the appointment.

The purpose of these provisions is to protect both the existing and the proposed auditors. The former by allowing him to express his opinion as to why the change is taking place and the latter by ensuring his decision is made with full knowledge of all circumstances.

13. In taking over an unfinished audit of the late Mr. Hemanth, the first consideration to be borne in mind by the new auditor is that he is the one, who is to sign the audit report, and therefore, bears total responsibility for the audit. Late Mr. Hemanth's work cannot be accepted without a through review by the new auditor. It will be important to find out whether he died after a long illness or whether he was in apparently good health before his death.

The extent of any extra work needed by the new auditor will depend on the results of this review. He cannot sign an audit report based on standards of work lower than his own.

The steps, which should be taken, are as follows:

(a) Request the audit working papers from the executors of Mr. Hemanth. They are not obliged to release them and if, for any reason, they refuse the request, the audit will have to be started again.

(b) Carry out a full review of the audit work done by Mr. Hemanth. This will involve the following:

   (i) Obtaining background knowledge of Escort Engineering Limited's business

   (ii) Discovering and assessing the company's systems and internal controls

   (iii) Determining what further audit work, in the new auditor's view, is necessary to arrive at an opinion on the truth and fairness of the view given by the accounts.

(c) Carry out, resulting from the review, any further audit work. However, it would be advisable to include a certain amount of test checking as an integral part of the review. If it appears that Mr. Hemanth's work was in any way negligent or below the standard that the new auditor would set for himself, or departed materially from the principles laid down by the auditing standards and guidelines, the new auditor will have to carry out a complete audit himself.

(d) The overall aim of the new auditor must be to ensure that the duties imposed on an auditor by the Companies Act have been properly carried out and that he was obtained all the evidence required to give his opinion on the accounts.

14. (a) The case was decided in favour of the auditor and he was not held guilty for negligence. It was held that the role of an auditor to the assessee is just like a lawyer or an advocate in a court. It is the responsibility of the income tax officer to investigate the accounts. The auditor owned no duty to the income tax department (third party) and as such, no question of negligence in duty could arise.

(b) The court could not establish any of the above charges against the respondent. However, the disciplinary committee of the Institute of Chartered Accountants of India made a charge against Mr. Rakesh that he had charged his fees at a certain percentage of relief of tax on the ground that no practicing chartered accountant can accept fee on percentage basis as per the provision of Clause 10, Part I of the First Schedule of the Chartered Accountants Act, 1949. Hence, he was held guilty of professional misconduct and suspended from practice for a period of three months.

15. (i) Audit of receipt – Section 16 of the CAG's (DPC) Act, 1971 confers upon him the authority to audit all receipts of the Union/States.

The important aspects of audit of receipts can be elaborated as follows:

   (a) Examine all revenue or other debts due to the Government – Examine all revenues or other debts due to the Government have been correctly assessed, realized and credited to Government account by the designated authorities.

   (b) Procedure for collection – Examine adequate regulations and procedures have been framed by the department/agency concerned to secure an effective check on assessment, collection and proper allocation of cases.

   (c) Implementation – Examine whether such regulations and procedures are actually bring carried out.

(d) Assess adequacy of checks over irregularities and fraud – Ascertain whether adequate checks are imposed to ensure prompt detection and investigation of irregularities, double refunds, fraudulent or forged refund vouchers or other loss of revenue.

(e) Review and suggestions – Review the system and procedure to examine whether there is correct and regular accounting of demands, collection and refunds and settlement of final dues.

(ii) Audit of stores and stock – The Comptroller and Auditor General of India has the power to audit and report on the accounts of stores and stock kept in any office or department of the Union or a State Government. "Stores" here denote all articles and materials purchased or other wise acquired for the use of Government such as plant, machinery, equipment, livestock, etc. The procedure for audit is as follows:

(a) Examine adequacy of regulation - Examine whether regulations governing purchase, receipt and issue, custody, sale and stock-taking of stores are well devised.

(b) Conduct audit of purchases –

- Conduct audit of purchase of stores in the similar manner as audit of expenditure.
- Ensure these are properly sanctioned, made economically and in accordance with the rules for purchases laid down by the competent authority, particularly, when purchases are made on the basis of lowest price determined through open competitive bidding.
- Examine whether the rates paid agree with those shown in the contract or agreement with the vendor.
- Also, examine certificates of quality and quantity furnished by the inspecting and receiving units.
- Comment upon the cases of uneconomical purchases of stores or losses attributable to defective or inferior quality of stores.

(c) Assess adequacy of accounts –

- Determine whether accounts of receipts, issues and balances are accurate and balance in stock is as per the prescribed norms for stock-holding and ascertain whether there is excess or idle stock.
- Review the system of physical verification of stock.

(d) Examine sanctions to write off

- Examine whether sanctions to write off stores have been accorded by a competent authority.

- Ensure that steps are taken to survey, segregate and dispose of unserviceable, surplus or obsolete stores in accordance with prescribed procedures.

(e) Special points in case of priced stores ledger – In case where a priced stores ledger is maintained, ensure that stores are priced accurately and revised where necessary; value accounts tally with physical accounts and adjustment of profits or losses due to revaluation, stock taking or other causes has been carried out.

16. Solvency margin in case of an insurer carrying on general insurance business: In case of an insurer carrying on general insurance business, the solvency margin should be the highest of the following amounts :

(i) fifty crore rupees (one hundred crores of rupees in case of reinsurer), or

(ii) a sum equivalent to twenty percent of the net premium income; or

(iii) a sum equivalent to thirty percent of net incurred claims.

Subject to credit for reinsurance in computing net premiums and net incurred claims being actual but a percentage, determined by the regulation but not exceeding fifty percent. It may be noted that conditions regarding maintenance of the above mentioned solvency margin may be relaxed by the authorities in certain special circumstances.

If, at any time, an insurer does not maintain the required solvency margin, the insurer is required to submit a financial plan to the authority indicating the plan of action to correct the deficiency in the solvency margin. If, on consideration of the plan, the authority finds it inadequate the insurer has to modify the financial plan.

Sub-section (2c) of Section 64 A states that if an insurer fails to comply with the requirements of the insurance Act, 1938, it shall deemed to be insolvent and may be wound up by the court.

17. Ceiling on audits

(a) Section 224(1B) has prescribed ceiling on auditorships.

(b) In case of partnership firm of auditors, the ceiling is twenty companies per partner of the firm.

(c) Moreover, any partner who is in full-time employment elsewhere is not to be taken into account while computing the ceiling of number of companies that the firm can audit.

(d) For the purposes of calculating the specified number of auditors, certain audits are not counted towards the ceiling. Audit of an Indian company and its branches is counted as one audit. Audit of foreign companies and its branches are not counted towards ceiling because a foreign company is not included in the definition of a company as defined under the Companies Act, 1956.

- The present case

  (i) The maximum number of audits RST and Co. who has three partners, R, S & T can take is 40. (20 audits per partner × 2 partners) T is in full employment. Therefore, the firm cannot take any audit on his behalf.

  (ii) At present firm has audit of 40 companies out of which one is a foreign company. For the purpose of section 224(B) audit of foreign company is not counted. Therefore, for section 224(1B) the number of audits the firm has at present is 39 and it can take one more company for audit.

  (iii) The firm can take audit of XYZ Ltd. and its 20 branches, as it would be counted as one audit only.

18\. (i) In terms of section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. There is however an exemption for the above if the second office is located in the same premises, in which the first office is located; or the second office is located in the same city, in which the first office is located; or the second office is located within a distance of 50 kms from the municipal limits of a city, in which the first office is located. Since the second office is situated beyond 50 kms of municipal limits of Bangalore city. Thus Mr. L would be liable for committing a professional mis-conduct.

(ii) According to Clause 4 of the First Schedule (Part-I) of the Chartered Accountants Act, 1949 Mr. X is guilty of professional misconduct, because a chartered accountant is restricted to enter into professional partnerships with non-chartered accountants. It is immaterial whether any professional assignment has been undertaken or not.

19\. (a) 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.

(b) disclosure of material facts: A Chartered Accountant in practice is deemed to be guilty of professional misconduct under clause 5 of Part I of the Second Schedule if he "fails to disclose a material fact known to him which is not disclosed in a financial statement but disclosure of which is necessary to make the financial statement not misleading". In this case, the Chartered Accountant was aware of the contraventions and irregularities committed by the trust as these were referred to in the confidential report given by the Chartered Accountant to the trustees of the company. However, he had issued the annual accounts without any qualification. On similar facts it was held by the Supreme Court in Kishorilal Dutta Vs. P. K. Mukherjee that it was the duty of the Chartered Accountant to have disclosed the irregularities and contravention to the beneficiaries of the fund in the statement of accounts signed by him. Accordingly, in the present case also it has to be held that the Chartered Accountant is guilty of professional misconduct if the amount of irregularities is proved material.

20. Adequate working capital is required for liquidity and smooth operations of the company. To ensure an adequate flow of working capital to the manufacturing company, the following action plan may be considered:

    (i) Working Capital Estimation: The company should start by preparing a statement of the projected working capital requirements. This should be based on the functional budgets in sales, production, expenses, capital expenditure and the Master Budget consisting of projected profit and loss and the Balance Sheet.

    (ii) Cash Flow Statement / Cash Budget: Month-wise cash budgets showing inflows and outflows of cash heading-wise should be prepared to analyse the major inflows and outflows affecting the entity. At this stage any wasteful outflow can be traced and eliminated. Bank reconciliation should be undertaken periodically so that outstanding can be traced and acted upon. This is also necessary to reduce the float time.

    (iii) Inventory / Stock Management: Raw materials and inventories should be classified properly to determine the level of stock of materials. The method of costing also needs to be looked at minutely. There is a need to establish linkage with the production pattern and work backwards accounting for time factor in receipt of material. This needs to be worked out carefully since at no cost, production schedule should be hampered. The caution also need to be exercised that there is no unused/obsolete inventory. The system of inventory management needs to be looked at so as to check the avoidable wastes/scraps generated during storage and handling. Just in time philosophy will enable the company to reduce processing time, stocks and related costs. The adoption of such a mechanism would bring down the cost to a considerable extent.

    (iv) Credit Management: The company should lay down a proper policy for evaluating customers, determining the credit period and offering discounts for early payment. An age-wise analysis of debtors should also be prepared so as to avoid credit to defaulters. The sale department need to be geared up so that realisation can be made in time. A careful analysis should be done of various customers according to pattern of sales so as to exercise control on their respective debit balances. The company should through its purchase department endeavour to avail the maximum credit period from its creditors. This would enhance the working capital of the company.

(v) Funds Flow Analysis: The company should prepare a funds flow analysis, distinguishing between long-term and short-term sources and applications.

(vi) Investment Management: The idle funds of the company, if any, should be invested in short-term securities to augment the income.

(vii) WIP Analysis: Minimum WIP should be monitored and for the purpose it is necessary to ensure that no bottlenecks develop at any stage during the production process.

21. (a) Recognition of Deferred Tax Assets: Accounting Standard 22 on "Accounting for Taxes on Income", requires that deferred tax should be recognised for all timing differences, subject to the considerations of prudence in respect of deferred tax assets. The standard further states that where an enterprise has unabsorbed depreciation or carry forward of losses under the tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised. In this context, virtual certainty supported by convincing evidence would mean that there is a reasonable certainty that the carry forward losses would be recouped in the future years. In the instant case, looking to the fact that the industry in which the company was functioning was not expected to perform well in the next few years, getting virtual certainty and convincing evidence for the same would be almost impossible. Hence, in the absence of virtual certainty for offset of the losses in future years, creating a deferred tax asset would not be possible for the company. The statutory auditor would therefore have to qualify his report by stating that deferred tax assets have been created though there is no virtual certainty for getting the said benefit in income tax. He would also have to mention the amount by which the loss for the year has been understated and the amount by which the reserves are overstated.

(b) Disclosure of Transactions with Related Parties: AS 18, "Related Party Disclosures" and SA 550 "Related Parties", if applicable, requires disclosure of related party relationships and transactions between a reporting enterprise and its related parties. The parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. The control can be exercised through controlling the composition of the Board or more than half of voting power or substantial interest in the voting power and the power to direct financial and/or operating policies. Significant influence can be exercised through several ways, e.g., participation in financial/operating policies, material inter-company transaction, etc. However as per the explanation given in the Standard, significant influence is said to exist in case the investing party has 20% or more voting power of the enterprise unless it can be demonstrated that this is not the case. As per the facts given, in the absence of other circumstances, it appears that father and son will be in a position to exercise significant influence since they are holding 34% of voting power in the company. Hence, relationship as well as nature of transactions would have to be disclosed. In case of non-disclosure, the auditor should qualify the audit report.

22. (i) Disposal of Fixed Assets: Under CARO, 2003, an auditor is required to state if substantial part of the fixed assets have been disposed off during the year, whether it has affected the going concern. This clause requires the auditor to carry out adequate audit procedures to satisfy himself that the company shall be able to continue as going concern for the foreseeable future despite the sale of substantial part of the fixed assets.

Accordingly, in the instant case, the auditor should satisfy himself as to whether disposal off of 1/3rd of fixed assets during the year had any effect on the going concern assumption on account of such sale of fixed assets. The Auditor is required to exercise his professional judgement to determine whether disposal off of one-third of total assets constitutes substantial part or not. Depending upon the judgement arrived at by the auditor, he shall report whether substantial part of fixed assets have been disposed off or not during the year and it has affected or not affected the going concern status of the company. Alternatively, in case the auditor is of the opinion that it constitutes substantial sale but the going concern assumption is appropriate because of mitigating factors then he has to ensure that the same are disclosed in the financial statements or else he shall have to modify the auditor report. The manner of reporting shall also be modified appropriately in case the going concern assumption is resolved or not.

(ii) Utilisation of Term Loans: Under CARO, 2003, an auditor is required to comment whether term loans were applied for the purpose for which the loans were obtained.

The auditor should examine the terms and conditions of the term loan with the actual utilisation of the loans. If the auditor finds that the fund has not been utilized for the purpose for which they were obtained, the report should state the fact.

In the instant case, since term loan taken for the purpose of R&D equipment has been utilized for purchase of car which has no relation with R&D equipment. Therefore, car though used for R&D Director cannot be considered as R&D equipment. The auditor should state the fact in his report that the out of term loan of R&D lack, Rs.12 lakhs was not utilised for the purpose of acquiring the R & D equipment.

23. Procedure for Audit of Transportation Charges

(i) Check rates contracted with transporters for carriage of goods.

(ii) Check whether the rates mentioned as per the contract are correctly taken in the transporter's invoice.

(iii) In case of discrepancy, check whether the same is authorised by the appropriate sanctioning authority.

(iv) Check that the transporter's invoice includes a delivery challan which has customers stamp indicating the receipt of goods.

(v) In case there is no stamp on the delivery challan, check whether the goods are received back and there is a corresponding inward note.

(vi) Check whether all the goods to be dispatched have a transport booking order reference.

(vii) Check whether each transporter's invoice mentions the transport booking order reference.

(viii) Check whether all the transport booking orders have corresponding transporters names.

(ix) Check whether the transport booking orders are prenumbered.

(x) Check whether all the invoices are correctly booked in the books of accounts.

(xi) In case there is an additional charge by the transporter due to extra carriage, check for the relevant supporting records (like material inward note/customer rejection note) and necessary authorisation by the sanctioning authority.

(xii) Check whether service-tax on the transporters is correctly calculated and accounted.

(xiii) Verify that for there is a mechanism for linking all the transport bills to the sale invoices.

24. Recognition of Deferred Tax Assets: Deferred Tax Assets (DTA) are to be recognised as laid down by AS 22 "Accounting for Taxes on Income" a DTA arises on account of a timing difference in which the taxable income is more than the book income. A deferred tax asset (and the corresponding tax saving) should be recognised only after applying the test of prudence. Thus, where the enterprise does not have unabsorbed depreciation and carried forward losses as per the tax laws, deferred tax assets should be recognised and carried forward to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realized. In other words, no deferred tax asset should be created if there is no reasonable certainty about the requisite future taxable income. The existence or absence of a reasonable level of certainty would normally be determined by examining the past record of the reasonable and by making realistic estimates of profits for the future.

A much stricter test of prudence has to be satisfied where the enterprise has unabsorbed depreciation or carried forward losses under tax laws. In such a situation, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised. The existence of unabsorbed depreciation or carried forward losses under tax laws is strong evidence that future taxable income may not be available. Therefore, in such a situation, the enterprise can recognise deferred tax assets only to the extent that it has timing differences the reversal of which will result in sufficient taxable income or there is other convincing evidence of virtual certainty of availability of sufficient taxable income against which deferred tax assets can be realised.

ICAI has stated that virtual certainty refers to the extent of certainty which, for all practical purposes, can be considered certain. Determination of virtual certainty of availability of sufficient future taxable income is a matter of judgement which will have to be made on a case-to-case basis.

LIST OF INSTITUTE PUBLICATIONS - NOVEMBER, 2009

I. Professional Topics/Subjects

1. Code of Ethics

   (The Chartered Accountants (Amendment) Act, 2006 is applicable for November, 2008 Final Examination)

II. Statements and Standards

1. Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services.
2. Standards on Auditing as given below. (All these SAs have been hosted in the Institute's website)

S.No.	Standards on Auditing and Number
1.	Basic Principles Governing an Audit (SA 200)
2.	Objectives and Scope of the Audit of Financial Statements (SA 200A)
3.	Terms of Audit Engagement (SA 210)
4.	Quality Control for Audit Work (SA 220)
5.	Audit Documentation (230) (Revised)
6.	The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (SA 240) (Revised)
7.	Consideration of Laws and Regulations in an Audit of Financial Statements (SA 250) (Revised)
8.	Communication of Audit Matters with Those Charged with Governance (SA 260) (Revised)
9.	Responsibility of Joint Auditors (SA 299)
10.	Planning an Audit of Financial Statements (300)
11.	Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment (SA 315) (Newly issued)*
12.	Audit Materiality (SA 320)
13.	The Auditor's Responses to Assessed Risks (SA 330) (Newly issued)*
14.	Audit Considerations Relating to Entities Using Service Organisations (SA 402)
15.	Audit Evidence (SA 500)

16. Audit Evidence - Additional Considerations for Specific Items (SA 501)

17. External Confirmations (SA 505)

18. Initial Engagements – Opening Balances (SA 510) (Revised)

19. Analytical Procedures (SA 520)

20. Audit Sampling (SA 530) (Revised)

21. Auditing of Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures (SA 540) (Revised)

22. Related Parties (SA 550) (Revised)

23. Subsequent Events (SA 560) (Revised)

24. Going Concern (SA 570) (Revised)

25. Written Representations (SA 580) (Revised)

26. Using the Work of Another Auditor (SA 600)

27. Relying Upon the Work of an Internal Auditor (SA 610)

28. Using the Work of an Expert (SA 620)

29. The Auditor's Report on Financial Statements (SA 700)

30. Comparatives (SA 710)

31. Engagements to Compile Financial Information (SRS 4410)

32. Engagements to Perform Agreed- upon Procedures Regarding Financial Information (SRS 4400)

33. Engagements to Review Financial Statements (SRE 2400)

34. The Examination of Prospective Financial Information (SRE 3400)

NOTE: 1

* Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (erstwhile AAS 1) and SA 200A (erstwhile AAS 2) will be merged into one Standard, i.e. SA 200.)

** SA 315 & SA 330 – become effective in April, 2008. For November 2009 Final (Old) Examination 34 standards on Auditing as given in the Annexure – I. The Standard on Auditing (SA) 400, "Risk Assessments and Internal Control", SA 310, "Knowledge of the Business", and SA 401, "Auditing in a Computer Information Systems Environment", issued in June 2002, April 2000 and January 2003, respectively, would stand withdrawn.

NOTE: 2

Newly issued SA 450 “Evaluation of Misstatements Identified during the Audit” effective for all audits relating to accounting periods beginning on or after April 1, 2010.It is not applicable for the November 2009 examination.

3. Statement on Reporting under Section 227(1A) of the Companies Act, 1956
4. Statement on the Companies (Auditor’s Report) Order, 2003 [2005 Edition].

III. Guidance Notes/Study Guide/Monograph

Guidance Notes on Auditing Aspects:

1. Guidance Note on Independence of Auditors
2. Internal Control Questionnaire.
3. Guidance Note on Audit Reports and Certificates for Special Purposes
4. Guidance Note on Audit of Fixed Assets.
5. Guidance Note on Audit under Section 44AB of the Income Tax Act [2005 Edition].
6. Guidance Note on Audit of Abridged Financial Statements.
7. Guidance Note on Audit of Inventories.
8. Guidance Note on Audit of Debtors, Loans and Advances.
9. Guidance Note on Audit of Investments.
10. Guidance Note on Audit of Miscellaneous Expenditure.
11. Guidance Note on Audit of Cash and Bank Balances.
12. Guidance Note on Audit of Liabilities.
13. Guidance Note on Audit of Revenue.
14. Guidance Note on Audit of Expenses.
15. Guidance Note on Section 227 (3) (e) and (f) of the Companies Act, 1956.
16. Guidance Note on Certificate of Corporate Governance [2006 Edition].
17. Guidance Note on Revision of Audit Report.
18. Guidance Note on Computer Assisted Audit Techniques (CAATs).
19. Guidance Note on Audit of Payment of Dividend.
20. Guidance Note on Audit of Capital and Reserves.

PAPER – 4: CORPORATE LAWS AND SECRETARIAL PRACTICE

UPDATES

I. Companies Bill, 2008 and Companies Bill, 2009 (Not applicable for November, 2009 examinations)

Students are aware that the Companies Bill, 2008 and Companies Bill, 2009 which was introduced in the Lok Sabha has made extensive changes in the existing Companies Act, 1956. At present, it in the form of a Bill only and hence it is not applicable for the November, 2009 examinations.

II. SEBI (DIP) Guidelines, 2000, February 24, 2009 (applicable for November, 2009 examinations)

(a) Amendments to SEBI (Disclosure and Investor Protection) Guidelines, 2000.

The full text of the amendments is given in Annexure I and the amendments are explained in brief as under:

(i) Enhancing the validity period of observations.

(a) The validity period of the observations issued by SEBI has been enhanced from the existing period of three months to twelve months. The benefit of extended validity period would be available in respect of all the observation letters whose validity period has not expired on December 4, 2008.

(b) Before opening of the issue, every issuer shall be required to file an updated offer document with SEBI, highlighting all changes made in the document.

(c) Where updation include significant changes in the offer document, such an updated Red herring prospectus/ prospectus or letter of offer shall be filed with SEBI at least one month before filing the same with Registrar of Companies or with Designated Stock Exchange as the case may be. The procedure for submitting such updated documents including what will constitute "significant changes", "additional fees" etc will be specified by SEBI shortly.

(ii) Reduction in timelines for completion of bonus issues.

(a) At present, in terms of the SEBI (DIP) Guidelines, a listed company is required to complete a bonus issue within a maximum period of six months from the date of approval of the issue by the board of directors of the company.

(b) The DIP Guidelines have been amended to reduce the timeline for completion of bonus issues. Accordingly, where no shareholders' approval is required as per the Articles of Association of the issuer, the bonus issue shall be completed within fifteen days from the date of the approval by the board of directors of the issuer in this regard. However, where shareholders' approval is required for capitalization of profits or reserves as per the Articles of Association of the issuer, the bonus issue shall be completed within sixty days from the date of the meeting of board of directors where-in bonus was announced subject to shareholders' approval.

(iii) Announcement of price band.

(a) At present, the floor price or price band in an initial public offer through the book building process is required to be disclosed in the Red Herring Prospectus registered with the Registrar of Companies, before the issue opening date.

(b) The amended DIP Guidelines permit the issuer making an initial public offer to announce the floor price or price band after the date of registration of the Red Herring Prospectus with the Registrar of Companies, atleast two working days before the issue opening date.

(c) Further, where the floor price or price band is announced after the date of registration of the Red Herring Prospectus with the Registrar of Companies, every issuer making a public issue, whether initial public offer or further public offer, shall ensure wide dissemination of the floor price or price band through various means, including newspaper advertisement. While announcing the floor price or price band, the issuer shall also disclose details of the relevant financial ratios used for justification of the floor price or price band. In case of a price band, such financial ratios shall be calculated for both upper and lower end of the price band.

(iv) Amendments in provisions pertaining to Preferential Allotment.

- Preferential allotment of warrants.

  (a) At present, the SEBI (DIP) Guidelines provide that warrants can be allotted on preferential basis, subject to the allottees paying upfront, an amount equivalent to at least 10% of the price fixed, at he time of allotment of warrants. It has now been decided to enhance the upfront amount payable from 10% to 25%.

  (b) Certain clarifications regarding lock-in requirements of instruments allotted on preferential basis have been made in clause 13.3.1(c) and (d) of the DIP Guidelines.

- Non-applicability of certain provisions of Chapter XIII of the SEBI (DIP) Guidelines.

  (a) It has been decided that an issuer, which has been granted relaxation by the Board in terms of regulation 29A of the SEBI (Substantial Acquisitions of Shares and Takeovers) Regulations, 1997, shall be exempted from certain provisions of Chapter XIII of DIP Guidelines, subject to the condition that in the explanatory statement to the notice for the general meeting of the shareholders, the issuer gives adequate disclosures about the details of the plan including the process proposed to be followed by it for identification of the allottees in addition to the disclosures required in other applicable laws.

(v) Policy on relaxation from strict enforcement of rule 19(2)(b) of the Securities Contracts (Regulation) Rules, 1957 (SCRR).

(a) At present the SEBI (DIP) Guidelines provides for the policy regarding considering the requests for relaxation of the strict enforcement of requirements of rule 19(2)(b) of the SCRR where an unlisted company intends to list its shares issued to the shareholders of a listed company pursuant to a scheme of arrangement approved by a High Court, without making an initial public offer.

(b) The DIP Guidelines have now been amended to provide for the policy for considering relaxation from strict enforcement of requirements of rule 19(2)(b) of SCRR in case of proposal for listing of following securities by a listed issuer :-

→ Equity shares with differential rights as to dividend, voting or otherwise, offered through rights or bonus issue.

→ Warrants issued along with Non Convertible Debentures through Qualified Institutions Placement.

ANNEXURE I

AMENDMENTS TO SEBI (DIP) GUIDELINES, 2000

CHAPTER II

ELIGIBILITY NORMS FOR COMPANIES ISSUING SECURITIES

1. In clause 2.2.2B, in sub-clause (iv), for the words and figures “sub-clause (iv)”, the words and figures “sub-clause (iii)” shall be substituted.

CHAPTER IV

PROMOTERS’ CONTRIBUTION AND LOCK-IN REQUIREMENTS

2. In clause 4.6.5:-

(a) the figures and punctuation “4.1.2,” and mark and figure “& 4.5.1” shall be omitted;

(b) for the punctuation mark “,” appearing after the figure “4.3.1” and before the figure “4.4.1”, the word “and” shall be substituted.

3. In clause 4.7.1:-

   (a) the figures and punctuation "4.1.2," and mark and figure "& 4.5.1" shall be omitted;

   (b) for the punctuation mark "," appearing after the figure "4.3.1" and before the figure "4.4.1", the word "and" shall be substituted.

4. In clause 4.11.1:-

   (a) the mark and figure "& 4.5" shall be omitted;

   (b) for the punctuation mark "," appearing after the figure "4.3" and before the figure "4.4", the word "and" shall be substituted.

CHAPTER V

PRE – ISSUE OBLIGATIONS

5. In clause 5.7.2, for the words "one week", appearing after the words "shareholders at least" and before the words "before the date of opening", the words "three days" shall be substituted.

CHAPTER VIII

OTHER ISSUE REQUIREMENTS

6. In clause 8.3.5, the words "by an unlisted company" appearing at the end shall be omitted.

7. After clause 8.3.5 and before the existing clause 8.3.5.1, the following clause shall be inserted, namely:-

   "8.3.5.1 Application by an unlisted company for listing of equity shares pursuant to scheme sanctioned by a High Court"

8. The existing clause "8.3.5.1" shall be renumbered as clause "8.3.5.1.1".

9. Clause "8.3.5.2" shall be omitted.

10. Clause "8.3.5.3" shall be renumbered as clause "8.3.5.1.2".

11. Clause "8.3.5.4" shall be renumbered as clause "8.3.5.1.3".

12. After the renumbered clause 8.3.5.1.3, the following clauses shall be inserted, namely:-

    "8.3.5.2 Application by a listed company for listing of equity shares with differential rights as to dividend, voting or otherwise.

    8.3.5.2.1 A listed company may make an application to the Board for relaxatio from applicability of clause (b) to sub-rule (2) of Rule 19 of the Securities Contracts (Regulation) Rules, 1957 for listing of its equity shares with differential rights as to dividend, voting or otherwise, without making an initial public offer of such equity shares, if it satisfies the following conditions:

i. issue of such equity shares are made to all the existing shareholders as on record date by way of rights or bonus;

ii the issuer is in compliance with the conditions of minimum public shareholding requirement with reference to the equity shares already listed and the equity shares with differential rights proposed to be listed;

iii. the issuer undertakes to disclose the shareholding pattern of the equity shares with differential rights separately under clause 35 of the Equity Listing Agreement.

8.3.5.3 Application by a listed company for listing of warrants offered along with Non Convertible Debentures (NCDs) under Chapter XIII A.

8.3.5.3.1 A listed company may make an application to the Board for relaxation from applicability of clause (b) to sub-rule (2) of Rule 19 of the Securities Contracts (Regulation) Rules, 1957 for listing of its warrants, if it satisfies the following conditions:

i. warrants are issued as combined offering of NCDs and warrants under Chapter XIII A of the SEBI (DIP) Guidelines,2000;

ii. the issuer is in compliance with all the provisions of Chapter XIII A, including eligibility of the issuer company, pricing guidelines, etc.;

iii. NCDs and warrants shall be traded in the minimum trade lot of Rs.1 lakh.

8.3.5.4 An application to the Board under clauses 8.3.5.1, 8.3.5.2 and 8.3.5.3 shall be made through the designated stock exchange of the listed company and the designated stock exchange may forward the application along with its recommendations, giving reasons in writing to the Board.

8.3.5.5 The Board may, while granting relaxation under clauses 8.3.5.1, 8.3.5.2 and 8.3.5.3, stipulate any other conditions as may be deemed necessary in the interest of investors and securities market under the facts and circumstances of the specific case."

13. In clause 8.21.1:-

(a) for the words "3 months", appearing after the words "shall open within" and before the words "from the date of issuance of the observation letter" the words "12 months" shall be substituted;

(b) in proviso the word "or fast track issue" appearing at the end, shall be omitted.

14. After clause 8.21.1, the following shall be inserted:-

"8.21.2 The issuer shall, before filing a red herring prospectus (in case of a book built issue) or prospectus(in case of a fixed price issue) with ROC or letter of offer with Designated Stock Exchange, as the case may be, file with the Board through the lead merchant banker an updated offer document highlighting all changes made in the document.

8.21.3 Where there are significant changes in the offer document, the updated offer document shall be filed with the Board, atleast one month before the date of filing of the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with ROC or letter of offer with Designated Stock Exchange, as the case may be, as per the procedure specified by the Board in this regard."

15. Clause 8.21.2 shall be renumbered as clause "8.22".

CHAPTER X

GUIDELINES FOR ISSUE OF CONVERTIBLE DEBT INSTRUMENTS

16. In clause 10.7.1.1:-

(a) in the opening para of the body, the words "or the NCDs", appearing after the words "portions of PCDs" and before the words "issued by a listed company" shall be omitted;

(b) in sub-clause (c), the words "NCDs or", appearing after the words "Before roll over of any" and before the words "non-convertible portion" shall be omitted.

17. In sub-clause (b) of clause 10.9:-

(a) for the word and comma "NCDs," occurring after the words "In case of", and before the words "redemption amount" the word "PCDs" shall be substituted;

(b) for the mark and word "/ NCDs" appearing at the end of the sub-clause, the word "PCDs" shall be substituted.

CHAPTER XI

GUIDELINES ON BOOK BUILDING

18. In clause 11.3.1, in sub clause (viii)(a) :-

(a) for the first proviso, the following provisos shall be substituted, namely:-

"Provided that the issuer may not disclose the floor price or price band in the red herring prospectus if the same is disclosed in case of an initial public offer, at least two working days before the opening of the bid and in case of a further public offer, at least one working day before the opening of the bid, by way of an announcement in all the newspapers in which the pre-issue advertisement was released by the issuer or the merchant banker;

Provided further that the announcement shall contain the relevant financial ratios, computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the offer document."

(b) in the second proviso:-

(i) for item (a), the following shall be substituted, namely:-

"a statement that the floor price or price band, as the case may be, shall be disclosed at least two working days (in case of an initial public offer) and at least one working day (in case of a further public offer) before the opening of the bid;"

(ii) in item (b), the words "in case of a further public offer" shall be added at the end.

19. In sub-clause (viii)(b)of clause 11.3.1, for the opening statement, the following shall be substituted, namely:-

"Where the issuer decides to opts for price band instead of floor price, the lead book runner shall ensure compliance with the following conditions:"

CHAPTER XIII

GUIDELINES ON PREFERENTIAL ISSUES

20. In clause 13.1.2.3, for the words "ten percent", appearing after the words "to atleast" and before the words "of the price", the words "twenty five percent" shall be substituted.

21. In clause 13.3.1,

(i) for sub-clause (c), the following clauses shall be substituted, namely:-

"(c) The instruments allotted on preferential basis and the shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to the promoter/promoter group of the issuer, in addition to the instruments or shares specified in sub-clauses (a) and (b) of clause 13.3.1, shall be locked-in for a period of one year from the date of their allotment.

(c-a) The instruments allotted on preferential basis and the shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to any person other than the promoter / promoter group of the issuer shall be locked-in for a period of one year from the date of their allotment."

(ii) in sub-clause (d), after the words "convertible instrument" wherever they appear, the words "other than warrants" shall be inserted.

(iii) in sub clause (h), before the explanation, the following proviso shall be inserted, namely:-

"Provided that the Board may, on an application made by the issuer in respect of the preferential allotment of shares fully convertible debentures and partly convertible debentures, grant relaxation from the requirements of this sub-clause if the Board has granted relaxation to the company in terms of Regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997."

22. In clause 13.4.1, after the existing proviso the following proviso shall be inserted, namely:-

"Provided that where the Board has granted relaxation to the issuer in terms of regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, the preferential allotment of shares, fully convertible debentures and partly convertible debentures, shall be made by it within such time as may be specified by the Board in its order granting relaxation."

23. After clause 13.7.2, the following clause shall be inserted, namely:-

"13.7.3 Clause 13.1.1, 13.1.2, 13.1.3, 13.1A, and 13.5.1 shall not be applicable to a preferential allotment of equity shares, fully convertible debenture and partly convertible debentures, where the Board has granted relaxation to the company in terms of Regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997; Provided that adequate disclosures about the plan including the process proposed to be followed for identifying the allottees, are given in the explanatory statement to notice for the general meeting of shareholders, in addition to disclosures required in terms of any other law."

CHAPTER XV

GUIDELINES FOR BONUS ISSUES

24. For clause 15.1.7 the following shall be substituted namely:-

"A company which announces bonus issue after the approval of board of directors and does not require shareholders' approval for capitalisation of profits or reserves for making bonus issue as per the Articles of Association, shall implement bonus issue within fifteen days from the date of approval of the issue by the board of directors of the company and shall not have the option of changing the decision.

Provided where the company is required to seek shareholders' approval for capitalisation of profits or reserves for making bonus issue as per the Articles of Association, the bonus issue shall be implemented within two months from the date of the meeting of the board of directors wherein the decision to announce bonus was taken subject to shareholders' approval."

Note: For further details, students may log on www.sebi.gov.in

III Amendments in Competition Act, 2002(List of Sections are not applicable for November, 2009 examinations)

(a) Competition Act, 2002 – Date of coming into force of certain Sections

The full text of amendments are given in Annexure II:

Annexure II

MINISTRY OF CORPORATE AFFAIRS
NOTIFICATION
New Delhi, 15th May 2009

S.O. 1241(E) - In exercise of the powers conferred by sub-section (3) of Section 1 of the Competition Act, 2002 (12 of 2003), the Central Government hereby appoints the 20th day of May, 2009 as the date on which Sections 3, 4 18, 19, 21, 26, 27, 28, 32, 33, 35, 38, 39 41, 42, 43, 45, 46, 47, 48, 54, 55 and 56 of the said Act, shall come into force.

(b) Competition (Amendment) Act, 2007 – Date of coming into force of certain Sections

The full text of amendments are given in Annexure III:

Annexure III

MINISTRY OF CORPORATE AFFAIRS
NOTIFICATION
New Delhi, 15th May 2009

S.O. 1242(E) - In exercise of the powers conferred by sub-section (2) of Section 1 of the Competition (Amendment) Act, 2007 (39 of 2007), the Central Government hereby appoints the 20th day of May, 2009 as the date on which Sections 3, 10, 13, 15, 16, 19, 20, 21, 25, 26, 28, 31, 33, 34, 35, 36, 38, 39 and 43 (53B, 53N, 53O, 53P, 53Q, 53R, 53S, 53T and 53U) of the said Act, shall come into force.

Note: For further details, students may log on www.cci.gov.in

In view of the above stated two notifications issued by the Ministry of Corporate Affairs, it is seen that most of the amended sections in the Competition Act, 2002 and further amended by the Competition (Amendment) Act, 2007 comes into force w.e.f. 15th May, 2009. Therefore these amended sections will be relevant for the May 2010 examinations.

In order to bring the clarity of the relevant applicable sections, students may study the definitional aspects covered in Sections 2 and Competition Commission of India covered in Sections 7-17 of the Competition Act, 2002 for November, 2009 examination.

IV The Companies (Appointment and Qualifications of Secretary) Amendment Rules, 2009 (Applicable for November, 2009 examinations)

The full text of amendments are given in Annexure IV:

Annexure IV

MINISTRY OF CORPORATE AFFAIRS
NOTIFICATION
New Delhi, 5th January 2009

G.S.R. 11(E) - In exercise of the powers conferred by clauses (a) and (b) of subsection (1) of Section 642 read with clause (45) of Section 2 and Section 383A of the Companies Act, 1956 (1 of 1956), the Central Government hereby makes the following rules further to amend the Companies (Appointment and Qualifications of Secretary) Rules, 1988, namely : –

1. (1) These rules may be called the Companies (Appointment and Qualification of Secretary) Amendment Rules, 2009.

   (2) They shall come into force from the 15th day of March, 2009.

2. In the Companies (Appointment and Qualification of Secretary) Rules, 1988, in rule 2 –

   (i) in sub-rule (1) and in the proviso to sub-rule (4), for the words "rupees two crores" the following words shall be substituted, namely : –

   "five crore rupees";

   (ii) in sub-rule (3), the second and third proviso shall be omitted;

   (iii) after sub-rule (3), the following sub-rule shall be inserted, namely : –

   "(3A) A company having a paid up share capital two crore rupees or more but less than five crore rupees may appoint any individual who possesses the qualification of membership of the Institute of Company Secretaries of India constituted under the Company Secretaries Act, 1980 (56 of 1980), as a whole-time secretary to perform the duties of a secretary under the Companies Act, 1956:

   Provided that where a company has appointed under subrule (3) or this sub-rule, a whole-time company secretary, possessing the qualification of membership of the Institute of Company Secretaries of India, such a company is not required to obtain a certificate from a secretary in wholetime practice under rule 3 of the Companies (Compliance Certificate) Rules, 2001."

   Note: For further details, students may log on www.mca.gov.in

QUESTIONS

COMPANIES ACT, 1956

Board Meetings & Proceedings-Frequency of a meeting

1. The Board of Directors of a public company met on three times in the previous year, the fourth meeting though called could not be held for want of quorum on two occasions successively. Discuss whether any provisions of the Companies Act,1956 has been contravened?

Board Meetings & Proceedings-Signing of minutes

2. Academy computers Ltd. maintains the Minutes Book of the Board Meetings in loose-leaf system and get them bound once in three months. Can it do so? Board meetings were held on 24th March, 2008 and 15th April, 2008. Mr. Mangal, who was the Chairman of these two Board Meetings died on 1.5.2008, without signing the Minutes. How should be the Minutes be signed and by whom?

Board Meetings & Proceedings-Quorum for a meeting

3. What is the required quorum for holding a Board meeting? Examine the following cases:
   (i) In a Board meeting, only 3 directors were present out of the total of 11 directors. None of the 3 directors was interested in any of the items of the agenda. Examine the validity of meeting.
   (ii) In a meeting of the Board, out of the total of 11 directors, 7 directors were present of which only 2 directors were not interested in one of the transactions. How should the meeting deal with the matter?

Board Meetings & Proceedings-Notice of a meeting

4. Kartik, a director residing abroad, complains that he does not receive notices for the Board meetings regularly. Advice.

Directors-Contracts in which directors are interested

5. Star Automobiles Ltd. having a paid up share capital of Rs. 80 Lakhs proposes to enter into contract with the following parties for the supply of certain components for a period of five years with effect from 1st January, 2008:
   (i) Active Forgings Private Limited where 'X', a director of Star Automobiles Limited, is interested as a director and member.
   (ii) Pure Casting Limited, where 'Y', a director of Star Automobiles Limited, is interested as a member holding 25 per cent of the paid up share capital.

   State briefly the legal requirements to be complied with under the Companies Act to give effect to the above proposals. Will the agreements continue to be valid after the paid up share capital of XYZ Machineries Ltd. is increased to Rs. 4 Crores in December 2008 by further issue of shares?

Directors-Restrictions on the directors

6. The Board of Directors of Excellent Fabrics Ltd. at a meeting held on 15.1.2008 resolved to borrow a sum of Rs. 15 crores from a nationalized bank. Subsequently the said amount was received by the company. One of the Directors, who opposed the said borrowing as not in the interest of the company has raised an issue that the said borrowing is outside the powers of the Board of Directors. The company seeks your advice and the following data is given for your information:

(i)	Share Capital	Rs. 5 crores
(ii)	Reserves and Surplus	Rs. 5 crores
(iii)	Secured Loans	Rs. 15 crores
(iv)	Unsecured Loans	Rs. 5 crores

Advice the management of the company.

Directors-Validity of acts done by directors

7. Leena was appointed as director of the company in an annual general meeting. She took over the office and carried on his functions as director. Subsequently, it was found that there were some irregularities in voting and hence the appointment was declared invalid. Would the acts done by Leena, while in office as director, be binding upon the company?

Directors-Casual vacancy

8. Mr. Ajay who was appointed as a Director at the last annual general meeting resigned. The Board filled up the casual vacancy by appointing Mr. Vijay. But within a few days of his becoming director, Vijay died. The Board wishes to fill up the casual vacancy by appointing Mr. Bijoy in place of Mr. Vijay in the next Board meeting. State the legal position.

Directors-Retire by rotation

9. Mars Travels Ltd. in its first General Meeting appointed six Directors whose period of office is liable to be determined by rotation. Briefly explain the procedure and rules regarding retirement of these directors. Will it make any difference, if Mars Travels Ltd. does not carry on business for Profit?

Directors-Disqualifications

10. The Managing Director of a company is convicted of an offence involving moral turpitude. He prefers an appeal against conviction. Can he continue as Managing Director pending disposal of the appeal? Can the appellate court remove the disqualification or stay the same pending the disposal of the appeal?

Directors-Appointment by single resolution

11. East West Garments Ltd. in its annual general meeting appointed all its directors by passing one single resolution. No objection was made to the resolution. Examine the validity of appointment of directors explaining the relevant provisions of the Companies Act, 1956. Will it make any difference, if East West Garments Ltd. was a private company?

Inter Corporate Loans and Investments

12. The Board of Directors of Hindustan Clothes Ltd. has agreed in principal to grant 'loan' worth Rs. 38 lakhs to Bharat Ltd. on the basis of the following information. Advice Hindustan Clothes Ltd. about the requirements to be complied with under the Companies Act, 1956 for the proposed inter corporate loan to Bharat Ltd.

(i)	Authorized share capital	Rs.	1,00,00,000
(ii)	Issued, subscribed and paid up capital	Rs.	50,00,000
(iii)	Free reserves	Rs.	10,00,000

Inter Corporate Loans and Investments

13. A group of shareholders consisting of 25 members decides to file a petition before the Company Law Board for relief against oppression and mismanagement by the Board of Directors of M/s Fortnight Operators Ltd. The company has a total of 300 members and the group of 25 members holds one-tenth of the total paid-up share capital accounting for one-fifteenth of the issued share capital. The main grievance of the group is that due to mismanagement by the Board of directors, the company is incurring losses and the company has not declared any dividends even when profits were available in the past years for declaration of dividend. Advise the group of shareholders regarding the success of (i) getting the petition admitted and (ii) obtaining relief from the Company Law Board.

Winding-up of Companies

14. Pacific Yarn Limited has its subsidiary company Woolmark Ltd, which is formed to carry out some of the objectives of Pacific Yarn Limited. Pacific Yarn Ltd suspends one of its several businesses, by passing a resolution at the company's extraordinary general meeting, with effect from Ist January 2007. The business so suspended continues to be suspended until March 2007. On Ist April 2007, a group of shareholders of Pacific Yarn Ltd file a petition in the court for winding of the company on the ground of suspension of business by the company.

    Referring to the provisions of the Companies Act, 1956, decide:

    (1) Whether the shareholders' contention shall be tenable?

    (2) What would be your answer in case Pacific Yarn Ltd suspends all its business?

(3) Can shareholders of Woolmark Ltd. file a petition in the court for winding up of their company (Woolmark Ltd) on the ground that the holding company viz, Pacific Yarn Ltd has suspended its entire business, though Woolmark Ltd. has not suspended business?

Winding-up of Companies

15. Write short notes on:

    (i) Overriding preferential payment;

    (ii) Workmen's dues.

Miscellaneous Provisions-Sole Selling Agent

16. On 1st January, 2008 the Board of Directors of Carbon Paper Ltd. appointed Mr. Y as Sole Selling Agent of the Company for a period of five years. On 6th February, 2008 Carbon Paper Ltd. in its General Meeting disapproved the appointment of Mr. Y as Sole Selling Agent of the Company. Explain:

    (a) Is Mr. Y entitled to payment of compensation for Loss of Office?

    (b) Are there some other circumstances when compensation for loss of office is prohibited to a Sole Selling Agent?

Miscellaneous Provisions- Foreign Company

17. Examine with reference to the provisions of the Companies Act, 1956 whether the following companies can be treated as foreign companies:

    (i) A company incorporated outside India having a share registration office at Mumbai.

    (ii) Indian citizens incorporated a company in Singapore for the purpose of carrying on business there?

Producer Companies

18. Who can become members of the producer Company and what are their voting rights?

Producer Companies

19. What provisions a Producer Company has to follow while investing in other companies, or in formation of subsidiaries?

Foreign Exchange Management Act, 1999

20. Mr. Samuel, an Indian national desires to obtain Foreign Exchange on current account transactions for the following purposes:

    (i) Payment of commission on exports made towards equity investment in wholly owned subsidiary abroad of an Indian Company.

(ii) Remittance of hiring charges of transponder.

(iii) Remittance for use of trade mark in India.

Advise Mr. Samuel whether he can obtain Foreign Exchange and, if so, under what conditions?

(SEBI) Act, 1992

21. Briefly examine the powers vested in the Securities and Exchanges Board of India to regulate and prevent undesirable transactions in securities under the Securities Contracts (Regulation) Act, 1956, by virtue of the SEBI Act, 1992.

The Competition Act 2002

22. Write short notes on-

    (i) Restriction on disclosure of information

    (ii) Members, Director General, Registrar, officers and other employees, etc. of Commission to be public servants

    (iii) Exclusion of jurisdiction of civil courts

Securities Contracts (Regulation) Act, 1956

23. Delhi Stock Exchange has refused to grant listing of the shares of Sunshine Floor Limited but the Exchange has not disclosed any reason therefore. The company wants to challenge the decision of the Stock Exchange in the Civil Court.

    Advise the company pursuant to relevant provisions of the Securities Contracts (Regulation) Act, 1956

Interpretation of Statutes, Deeds and Documents

24. Explain the rules relating to interpretation of the terms 'subject to' and 'notwithstanding' used in the provisions of an Act. State the effect of the term 'notwithstanding anything contained in this Act' used in Section 408 of the Companies Act empowering the Central Government to prevent oppression or mismanagement.

Corporate Secretarial Practice

25. Draft a Board Resolution for Purchase of shares of other companies.

SUGGESTED ANSWERS/HINTS

1. As per section 285 of the Companies Act, 1956, a company must hold a meeting of its Board of Directors at least once in every 3 calendar months and there should be at least 4 meetings of the Board every year. But, section 288(2) of the said Act provides that where a meeting is called but could not be held for want of quorum, there is no contravention of section 285. Thus, as per the facts in the above case, there has been no contravention of any provisions of the Companies Act, 1956.

2. Ordinarily minutes cannot be kept in loose-leaf system. Section 193(1) of the Companies Act, 1956 enjoins the Minutes must be entered within 30 days of the conclusion of the relevant meeting. Ordinarily Minutes cannot be kept in loose-lead system. The Department of Company Affairs, however, has expressed that it would refrain from taking any action against a company which maintained its minutes in the loose-leaf form, provided that adequate safeguards are taken against falsification, and loose-leaves are bound in books at reasonable intervals, say six months.

   In this case, since the Minutes Book leaves are bound once in three months (January to March, 2008), and as such the same is in order.

   The minutes of the Board Meeting are required to be written within a period of 30 days from the date of the meeting held. [Section 193(1)]. But there cannot be any insistence that the same must be signed within a period of 30 days from the date of the Board Meeting. (Dept.'s circular No. 25/76 dated 1.9.1976). According to section 193(1A), the minutes of a Board Meeting may be signed by the Chairman of the said meeting or the Chairman of the next succeeding meeting.

   In this case, Mr. Mangal, who was the Chairman of the Board Meeting held on 24.3.2008 and 15.4.2008 died on 1.5.2008 without signing the minutes.

   The Chairman of the Board Meeting held after 15th April, 2008 for the first time may sign the minutes of Board Meeting, held on 15th April, 2008 in accordance with section 193(1A)(a).

   According to the provisions of section 193(1) read with section 193(1A) the minutes of Board Meeting held on 24th March, 2008 should have been signed by Mr. Mangal himself as he was the Chairman of the Board Meeting held on 24th March, 2008 as well as the Chairman of the next succeeding meeting. There is no specific provision in the Companies Act, 1956 as to the person who can sign the minutes of Board Meeting held on 24th March, 2008 in this case. Hence a board meeting may be convened and the Chairman of the said meeting may sign the minutes of Board Meeting held on 24th March, 2008.

3. The provisions relating to quorum for a Board meeting are contained in section 287 of the Companies Act,1956. Unless the articles provide for a higher quorum, the quorum shall be one third of the 'total strength' (any fraction contained in that one third shall be rounded off to one) or two directors whichever is higher [Section 287(2)]. However, proviso to section 287(2) states that where at any time the number of interested directors exceeds or is equal to two third of the 'total strength', the number of disinterested directors present at the meeting, being not less than two, shall form the quorum.

    (a) In the instant case, one third of 11 comes to 3.67; the fraction 0.67 shall be rounded off to 1. Thus, at least 4 disinterested directors must be present in the Board meeting. However, only 3 directors are present in the Board meeting.

        Moreover, there is no interested director present in the meeting and so the benefit of proviso to section 287 cannot be availed. Therefore, the quorum is not present and the meeting cannot be held valid.

    (b) In the given case, the required quorum comes to 4 directors, but only 2 disinterested directors are present.

        Two third of the 'total strength' comes to 8 (Being two third of 11 is 7.33; the fraction 0.33 shall be rounded off to 1). Since the number of interested directors is only 5, the proviso to section 287 is not attracted. Thus, the remaining 2 directors who are not interested do not constitute a quorum and hence the Board meeting cannot be validly convened.

        In the case of a private company, interested directors are also counted in quorum. In this case, if the company is a private company, all the 7 directors shall be counted while determining quorum. Since the required quorum is only 4, the quorum is present if it is assumed that the company is a private company.

4. As per section 286 of the Companies Act, 1956, notice to a director who is out of India must be sent at his usual address in India. Section 286 does not differentiate between a director who is resident of India but is temporarily out of India and a director who is permanently resident outside India.

    In a similar question, the Company Law Board has held that if notice is sent to a director who mostly stays out of India at his usual local address, the notice is inadequate (even if the articles of the company do not require the sending of notice abroad). He would not be able to attend the meeting. It would show lack of probity and fair play on the part of directors. The meeting was held to be null and void [Dr. Kamal Kumar Dutta vs Ruby General Hospital Ltd. (2000) 36 CLA 214, 231].

    In the given case, there is no legal requirement of sending notice to Mr. Kartik at his foreign address; notice given to him at his usual address in India is sufficient (Section 286). However, considering the judgement given by the Company Law Board in Dr. Kamal Kumar Dutta vs Ruby General Hospital Ltd., the company should also give a copy of the notice to Mr. Kartik at his foreign address, if any.

5. (i) Under section 297 of the Companies Act, 1956 it will require a resolution of the Board of Directors to be passed at its meeting.

In the event of capital of Star Automobiles Ltd. being increased to Rs. 4 crores, previous approval of the Central Government shall also be required under section 297. Approval of the Central Government is required where the paid up share capital of the company is Rs. 1 Crore or more. But, applicability of the section is to be deteremined at the time of entering into the contract. If no permission under this section is required at the time of entering into the contract, subsequent permission is not necessary even though there may be a change of circumstances which would require permission to be taken for a fresh contract.

Thus, it appears that, where contracts entered into by companies when their paid up capital was less than Rs. 1 Crore, and raised upwards subsequently [as in the given case], approval of the Central Government would not be necessary until the expiry of the contract.

Also under section 299, 'X' must disclose his interest to the Board and not participate in the said meeting/deliberations.

(ii) Section 297 does not cover cases of public limited companies. Thus, the aforesaid approvals shall not be necessary.

6. According to the provisions of Section 293(1)(d) of the Companies Act, 1956 there are restrictions on the borrowing powers to be exercised by the Board of directors. According to this section, the borrowings should not exceed the aggregate of the paid up capital and free reserves. While calculating the limit, the temporary loans obtained by the company from its bankers in the ordinary course of business will be excluded. However, from the figures available in the present case the proposed borrowing of Rs. 15 crores will exceed the limit mentioned. Thus the borrowing will be beyond the powers of the Board of directors. However the share holders have the power to ratify the act of the Board of Directors, if it is not beyond the powers of the company as laid down in the memorandum of association. In that case the shareholders can ratify as it is intra vires the company even though it may be beyond the powers of the Board of Directors.

Thus the management of Excellent Fabrics Ltd., should take steps to convene the annual general meeting and pass a resolution by the members in the meeting as stated in Section 293(1)(d) of the Act. Then the borrowing will be valid and binding on the Company and its members.

7. According to section 290 of the Companies Act, 1956, the acts done by a director shall be valid notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification in his appointment. The section will protect, the bonafide acts and not where they are done with notice that they were done wrongfully or illegally. Hence, the acts done by Leena as a director, before the irregularity

was found, are in order and interests of company as well as outsiders dealing with the company would be protected. But the acts done after the discovery of invalidity would not be protected.

8. Section 262 of the Companies Act, 1956 provides that in the case of a public company or a private company which is a subsidiary of a public company, if the office of any director appointed by the company in general meeting is vacated before the expiry of his term of office in the normal course, the resulting casual vacancy may, subject to any regulations in the Articles of the company, be filled by the Board of directors at a meeting of the Board.

   It would thus be noted that the Board of directors is empowered to fill a casual vacancy only in respect of a director appointed by the company in general meeting. If a casual vacancy arises in the office of a director appointed in the casual vacancy under section 262, there is no casual vacancy within the meaning of section 262. However, the Deptt. Of Company Affairs has opined that the same may be filled by the Board of directors as a casual vacancy. Consequently Board can appoint Mr. Bijoy in place of Mr. Vijay.

9. According to section 255 of the Companies Act 1956, unless the articles provide for the retirement of all directors in every general meeting, at least 2/3rds of the total number of directors of the public limited company in question must, in the first place, be appointed, save as otherwise expressly provided in the Act by the company in general meeting; Secondly, they must be persons whose period of office is liable to be determined by rotation.

   According to section 256, out of 2/3rd rotational directors only 1/3rd must retire by rotation at one general meeting.

   If the number is not three or multiple of three, then the number nearest to 1/3 must retire from office.

   Yes it will make a difference if Mars Travel Ltd. does not carry on business for Profit. Provisions of Section 256 do not affect those companies which do not carry on business for profit or those which by their articles prohibit the payment of dividend to their members. Such companies are not affected by Section 255 also which provides that at least 2/3rd of the directors shall retire by rotation while section 256 provides that 1/3rd of the retiring directors shall retire every year.

10. The Managing Director cannot continue as such, as he is disqualified to act as managing director, pursuant to section 267 of the Companies Act, 1956. The purpose of section 267 is to ensure that the management and affairs of the company and its control is not in the hands of a person who has been found by a competent Court to be guilty of an offence involving moral turpitude. Section 267 enacts that any person who has suffered a conviction by a Court of an offence involving moral turpitude shall not be appointed or

employed or continue in employment or appointment by any company as its managing director. Thus, the provisions are stringent. Under Criminal Procedure Code (CrPC), an appeal against the order of conviction may either be dismissed summarily or heard by an Appellate Court. However, order of conviction does not on the mere filing of an appeal disappear and it is difficult to hold that Section 267 of the Companies Act must be read to apply only to final order of conviction as such interpretation may defeat the very object and purpose for which it came to be enacted. In view of the above observation, the Appellate court will not be inclined to stay the operation of section 267 pending disposal of appeal [See Roma Narang v. Ramesh Narang (1995)SCALE 276]

11. Section 263 (1) of the Companies Act 1956 requires that the appointment of every director shall be voted on individually. Thus two or more directors cannot be appointed by a single resolution. However an exception has been carried out where under if a resolution has been first passed to the effect that all the directors shall be appointed by a single resolution without any vote being against it.

    Any resolution, as per Section 263(2), in contravention of the aforesaid provisions shall be void whether or not objection was taken at the time of its being so moved.

    The aforesaid provision, however apply to a public company or a private subsidiary of a public company. Hence, the appointments so made are void. However if East West Garments Ltd. was a private limited company, then the condition of provision of Section 263(1)(2) were not applicable as regards the condition of single resolution is concerned.

12. Inter corporate loans and investments are governed by the provisions of Section 372A of the Companies Act, 1956. As per this Section, a company can advance loans to other companies or invest in the securities, of other companies up to 60% of the paid-up capital and free reserves or upto 100% of free reserves, which is more. Further no loan or investment exceeding the said limits can be made by a company unless authorized by a previous special resolution passed in this regard.

    First determine whether a special resolution is required for providing loans to Bharat Ltd.

    This can be determined as follows:

Paid up capital of the company	(A)	Rs. 50,00,000.00
Free reserves	(B)	Rs. 10,00,000.00
Aggregate of paid up capital and free reserves	(C)	Rs. 60,00,000.00
60% of aggregate of paid up capital and free reserves	(D)	Rs. 36,00,000.00

    Higher of (B) or (D) i.e. the ceiling limit for incorporate loan and investment etc. without requiring a special resolution Rs.36,00,000.00

    Proposed loans to Bharat Ltd. Rs. 38,00,000.00

Since the proposed loan exceeds the ceiling limit a special resolution is required. The company shall adopt the following procedure for providing loan to Bharat Ltd.

(i) Unanimous approval of the Board shall be obtained by passing a resolution at a Board meeting.

(ii) A special resolution shall be passed in the general meeting

The notice of special resolution shall stake the specific limits, particulars of the company to which loan is proposed to given, specific source of funding and other relevant details. The company shall file a copy of special resolution with the registrar within 30 days of passing the special resolution. If the company is listed company, it shall pass the resolution by postal ballot as prescribed under Section 192A.

(iii) The company shall obtain the prior approval of the Public Financial Institution, if any, from whom it has taken a term loan.

(iv) The company can provide such loan to other companies only if no default in respect of public deposits is subsisting.

(v) The prescribed particulars shall be entered in the register maintained under Section 372A(5).

13. (i) Since the group of shareholders do not number 100 or hold 1/10 of the issued share capital or 1/10 of the total number of members, they have no right to approach the Company Law Board for relief. However, the Central Government, if it is of the view that circumstances exist which make it just and equitable to do so, may authorise any member(s) to apply to the Company Law Board [Section 399(4)]. So members may approach Central Government to authorise them to approach Company Law Board inspite of deficiency in number.

(ii) As regards obtaining relief from Company Law Board, continuous losses cannot, by itself, be regarded as oppression. [Ashok Betelnut Co. (P.) Ltd. vs M.K.Chandrakanth].

Similarly, failure to declare dividends or payments of low dividends also does not amount to oppression (Thomas Vekkon vs. Kuttanand Rubber Co. Ltd.). Thus, the shareholders may not succeed in getting any relief from Company Law Board.

14. The problem relates to suspension of business by a company. Section 433 of the Companies Act, 1956 provides that if a company does not commence its business within a year from its incorporation or suspends its business for a whole year, it may be wound up by the court .The contention of the shareholders of Pacific Yarn Ltd that the company is liable to be wound up in the ground so suspension of business, is not tenable for the following reasons:

(i) (a) A company may be wound up by court if a company suspends its business for a whole year. Here the business was suspended only on 1.1.2007. Hence on 1st April, 2007 the business has not been suspended for the whole year to attract Section 433(c)

(b) Where a company having much business discontinues one of them, it cannot be said to have suspended business within the meaning of Section 433(c).

(c) Where a company ceases to do any business but is a holding company of subsidiaries engaged in the pursuit of the business, which it was previously doing, it cannot be said that the company has suspended its business (Ref; Eastern Telegraph Company Ltd).

(ii) Even if Pacific Yarn Ltd suspended all its business the suspension was not for a period of more that 1year as on1.4.2007 and hence the provisions of Section 433(c) are not applicable. Again for the reasons stated in (i) (c) above Pacific Yarn Ltd cannot be said to have suspended its business as its subsidiary is carrying on the business.

(iii) As Woolmark Ltd has not suspended its business, the shareholders of Woolmark Limited have no right to file winding up petition on the ground that its holding company has suspended its business. Again for reasons stated in (i)(c) above the holding company also cannot be said to have suspend its business.

15. (i) Overriding preferential payment: Under Section 529A of the Companies Act, 1956 notwithstanding anything contained in other provisions of this Act or any other law for the time being in force in the winding-up of a company – (i) workmen's dues and (ii) debts due to secured creditors to the extent such debts rank, under clause (c) of the proviso to Sub-section (1) of Section 529, pari passu with such dues, shall be paid in priority to all other debts. These debts payable under (i) and (ii) above shall be paid in full, unless the assets are insufficient to meet them, in which the case they shall be paid in equal proportions.

(ii) "workmen's dues" means the aggregate of the following sums due from the company to its workmen, namely:

(a) all wages, salaries including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workmen, in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947;

(b) all accrued holiday remuneration becoming payable to any workman, or in the case of his death to any other person in his right, o the termination of, the winding-up other or resolutions;

(c) unless the company is being wound-up voluntarily merely for the purposes of reconstruction or of amalgamation with another company or unless the company has, at the commencement of the winding-up, under such a contract with insurers as mentioned in Section14 of the Workmen's Compensation Act, 1923, rights capable of being transferred to and vested in the workman, all amounts due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any workman of the company. In other words, in the absence of alternative circumstances mentioned in the beginning of this clause the provision of this clause will fall within the provision of the phrase “workmen’s dues”;

(iii) all sums due to any workman from a provident fund, a gratuity fund or any other fund for the welfare of the workman maintained by the company.

16. (i) According to Section 294(2)of the Companies Act, 1956, the Board of Directors of Carbon Paper Ltd. shall not appoint a sole selling agent for any area except subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made.

It has been held that the appointment of a sole selling agent must be made by the company in its general meeting and such clause must be inserted as a mandatory condition in all appointments of sole selling agents; an appointment without such a clause being inserted is void ab-intio (Arante manufacturing Corp. vs. Bright Bills Private Ltd. 1967 Comp/ Case 759, Shelagram Jhaigharia vs. National Co. Ltd. 1965 Comp. Cas. 706) If the company in the general meeting disapproves the appointment it shall become invalid form the date of the general meeting.

In the given case, assuming that the general meeting of Carbon Paper Ltd. held on February 6, 2008 was their first general meeting after January 1 , 2008 and the disapproval of the company, in this meeting will make the appointment of Mr. Y as sole selling agent invalid w.e.f. February 6, 2008.

(ii) Section 294(A) prohibits payment of compensation to the sole selling agent for the loss of his office in the following cases in addition to the one discussed in part (2) above :

(a) Where the sole selling agent resigns his office as a result of reconstruction or amalgamation of the company, and is appointed as the sole selling agent of the reconstructed company or the body corporate resulting from the amalgamation.

(b) Where the sole selling agent resigns his office otherwise than in the circumstances envisages in the foregoing clause (i)

(c) Where a sole selling agent has been found to be guilty of fraud or breach of trust in relation to, or of gross negligence in the conduct of his duty as the sole selling agent.

(d) Where the sole selling agent has investigated or taken part directly or indirectly in bringing about the termination of the sole selling agency.

17. "Foreign company" as per Section 591 of the Companies Act 1956, means a company incorporated outside India but having a place of business in India. Accordingly, to qualify as 'foreign company' a company must have both the following features:

    (a) it should be a company incorporated outside India; and

    (b) it should have a place of business in India.

    As to what amount to having a place of business in India, Section 602 (e) provides that the expression 'place of business' includes a share transfer or share registration office.

    Thus a company incorporated outside India having a share registration office at Mumbai is a foreign company.

    But, the company incorporated in Singapore for the purpose of carrying on business in Singapore is not a foreign Company. Its incorporation by Indian citizen is immaterial. In order to be a foreign company it has to have a place of business in India.

18. Membership and voting rights of members (Section 581D)

    A person, who has any business interest which is not in conflict with business of the producer company, shall become a member. On the other hand, a member, who acquires any business interest which is in conflict with the business of the producer company, shall cease to be a member and be removed as a member in accordance with articles of the producer company.

    The articles of any producer company may provide for the conditions, subject to which a member may continue to retain his member, and the manner in which voting rights shall be exercised by the members.

    These voting's rights are:

    (a) In a case where the member consists solely of individual member, the voting rights shall be based on a single vote for every member, irrespective of his shareholding or patronage of the producer company.

    (b) In a case where the member consists of producer institutions only, the voting rights of such Producer institutions shall be determined on the basis of their participation in the business of the producer company in the previous year, as may be specified by articles.

        Provided that during the first year of registration of a producer company, the voting rights shall be determined on the basis of the shareholding by such Producer institutions.

    (c) In a case where the member consists of individuals and producer institutions, the voting rights shall be computed on the basis of a single vote for every member. However, a producer company may, if so authorised by its articles, restrict the voting rights to active member, in any special or general meeting.

19. Investment in other companies, formation of subsidiaries, etc. (Section 581ZL)

The producer company has to follow the following provisions under this Section.

(1) The general reserves of any producer company shall be invested to secure the highest returns available from approved securities, fixed deposits, units, bonds issued by the Government or co-operative or scheduled bank or in such other mode as may be prescribed.

(2) Any producer company may, for promotion of its objectives acquire the shares of another producer company.

(3) Any producer company may subscribe to the share capital of, or enter into any agreement or other arrangement, whether by way of formation of its subsidiary company, joint venture or in any other manner with any body corporate, for the purpose of promoting the objects of the producer company by special resolution in this behalf.

(4) Any producer company, either by itself or together with its subsidiaries, may invest, by way of subscription, purchase or otherwise, shares in any other company, other than a producer company, specified under sub-section (2), or subscription of capital under sub-section (3), for an amount not exceeding thirty per cent of the aggregate of its paid-up capital and free reserves:

Provided that a producer company may, by special resolution passed in its general meeting and with prior approval of the Central Government, invest in excess of the limits specified in this section.

(5) All investments by a producer company may be made if such investment are consistent with the objects of the producer company.

(6) The Board of a producer company may, with the previous approval of member by a special resolution, dispose of any of its investments referred to in sub-sections (3) and (4).

(7) Every producer company shall maintain a register containing particulars of all the investments, showing the names of the companies in which shares have been acquired, number and value of shares; the date of acquisition; and the manner and price at which any of the shares have been subsequently disposed of.

(8) The register referred to in sub-section (7) shall be kept at the registered office of the producer company and the same shall be open to inspection by any member who may take extracts there from.

20. Under Section 5 of Foreign Exchange Management Act, 1999, certain rules have been framed for drawal of foreign exchange on current account. According to the said rules, drawal of foreign exchange for certain transactions is prohibited. In respect of certain

transactions drawal of foreign exchange is permissible with the prior approval of Central Government. In respect of some of the transaction, prior permission of Reserve Bank of India is sufficient for drawal of foreign exchange.

(i) In respect of item No.1 i.e. Payment of Commission on exports made towards equity investment in wholly owned subsidiary abroad of an Indian company is prohibited.

(ii) Drawal of foreign exchange for remittance of hiring charges of transponder, can be made with the prior approval of the Central Government.

(iii) So far as remittance for use of Trade Mark in India is concerned, the necessary foreign exchange can be obtained with the prior permission of the Reserve Bank of India.

In the case of (ii) & (iii) above, approval of concerned authority is not required if the payment is made out of funds held in Resident Foreign Currency (RFC) Account or Exchange Earner's Foreign Currency (EEFC) Account of the remitter. Further foreign Exchange can be drawn only from an authorised person.

21. By virtue of the SEBI Act, certain provisions contained in the Securities Contracts (Regulation) Act, 1956 have been amended with a view of giving power to SEBI to regulate and prevent undesirable transacations in securities by regulating the business of dealing therein, by prohibiting options and by providing for certain othere matters connected therewith. The functions of the Central Government under the Act have been granted to SEBI. These are:

(a) Power to call for periodical returns or direct enquiries to be made (Section 6)

(b) Power to approve the bye-laws of stock exchanges (section 9)

(c) Power of SEBI to make or amend bye-laws of recognized stock exchanges (Section 10)

(d) Licensing of dealers in securities in certain areas (section 17)

(e) Power to compel listing of securities by public companies (Section 21), and to punish.

22. (i) Restriction on disclosure of information (Section 57)

No information relating to any enterprise, being an information which has been obtained by or on behalf of the Commission for the purposes of this Act, shall, without the previous permission in writing of the enterprise, be disclosed otherwise than in compliance with or for the purposes of this Act or any other law for the time being in force.

(ii) Members, Director General, Registrar, officers and other employees, etc. of Commission to be public servants (Section 58)

The Chairperson and other Members and the Director General, Additional, Joint, Deputy or Assistant Directors General and Registrar and officers and other employees of the Commission shall be deemed, while acting or purporting to act in pursuance of any of the provisions of this Act, to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860).

(iii) Exclusion of jurisdiction of civil courts (Section 61)

This section provides no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Commission is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

23. Under section 22A of the Securities Contracts (Regulation) Act, 1956 where a recognised Stock Exchange refuses to list the securities of any public company, the company shall be entitled to be furnished with reasons for such refusal. If aggrieved, the company may appeal to the Securities Appellate Tribunal:

(i) within 15 days from the date on which the reasons for such refusal are furnished to it, or

(ii) where the Stock Exchange has omitted or failed to dispose of within the time specified in section 73(1A) of the Companies Act, 1956 (i.e., before the expiry of ten weeks from the date of closing of the subscription list as per prospectus) within 15 days from the expiry of the specified time or within such further period not exceeding one month as Securities Appellate Tribunal may allow.

In terms of section 22E of the Act, Civil Court has no jurisdiction to entertain any suit in respect of this matter.

The company may be advised accordingly.

24. Interpretation of the terms 'notwithstanding' and 'subject to'

The word 'notwithstanding anything contained' characterise the non obstante clause. It is generally included to give an overriding effect to the clause over the other. If there is any inconsistency or departure between the non obstante clause and another provision, it is the non obstante clause which will prevail (K. Parasuramaiah v. Pakari Lakshman, A/R 1965 AP 220).

But the word 'subject to' conveys the idea of a provision yielding place to another provision or provisions to which it is made 'subject to'. Hence the effect of non obstante clause (i.e. notwithstanding) is the opposite of a provision which states 'subject to'.

Section 408 of the Companies Act, 1956 opens with the words 'notwithstanding anything contained in this Act. This is a non obstante clause which vests overriding powers in the Government to nominate directors to prevent mismanagement or oppression (Oriental Industrial Investment Corporation Ltd vs. Union of India (1981) 52 Com cases 487, 493 (Del)). This expression indicates that the appointment of directors under this section is not to be controlled by the maximum number or other proportion, if any, fixed by any provisions of the Act. Further, they cannot be removed by the company at general meeting under section 284 of the Companies Act.

25. Board Resolution for purchase of shares of other companies

"Resolved that pursuant to Section 372A of the Companies Act, 1956, the company do purchase 3,50,000 equity shares of Rs. 10 each to M/s MPC & Company Limited (not being under the same management as this company) and that the resolution be passed by all the directors present unanimously.

Resolved further that Mr John, a Director of the company, be and is hereby authorized to sign/ execute the necessary documents in this connection."