

ADAG

Number of Pages : 6
Number of questions: 6

Total Marks: 100
Time Allowed: 3 Hrs

Answer **all** the questions

1. The Balance Sheet of A Ltd. and B Ltd as on 31.3.2009 are given below:

Liabilities	A Ltd Rs	B Ltd Rs	Assets	A Ltd Rs	B Ltd Rs
Share capital (Rs 10)	1,20,000	1,00,000	Fixed Assets	44,000	84,000
General reserve	20,000	36,000	Investment in B		
P&L account	12,000	20,000	Ltd 8000 shares		
Bills Payable	2,000	5,000	@ Rs.11	88,000	
Sundry Creditors	4,000	7,000	Sundry Debtors	6,000	15,000
Contingent liabilities of A Ltd:			Bills Receivable	4,000	16,000
Bills discounted not yet matured Rs 2,500			Stock in trade	10,000	40,000
			Cash at bank	6,000	13,000
	1,58,000	1,68,000		1,58,000	1,68,000

Shares were purchased on 1.4.2006. When shares were purchased General Reserve and Profit and Loss Account of B Ltd. stood at Rs.30,000 and Rs. 16,000 respectively. Dividends have been paid @ 10% every year after acquisition of shares. First dividend being paid out of pre-acquisition profits. No dividend has been proposed for 2008-2009 as yet and no provision need be made in consolidation Balance Sheet. A Ltd. has credited all dividends received to Profit and Loss Account.

On 31.3.2009, bonus shares has been declared by B Ltd. @ 1 fully paid share for 5 held, but no effect has been given to that in the above accounts. The Bonus was declared out of profits earned prior to 1.4.2006 from General Reserve.

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

Depreciation has been charged @ 10 % p.a on the book value as on 1.4.2006 (on straight line method), there being no addition or sale since then.

Out of current profits, Rs. 2,000 has been transferred to General Reserve every year. Bills receivable of A Ltd. include Rs. 2,000 bills accepted by B Ltd. and bills discounted by A Ltd., but not yet matured include Rs 1,500 accepted by B Ltd. Sundry creditors of A Ltd include Rs 2,000 due to B Ltd. whereas Sundry Debtors of B Ltd. include Rs. 4,000 due from A Ltd. It is found that A Ltd has remitted a cheque of Rs 2,000 which has not yet been received by B Ltd.

Prepare consolidated Balance Sheet as at 31.3.2009 of A Ltd and its subsidiary.

(20 Marks)

2. Sun Ltd. agreed to take over Moon Ltd. as on 1st October, 2008. No Balance Sheet of Moon Ltd. was prepared on that date:

Balance sheet of Sun Ltd. and Moon Ltd. as at 31st March, 2008 were as follows:

	Sun Ltd. Rs	Moon Ltd. Rs		Sun Ltd. Rs	Moon Ltd. Rs
<i>Share capital:</i> in Equity shares of Rs. 10 each fully paid up	15,00,000	10,00,000	Fixed Assets	12,50,000	8,75,000
<i>Reserves and Surplus:</i>			<i>Current Assets:</i>		
Reserve	4,15,000	2,56,000	Stock	2,37,500	1,87,500
Profit and Loss	1,87,500	1,50,000	Debtors	3,90,000	2,56,000
creditors	93,750	75,000	Bank	2,93,750	1,50,000
			<i>Miscellaneous Expenditure:</i>		
			Preliminary Expenses	25,000	12,500
	<u>21,96,250</u>	<u>14,81,000</u>		<u>21,96,250</u>	<u>14,81,000</u>

Additional information available:

- For the six months period from 1st April, 2008, Sun Ltd. made a profit of Rs. 4, 20,000 after writing off depreciation at 10% per annum on its fixed assets.
- For the same period, Moon Ltd., made a net profit of Rs 2, 04,000 after writing of depreciation at 10% p.a. on its fixed assets.
- Both the companies paid on 1st August, 2008, equity dividends of 15%. Tax at 10% on such payments was also paid by each of them.
- Goodwill of Moon Ltd. was valued at Rs. 1,20,000 on the date of take-over; stock of Moon Ltd., subject to an abnormal item of Rs.7,500 to be fully written off, would be appreciated by 25% for purpose of take-over:
- Sun Ltd. to issue to Moon Ltd.'s shareholders fully paid equity shares of Rs.10 each, on the basis of the comparative intrinsic values of the shares on the take-over date.

Draft the Balance Sheet of Sun Ltd. after absorption of Moon Ltd. All workings are to form part of your answer.

(16 Marks)

3. A factory went into commercial production on 1st April, 2008. It uses as its raw materials product X on which excise duty of Rs.30 per kg is paid and product Y on which excise duty of Rs.20 per kg is paid on 31st March, 2008 it had stock of Rs 20,000 kgs. of X and 15,000 kgs of Y which it has purchased at an all inclusive price of Rs.150 per kg. for X and Rs 120 per kg for Y. The suppliers of X and Y are to receive payment on 15th May, 2008.

During April 2008, the factory manufactured 40,000 units of the end product for which the consumption of material X was 60,000 Kgs. and material Y was 45,000 kgs. The excise duty on the end product is Rs.60 per unit. 30,000 units of the end

product were dispatched, 8,000 units were kept in warehouse and balance 2,000 kgs. Were kept in finished goods godown.

During the month the factory purchased 50,000 kgs of X at Rs. 145 per kg. (Inclusive of excise duty of Rs. 30 per kg) on credit of 60 days and 50,000 kgs of Y at Rs 110 per kg. (Inclusive of excise duty of Rs 20 per kg) on credit of 45 days.

The cost of “converting” the raw material into finished goods amounts to Rs.150 per unit of end product of which Rs.100 is “cash cost” paid immediately and Rs.50 represent non-cash charge for depreciation. There is no work-in-process.

Sales are effected at Rs.750 per unit in respect of credit transaction and at Rs.700 per unit in respect of cash transactions. 20% of despatches were in respect of cash transactions while the balance 80% were in respect of credit transactions (one month credit).

You are required to:

- a) (i) Calculate Cenvat credit available, Cenvat credit availed of and balance in Cenvat credit as on 30th April, 2008.
(ii) Show the necessary ledger accounts in respect of Cenvat. (3 + 2 = 5 Marks)
- b) Value the inventory of:
 - (i) raw material
 - (ii) finished goods in warehouse
 - (iii) Finished goods in finished goods god own on “first in first out” principle. (3 Marks)
- c) Show the ledger account of the customers, suppliers and bank assuming that the necessary bank balance is available at the start of the month to meet “cash” expenses of that month. (3 Marks)
- d) Calculate the working capital as on 30th April, 2008. (3 Marks)
- e) State the impact of ‘Cenvat’ on working capital requirement of the factory as on 30th April, 2008. (2 Marks)

4. The following is the extract from the Balance Sheets of Zed Ltd.:

Liabilities	Rs in Lakhs		Assets	Rs in Lakhs	
	As at 31.3.2008	As at 31.3.2009		As at 31.3.2008	As at 31.3.2009
Share capital	500	500	Fixed assets	550	650
General reserve	400	425	10% investment	250	250
Profit & loss a/c	60	90	Stock	260	300
18% term loan	180	165	Debtors	170	110
Sundry creditors	35	45	Cash at bank	46	45
Provision for tax	11	13	Fictitious assets	10	8

Proposed dividend	100	125			
	1,286	1,363		1,286	1,363

Additional information:

- (i) Replacement values of fixed assets were Rs.1, 100 lakhs on 31.3.08 and Rs 1,250 lakhs on 31.3.2009 respectively.
- (ii) Rate of depreciation adopted on fixed assets was 5% p.a.
- (iii) 50% of stock is to be valued at 120% of its book value.
- (iv) 50% of the investments were trade investments.
- (v) Debtors on 31st March, 2009 included foreign debtors of \$35,000 recorded in the books at Rs.35 per U.S.Dollar. The closing exchange rate was \$1=Rs.39.
- (vi) Creditors on 31st March, 2009 included foreign creditors of \$60,000 recorded in the books at \$1=Rs.33. the closing exchange rate was \$1=Rs.39.
- (vii) Profits for the year 2008-09 included Rs.60 lakhs of government subsidy which was not likely to recur.
- (viii) Rs.125 lakhs of research and development expenditure was written off to the Profit & Loss Account in the current year. This expenditure was not likely to recur.
- (ix) Future maintainable profits (pre-tax) are likely to be higher by 10 %.
- (x) Tax rate during 2008-09 was 50%, effective future tax rate will be 40%.
- (xi) Normal rate of return expected is 15 %.

One of the directors of the company Arun, fears that the company does not enjoy goodwill in the prevalent market circumstances.

Critically examine this and establish whether Zed Co. has not any goodwill.

If your answers were positive on the existence of goodwill, show the leverage effect it has on the company's result.

Industry average return was 12% on long-term funds and 15% on equity funds.
(16 Marks)

5. Write short notes on:

- a) Possible objections to segmental reporting (4 Marks)
- b) Book of account required to be maintained by Stock Broker. (4 Marks)
- c) Concept of 'Economic value added' and its uses. (4 Marks)
- d) Corporate Social Reporting. (4 Marks)

6. a) From the following details of Loan Fund of Gurgau Institute of Management for the year 2008-2009, you are required to prepare a statement showing changes in the Loan Fund Balance:

	Rs.
Fund balance as on 1.4.2008	25, 00,000
Grants from the government and society	12, 00,000
Grants from revenue fund	50,000
Other transfer from unrestricted fund	70,000
Investment income	60,000
Interest on Loan	40,000
Refund to Granters	25,000
Bad debts written off	15,000
Administration and collection costs	25,000

(4 Marks)

- b) JP Co. Ltd., has obtained an institutional loan of Rs.680 lakhs for modernization and renovation of its plant & machinery. Plant & machinery acquired under the modernization scheme and installation completed on 31.3.2009 amounted to Rs. 520 lakh, 30 lakhs has been advanced suppliers for additional assets and the balance loan of Rs. 130 has been utilized for working capital purpose. The total interest paid for the above loan amounted Rs. 62 lakhs during 2008-2009. You are required to state how the interest on the institutional loan is to be accounted for in the year 2008-2009.

(4 Marks)

- c) Popular Ltd.'s accounting year ends on 31st March. The company made a loss of Rs 2, 00,000 for the year ending 31.3.2007. For the years ending 31.3.2008 and 31.3.2009, it made profits of Rs. 1, 00,000 and Rs. 1, 20,000 respectively. It is assumed that the loss of year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.2007, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the year ending 2008 and 2009 for tax purposes. Prepare a statement of profit and loss for the years ending 2007, 2008 and 2009.

(4 Marks)

- d) At the end of the financial year ending on 31st December, 2008, company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	Probability	Loss (Rs)
In respect of five cases (Win)	100%	-
Next ten cases (Win)	60%	-
Lose (Low damages)	30%	1,20,000
Lose (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	-
Lose (Low damages)	30%	1,00,000
Lose (High damages)	20%	2,10,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

(4 Marks)

PRIME ACADEMY
29Th SESSION MODEL EXAM
ADVANCED ACCOUNTING-OLD SYLLABUS
SUGGESTED ANSWERS

1(a)

Consolidated Balance Sheet of A Ltd.
And it's Subsidiary B Ltd. As at 31st March, 2009.

Liabilities	Amount Rs	Assets	Amount Rs
Share capital (Rs.10)	1,20,000	Fixed assets	
Monthly interest	29,520	A Ltd	44,000
Capital reserve	19,200	B Ltd	<u>75,600</u>
General reserve	24,800	(84000-12000+3600)	
Profit & loss account	18,080	Stock in trade	
Bills payable		A Ltd	10,000
A Ltd	2000	B Ltd	<u>40,000</u>
B Ltd	<u>5000</u>	Sundry debtors	
7000		A Ltd	6,000
Less: Mutual		B Ltd	<u>13,000</u>
Indebtedness	<u>2000</u>	(15000-2000 cheque in transit)	19,000
Sundry creditors		Less: Mutual	
A Ltd	4,000	indebtedness	<u>2,000</u>
B Ltd	<u>7,000</u>	Cash at bank	
11,000		A Ltd	6,000
Less: Mutual		B Ltd	<u>13,000</u>
Indebtedness	<u>2000</u>	Remittance in transit	
	9,000	Bills receivable	
		A Ltd	4,000
		B Ltd	<u>16,000</u>
		20,000	
		Less: Mutual	
		Indebtedness	2,000
			18,000
	2,25,600		2,25,600

Contingent liability

Bills discounted not yet matured Rs.1000

Working notes:**(1) Analysis of Profit of Moon Ltd**

		Capital Profits Rs.	Revenue Reserves Rs.	Revenue Profits Rs.
General reserve on 1.4.2006	30000			
Less: Bonus issue	20000	10,000		
Increase in reserve (Annual transfer of Rs. 2,000 for 3 years) (36,000-30,000)			6,000	
Profit and loss account 1.4.2006	16000			
Less: Dividend for 2006-07	<u>10000</u>	6,000		
Increase in profit (20000-6000)				14,000
Loss on revaluation [84000 x 100/70 i.e. 1,20,000]-1,08,000]		(12,000)		
Additional depreciation written back (12000 x 10/100 x 3)				3,600
		4,000	6,000	17,600
A Ltd's share (80%)		<u>3,200</u>	<u>4,800</u>	<u>14,080</u>
Minority's share (20%)		800	1,200	3,520

(2) Minority Interest

Rs.

Share capital (including bonus shares)

(20000+20000*1/5)

24,000

Capital profits

800

Revenue reserve

1,200

Revenue profits

3,52029,520**(3) Cost of Control**

Investment in Moon Ltd

88,000

Less: dividend of capital profits

8,000

80,000

Less: Face value of investment

(Including bonus shares

(80000 + 80000 x 1/5) 96,000

Capital profits 3,200

99,200

Capital reserve

19,200**(4) General Reserve –A Ltd. Balance**

20,000

Add: Shares in B Ltd

4,80024,800**(5) Profit and Loss account - A Ltd. Balance**

12,000

Less: Dividend Credited to investment

8,000

4,000

Add: Shares in B Ltd

14,08018,080

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

2

Balance Sheet of Sun Ltd. (after absorption of Moon Ltd.)

Liabilities	Amount Rs	Assets	Amount Rs
<i>Share capital</i> 2,56,000 equity shares of Rs 10 each fully paid(1,06,000 shares allotted as fully paid without payment being received in cash)	25,60,000	<i>Fixed assets</i> Goodwill Other fixed assets 21,25,000 (12,50,000 + 8,75,000) <i>Less: Depreciation</i> <u>1,06,250</u>	1,20,000 20,18,750
<i>Reserves and surplus</i> Securities premium Reserves Profit and loss account	5,30,000 4,15,000 3,60,000	<i>Current assets, loans and advances</i> Stock (2,37,500 + 2,25,000) Debtors (3,90,000 + 2,56,000) Bank balance (5,28,750 + 2,32,750)	 4,62,500 6,46,000 7,61,500
<i>Current liabilities</i> Sundry creditors	1,68,750	<i>Miscellaneous expenditure</i> Preliminary Expenses	 25,000
	40,33,750		40,33,750

Working notes:

(1) Bank Balance on 1.10.2008

	Sun Ltd. Rs.	Moon Ltd. Rs.
Bank balance as on 31.3.2008	2,93,750	1,50,000
<i>Add: Net Profit</i>	4,20,000	2,04,000
<i>Depreciation</i>	<u>62,500</u>	<u>43,750</u>
	7,76,250	3,97,750
<i>Less: Dividend</i>	<u>2,25,000</u>	<u>1,50,000</u>
	5,51,250	2,47,750
<i>Less: Dividend Tax</i>	<u>22,500</u>	<u>15,000</u>
Bank balance as on 1.10.2008	5,28,750	2,32,750

(2) Profit and Loss Account as on 1.10.2008

	Sun Ltd. Rs.	Moon Ltd. Rs.
Balance as on 31.3.2008	1,87,500	1,50,000
Add: 6 months profit	<u>4,20,000</u>	<u>2,04,000</u>
	6,07,500	3,54,000
Less: Dividend	2,25,000	1,50,000
Dividend tax	<u>22,500</u>	<u>15,000</u>
	3,60,000	1,89,000

(3) Balance Sheet of Sun Ltd. and Moon Ltd.
as on 1st October, 2008 (before absorption)

	Sun Ltd. Rs.	Moon Ltd. Rs.		Sun Ltd. Rs.	Moon Ltd. Rs.
Share capital	15,00,000	10,00,000	Fixed Assets	12,50,000	8,75,000
Reserves	4,15,000	2,56,000	Less: Depreciation	<u>(62,500)</u>	<u>(43,750)</u>
Profit and loss	3,60,000	1,89,000	Net Fixed Assets	11,87,500	8,31,250
Creditors	93,750	75,000	Current assets		
			Stock*	2,37,500	1,87,500
			Debtors*	3,90,000	2,56,000
			Bank	5,28,750	2,32,750
			Miscellaneous exp		
			Preliminary expenses	25,000	12,500
	23,68,750	15,20,000		23,68,750	15,20,000

* It is assumed that these amounts as on 1st October, 2008 are same in the absence of any other information.

(4) Purchase consideration

	Sun Ltd. Rs.	Moon Ltd. Rs.
Good will	--	1,20,000
Fixed Assets	11,87,500	8,31,250
Stock	2,37,500	2,25,000
Debtors	3,90,000	2,56,000
Bank balance	<u>5,28,750</u>	<u>2,32,750</u>
	23,43,750	16,65,000
Less: Creditors	<u>93,750</u>	<u>75,000</u>
Net Assets	<u>22,50,000</u>	<u>15,90,000</u>
Number of Shares	<u>1,50,000</u>	<u>1,00,000</u>
Intrinsic value	15.00	15.90

Purchase consideration Rs 15,90,000 in the form of Share capital Rs. 10,60,000 and securities premium Rs 5,30,000.

3 (a) (i) Excise duty paid on raw materials:

	X			Y			
	kgs	@ Rs.	Amount Rs.	Kgs	@ Rs.	Amount Rs.	Total Amount Rs.
Stock on 31 st March 2008	20,000	30	6,00,000	15,000	20	3,00,000	9,00,000
Purchases	50,000	30	15,00,000	50,000	20	10,00,000	25,00,000
			21,00,000			13,00,000	34,00,000

Cenvat credit available :

Rs 21,00,00 + Rs 13,00,000 = Rs 34,00,000
 Cenvat credit available of:
 Production = 40,000 units
 Excise duty on the end product = Rs 60 per unit
 Cenvat credit available of = 40000 x 60 = Rs. 24,00,000
 Balance in Cenvat credit Rs 34,00,000 – Rs 24,00,000 = Rs 10,00,000

Note: Normally goods are removed from factory on payment of excise duty. However in respect of certain goods, provision has been made to store the goods in warehouses without payment of duty (Rule 20 of Central Excise Rules, 2002). These provisions are also applicable to goods transferred to customs warehouse.

It is to be noted that as per para 33 of The Guidance Note on Accounting Treatment for Excise Duty, it is necessary that a provision for liability in respect of unpaid excise duty should be made in the accounts in respect of stocks lying in the factory or warehouse since the liability for the excise duty arises when the manufacture of the goods is complete.

(ii) Dr. Cenvat Credit Receivable Account Cr .

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2008 April 1	To Balance b/d		2008 April	By Excise Duty A/c	24,00,000
	X 600000				
	Y 300000	9,00,000		By Balance c/d	10,00,000
April	To Suppliers A/c		April 31		
	X 1500000				
	Y 1000000	25,00,000			
		34,00,000			34,00,000

Dr.			Purchase Account			Cr.	
Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.		
2008 April	To Suppliers A/c X:[50,000 x (145-30)] Y:[50,000 x (110-20)]	57,50,000 45,00,000	2008 April 31	By Balance c/d	1,02,50,000		
		1,02,50,000			1,02,50,000		

(b) Valuation of inventory

(i) Raw Material

	X (kgs)	Y (kgs)
Opening stock	20,000	15,000
Purchases	50,000	50,000
	<u>70,000</u>	<u>65,000</u>
Consumption	60,000	45,000
Closing stock	<u>10,000</u>	<u>20,000</u>

Inventory:	Rs.
X: 10,000 x (145-30)	11,50,000
Y: 20,000 x (110-20)	<u>18,00,000</u>
	29,50,000

(ii) Finished goods in warehouse

	Rs.
Raw material cost of 80,000 units of output	
X: 12,000* x (145-30)	13,80,000
Y: 9,000* x (110-20)	<u>8,10,000</u>
	21,90,000
Conversion cost	
Cash cost :8,000 x Rs. 100	8,00,000
Non-cash: 8,000 x Rs. 50	<u>4,00,000</u>
	12,00,000
Excise duty 8,000 x Rs. 60	<u>4,80,000</u>
	<u>38,70,000</u>

* For 40,000 units of output,
input of X = 60,000 kgs
input of Y = 45,000 kgs
Therefore for 8,000 units of finished goods in warehouse:
Input of X = 60,000/40,000 x 8,000 = 12,000 kgs
Input of Y = 45,000/40,000 x 8,000 = 9,000 kgs

(iii) Finished goods in finished goods godown

	Rs.
Cost of 8,000 units of finished goods in warehouse	38,70,000
Cost of 2,000 units of finished goods in finished goods godown = 38,70,000/8,000 x 2,000	= 9,67,500

(c)

Customers Account

Dr.			Cr.
	Rs.		Rs.
To Sales A/c (80/100 x 30,000 x 750)	1,80,00,000	By Balance c/d	1,80,00,000
	<u>1,80,00,000</u>		<u>1,80,00,000</u>

Suppliers Account

	Rs.		Rs.
To Balance c/d	1,75,50,000	By Balance b/d	
		X: 20000 x Rs 150 = 30,00,000	
		Y: 15000 x Rs 120 = <u>18,00,000</u>	48,00,000
		By Purchase A/c	1,02,50,000
		By Modvat credit receivable A/c	
		X: 50000 x 30 = 15,00,000	
		Y: 50000 x 20 = <u>10,00,000</u>	25,00,000
	<u>1,75,50,000</u>		<u>1,75,50,000</u>

Dr.		Bank Account	Cr.
	Rs.		Rs.
To Balance b/d	40,00,000	By Cash Expenses	40,00,000
To sales (cash sales) A/c (20/100 x 30,000 x Rs 700)	42,00,000	(40000 x 100)	42,00,000
		By Balance c/d	
	<u>82,00,000</u>		<u>82,00,000</u>

(d) Working capital as on 30th April, 2008

Current assets:	Rs	Rs
Inventory		
(i) Raw material		
X	11,50,000	
Y	<u>18,00,000</u>	29,50,000
(ii) Finished goods in warehouse	38,70,000	
in finished goods godown	<u>9,67,500</u>	48,37,500
Customers		1,80,00,000
Bank balance		42,00,000
Cenvat credit receivable		<u>10,00,000</u>
		3,09,87,500
Less: Current liabilities		
Sundry creditors		<u>1,75,50,000</u>
		<u>1,34,37,500</u>

(e) Impact of Cenvat on Working Capital Requirement

Cenvat has enabled

- (i) dispatch on sale of 30,000 units of finished product,
- (ii) removal of 10,000 units of finished product, without payment of a single rupee in cash. Cash outlay so saved at Rs.60 per unit is Rs. 24,00,000.

It has also ensured creation of a current asset worth Rs. 10,00,000 in Cenvat Credit Receivable Account.

Thus Cenvat reduces the pressure on working capital.

4

1. Calculation of Capital Employed (CE)

	<i>Rs. in lakhs</i>	
	<i>As on 31.3.08</i>	<i>As on 31.3.09</i>
Replacement cost of fixed assets	1100.00	1250.00
Trade investment (50%)	125.00	125.00
Current cost of stock		
130 + 130 x 120/100	286.00	
150 + 150 x 120/100		330.00
Debtors	170.00	111.40
Cash at Bank	46.00	45.00
Total (A)	<u>1727.00</u>	<u>1861.40</u>
Less: Outside Liabilities		
18% term loan	180.00	165.00
Sundry creditors	35.00	48.60
Provision for taxation	11.00	13.00
Total (B)	<u>226.00</u>	<u>226.60</u>
Capital employed (A-B)	<u>1501.00</u>	<u>1634.80</u>

$$\begin{aligned} \text{Average capital employed at current value} &= \frac{\text{CE as on 31.3.2004} + \text{CE as on 31.3.2005}}{2} \\ &= \frac{1501 + 1634.80}{2} = 1567.90 \text{ Lakhs}^* \end{aligned}$$

* Average capital employed can also be calculated in the following manner:

Closing capital employed as on 31.3.2005	Rs. 1,634.80 lakhs
Less: ½ of actual post tax profit for 2004-2005	Rs. 90.00 lakhs
Average capital employed	Rs. <u>1,544.80 lakhs</u>

2. Future Maintainable Profit

	<i>Rs. In lakhs</i>
Increase in General Reserve	25
Increase in Profit and Loss Account	30
Proposed Dividends	<u>125</u>
Profit after tax	<u>180</u>
Pre-tax profit = 180/1-0.5	360.00
Less: Fictitious Assets written off (10-8)	2.00

Non-trading investment income (10% of Rs.125)	12.50	
Subsidy	60.00	
Exchange loss on creditors[0.6 lakhs x (39-33)]	3.60	
Additional depreciation on increase in value of Fixed Assets (current year)(1250-650= 600 x 5/100) i.e.,	<u>30.00</u>	<u>108.10</u>
		251.90
Add: Exchange Gain on Debtors [0.35 lakhs x (39-35)]	1.40	
Research and development expenses written off	125.00	
Stock adjustment (30-26)	<u>4.00</u>	<u>130.40</u>
		382.30
Add: Expected increase of 10%		<u>38.23</u>
Future maintainable Profit before Tax		420.53
Less: Tax @ 40 % (40 % of Rs.420.53)		<u>168.21</u>
Future Maintainable Profit		<u>252.32</u>

3. Valuation of Goodwill Rs. in Lakhs

(i) According to Capitalization of Future Maintainable Profit Method

Capitalized value of future maintainable profit = $256.28/15 \times 100$	1,682.13
Less: Average capital employed	<u>1,567.90</u>
Value of goodwill	<u>114.23</u>

Or

(ii) According to Capitalisation of Super Profit Method

Future Maintainable Profit	252.32
Less: Normal Profit @ 15 % on average capital employed (1567.90 x 15 %)	<u>235.19</u>
Super Profit	<u>17.13</u>
Capitalized value of super profit $17.13/15 \times 100$ i.e. Goodwill	114.02
Goodwill exists; hence director's fear is not valid.	

Leverage effect on goodwill

Rs. In lakhs

Future Maintainable Profit on equity fund	252.32
Future Maintainable Profit on Long-term Trading Capital employed	
Future Maintainable Profit After Tax	252.32
Add: Interest on Long-term loan (Term Loan) (After consideration Tax) $165 \times 18\% = 29.7 \times 50/100$	<u>14.85</u>
Average capital employed (equity approach)	1567.90
Add: 18% term loan $(180+165)/2$	<u>172.50</u>
Average capital employed (Long-term Fund approach)	<u>1740.40</u>

Value of Goodwill

(a) Equity Approach

Capitalized value of future maintainable profit = $252.32/15 \times 100 =$	1682.13
Less: average capital employed	<u>1567.90</u>
Value of Goodwill	<u>114.23</u>

(b) Long-Term Fund Approach	
Capitalized value of future maintainable profit = $267.17/12 \times 100 =$	2226.42
Less: Average capital employed	<u>1740.40</u>
Value of Goodwill	<u>486.02</u>

Comments on Leverage effect of goodwill:

Adverse leverage effect on goodwill is 371.79 lakhs (i.e. Rs.486.02-114.23). In other words, leverage ratio of Popular Ltd. is low as compared to industry for which its goodwill value has been reduced when calculated with reference to equity fund as compared to the value arrived at with reference to long term fund.

Working notes:

1. <i>Stock adjustments</i>	Rs. In lakhs
(i) Excess current cost of closing stock over its Historical cost (330-300)	30.00
(ii) Excess current cost of opening stock over its Historical cost (286-260)	<u>26.00</u>
(iii) Difference [(i- ii)]	<u>4.00</u>
2. <i>Debtors adjustment</i>	
(i) Value of foreign exchange debtors at the closing exchange rate (\$35,000 x 39)	13.65
(ii) Value of foreign exchange debtors at the original exchange rate (\$35000 x 35)	<u>12.25</u>
(iii) Difference [(i-ii)]	<u>1.40</u>
3. <i>Creditors adjustment</i>	
(i) Value of foreign exchange creditors at the closing exchange rate (\$60,000 x 39)	23.40
(ii) Value of foreign exchange creditors at the original exchange rate (\$60,000 x 33)	<u>19.80</u>
(iii) Difference [(i)-(ii)]	<u>3.60</u>

5 a) Possible objections to segmental reporting:

The possible objections to segmental reporting can be enumerated as below:

- (i) It is generally felt that segmental revenues and expenses are not distinguishable objectively in many cases. Revenues of a weak product line may be derived only because of the existence of a strong product line. Also many joint costs are only separable arbitrarily.
- (ii) Much of segmental results depend on the inter-departmental transfer pricings which are not always logically established.
- (iii) Various segments of an enterprise may use common resources which makes it difficult to arrive at a segment wise performance ratio.
- (iv) Since the users are in no position to know the proper base for cost allocation, the segment results would be less than meaningful.
- (v) The last objection consists of the competitive implications to the firm. Some academics contend that company secrets will be disclosed while others referred to

the competitive hardship suffered by some firms if segmented data is required. Suppose that Company X, a small company, has a segment identical to one in Company Y, a huge conglomerate. Company X would have to disclose the segment while Company Y would not because the segment is not considered material to Y's operations.

However, considering the problems of joint cost allocation, often it is suggested to follow a contribution margin approach for reporting segmental results. By this only identifiable costs are deducted from segment revenues and gross segment margins may only be indicated. But for all practical purposes, this becomes a useless exercise which proportion of identifiable cost is insignificant.

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 Broker and Sub-Broker) 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) Member's 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 arrangement with sub-broker specifying the scope of authority and responsibilities of the stock brokers and such sub-brokers.

In addition to the above statutory requirements, stock brokers are also required to maintain scripwise clientwise 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 authorizing directors and employees and copies of pool account statements.

c) Economic Value Added (EVA) for short, is primarily a benchmark to measure earnings efficiency. Though the term "Economic Profit" was very much there since the

inception of “Economics”, Stern Stewart & Co., of USA has got a registered trade mark for this by the name “EVA”, an acronym for Economic Value Added.

EVA as a residual income measure of financial performance is simply the operating profit after tax less a charge for the capital, equity as well as debt, used in the business. EVA includes both profit and loss as well as balance sheet efficiency as well as the ROCE, or ROE.

In addition EVA is a management tool to focus managers on the impact of their decision in increasing shareholders wealth. These include both strategic decisions such as what investment to make, which business to exist, what financial structure is optimal; as well as operational decisions involving trade-offs between profit and asset efficiency such as whether to make in house or outsource, repair or replace a piece of equipment, whether to make short or long production runs etc.

Most importantly the real key to increasing shareholder wealth is to integrate the EVA frame work in four key areas; to measure business performance; to guide managerial decision making; to align managerial incentives with shareholders interests; and to improve the financial business literacy throughout the organization.

To better align managers interests with shareholders – the EVA framework needs to be holistically applied in an integrated approach – simply measuring EVAs is not enough it must also become the basis of key management decision as well as be linked to senior management’s variable compensation.

- d) The content of Corporate Social Reporting is essentially based on the social objectives. Brummet identified five areas wherein social objectives can traced out, namely, Net Income Contribution, Human Resources Contribution, Public Contribution, Environmental Contribution and Product or Service Contribution.

In view of the social objective, the importance of earning objective is not understated, rather attainment of social objectives is dependent on earning objective. A sick business entity becomes liability to the society and sustains social cost instead of generating social benefits.

Human Resources Contribution is the indicate of the impact of organizational activities (viz. pay and allowances, perks and incentives, recruitment, training and development, placement, promotion and transfer, welfare measure, etc.) on people of the organization. Public contribution is the indicator of general philanthropy in the culture and social welfare programmes and contribution to national exchequer by way of tax and duties.

Industrial activity is supposed to consume irreplaceable resources and produces solid wastes. By this process it pollutes air and water, causes noise and spoils environment. These are termed as negative social effects. The corporate social objective is the abatement of such negative effect. It is covered by environmental contribution.

Lastly, the product or service contribution covers the qualitative aspects of the organization's product or service. It includes quality guarantee, redressal of customer's grievance, honest exposure in advertisement etc.

Although Brumment covered wide range of objectives, still these are not essentially exhaustive. Social objectives are determined by socio- economic conditions of a country. It is difficult to set universal list of social objectives to be pursued by the corporate sector. For example, in India, regional imbalance, unemployment, reservations for weaker sections of the population, scarcity of foreign exchange, energy deficit, population pressure and literacy are some of the widely accepted social-economic problems. And obviously the general expectation is that the corporate sector will positively contributes to such socio-economic problems. Since the socio-economic problems of a country changes over time or the priority attached to a problem shifts. Brumment's over simplified set of contribution should be suitably moulded to fit in the perspective of socio-economic problem of a country.

6 (a) Gurgau Institute of Management
Statement of changes –Loan funds

	Rs	Rs
Balance as on 1.4.2008		25,00,000
<i>Additions during the year 2008-2009:</i>		
Grants from government and society	12,00,000	
Investment income	60,000	
Interest on loan	40,000	
Grants from revenue fund	50,000	
Other transfer from unrestricted funds	70,000	14,20,000
<i>Deduction during the year 2008-2009:</i>		
Refund to granters	25,000	
Baddebts written off	15,000	
Administration and collection costs	25,000	(65,000)
Balance as on 31 st March, 2009		38,55,000

b) The treatment of total interest amount of Rs. 68 lakhs can be given as follows.

Purpose	Nature	Interest to be capitalized Rs in lakhs	Interest to be charged to profit and loss account Rs in lakhs
Modernization and renovation of plant and machinery	Qualifying Asset	$62 \times 520 / 680 = 47.41$	
Advance to suppliers for additional assets	Qualifying Asset	$62 \times 30 / 680 = 2.74$	
Working capital	Not a qualifying asset		$62 \times 130/680 = 11.85$
		<u>50.15</u>	<u>11.85</u>

c)

Statement of Profit and Loss

	31.3.2001 Rs	31.3.2002 Rs	31.3.2003 Rs
Profit (loss)	(2,00,000)	1,00,000	1,20,000
Less: current tax			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year	80,000		
Tax effect of timing differences reversed/adjusted during the year		(40,000)	(40,000)
Profit (loss) after tax effect	<u>(1,20,000)</u>	<u>60,000</u>	<u>72,000</u>

d) According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets' contingent liability should be disclosed in the financial statements if following conditions are satisfied:

- (i) There is a present obligation arising out of past events but not recognized as Provision.
- (i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- (iii) The possibility of an outflow of resource embodying economic benefits is also remote.
- (iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In the case, the probability of winning of the first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 60% and for remaining five cases is 50%. As per 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 the way of note should be made. For the purpose of the disclosure of contingent by way note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

$$\begin{aligned}\text{Expected loss in next ten cases} &= 30\% \text{ of Rs. } 1,20,000 + 10\% \text{ of Rs } 2,00,000 \\ &= \text{Rs. } 36,000 + \text{Rs. } 20,000 \\ &= \text{Rs. } 56,000\end{aligned}$$

$$\begin{aligned}\text{Expected loss in remaining five cases} &= 30\% \text{ of Rs. } 1,00,000 + 20\% \text{ of Rs } 2,10,000 \\ &= \text{Rs } 30,000 + \text{Rs } 42,000 \\ &= \text{Rs } 72,000\end{aligned}$$

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore the better approach will be to disclose the overall expected loss of Rs. 9, 20,000 (Rs. 56,000 x 10 + 72000 x 5) as contingent liability.

MGFS

Number of Pages : 5

Total Marks: 100

Number of questions: 6

Time Allowed: 3 Hrs

Question 1 is compulsory and Answer any 4 from the rest

- 1 a.** Television Ltd. has a proposal for manufacturing car televisions. The project would involve cost of plant Rs.500 lacs, installation cost of Rs.100 lacs and working capital of Rs.125 lacs. The annual capacity of the plant is to manufacture 20,000 sets. Price per set is Rs.20, 000/-, with a variable cost ratio of 65%. Cash-fixed costs in the first year, including promotion expenditure of Rs. 120 lacs, is Rs. 420 lacs and is thereafter Rs. 300 lacs each year. Depreciation at is at 25% WDV. Working capital requirements is 25% of sales. The company expects that the plant's capacity utilization over its estimated useful life of seven years is as under:

Year	1	2	3	4	5	6	7
Capacity utilization %	25	40	50	75	100	100	100

Terminal value of the project is 20% at invoice price. If the hurdle rate is 12%, and tax rate is 35% plus 5% surcharge, can the project be accepted? While evaluating, you have to keep in mind that the Company has other sources of income against which the losses if any from this project, can be set off. Also assume that the terminal value would include release of funds blocked in working capital.

(14 Marks)

- b.** An initial outlay of Rs. 12 lacs is contemplated in a project, for which the following cash flow estimates have been prepared:

	Net CFAT (Rs.)	Probability
Year 1	4,00,000	0.30
	3,50,000	0.40
	2,50,000	0.30
Year 2	3,50,000	0.25
	4,50,000	0.35
	5,00,000	0.40
Year 3	2,60,000	0.45
	3,20,000	0.25
	4,10,000	0.30

Advise whether the project is worthwhile, if RADR is 17%? What should be the maximum project cost, if it were to be taken up.

(6 Marks)

- 2 a.** ABC Co. has taken a six-month loan from their foreign collaborators for US \$2 million. Interest payable on maturity is at LIBOR + 1%. Current 6-month LIBOR is 2%. Enquiries regarding exchange rates with their bank elicit the following information.

Spot USD: Rs. 48.5275

6 month forward: Rs.58.4575

Required: (i) What would be their total commitment in rupees, if they enter into a forward contract?

(ii) Will you advise them to do so? Explain giving reasons.

(12 Marks)

- b.** X Ltd has 25000 equity shares outstanding at the beginning of the year. The current market price is Rs 100 and the directors have recommended a dividend of Rs 5 per share. The appropriate capitalization rate is 10%

Applying MM model calculate the market price of the share when the recommended dividend is

(i) Declared and (ii) not declared. The investment budget is Rs 5 lacs and the anticipated profits are Rs 2.5 lacs, compute how many new shares have to be issued if dividends are declared and if dividends are not declared.

Show that the declaration or non-declaration of dividends does not change the market price.

(8 Marks)

3 a. Information regarding security of Textures Ltd and Aroma Ltd. are shown in the following Table.

Security Aroma	Security Aroma	Security Textures	Security Textures
Probability	Return (%)	Probability	Return (%)
0.05	6	0.05	8
0.20	12	0.20	18
0.50	20	0.50	28
0.20	24	0.20	34
0.05	30	0.05	44

Required: Compute Expected return from the portfolio and Risk of the portfolio

If (i) Investment in A and T is in the ratio of 70/30, and

(ii) It is in the ratio of 20/80 and offers your comments on findings

(16 Marks)

b. Write Short notes on Net Asset Value.

(4 Marks)

4. a. Consider the following data relating to KM stock. KM has a beta of 0.7 with NIFTY. Each Nifty contract is equal to 200 units. KM now quotes at Rs 150 and the Nifty future is 1400 Index points. You are long on 1200 shares of KM in the spot market.

(i) How many futures contracts will you have to take?

(ii) Suppose the price in the spot market drops by 10%, how are you protected?

(iii) Suppose the price in the spot market jumps up by 5%, what happens?

(4 Marks)

- b. A stock is selling at 62. An investor observes the market prices of 3-month calls and notes the following.

Exercise price	Call price
55	10
60	7
65	5

The investor chooses to go long on two calls viz 55 and 65 and writes two calls with an exercise price of Rs. 60. Name the strategy adopted. Determine his payoff function for different levels of stock prices.

Also, find his profit or loss when the stock price at maturity is

- (i) 52 (ii) 57 (iii) 64 and (iv) 70

(8 Marks)

- c. Write short note on Direct Quote

(4 Marks)

- d. What do you mean by the term 'spread'? What are the factors determining it?

(4 Marks)

- 5 a. There are 15 lac shareholders in Genetics DNA Ltd. Each share with a face value of Re.2/- is traded in the market at Rs.8/-. The company informs all the shareholders that it proposes to issue rights shares, in the proportion of 1 for every 3 shares held, at a price of Rs.6.40 per share. Mr. R.A. Bandhopadhyaya who holds 450 shares also receives this intimation, but does not know what to do. You are his good friend. Advise him what would be the change in his wealth (inso far as these shares are concerned), in case:

- (i) He subscribes fully
- (ii) He sells the rights and receives cash for its value
- (iii) He does nothing.

(8 Marks)

- b. Company X is contemplating the purchase of company Y. company X has 3,00,000 shares having a market price of Rs.30 per share, which company Y has 2,00,000 shares selling at Rs.20 per share. The

EPS are Rs.4.00 and Rs. 2.25 for company X and Y respectively. Managements of both companies are discussing two alternative proposals for exchange of shares as indicated below:

- (i) In proportion to the relative earnings per share of two companies.
- (ii) 0.5 share of company X for one share of company Y (0.50:1) you are required:
 - (a) To calculate the earnings per share (EPS) after merger under two alternatives: and
 - (b) To show the impact on EPS for the shareholders of two companies under both the alternatives.

(8 Marks)

c. Consider the following rates and suggest which currency is quoting at premium and which at a discount.

- (a) Spot Rs. /HK\$ is 6.02. 1-month forward = Rs.6.04
- (b) Spot Rs. /HK\$ 26.83. 3-months forward = Rs.26.73

(4 Marks)

6. Write short notes on any four:

- (i) Diversifiable risk or Unsystematic risk
- (ii) Options contract
- (iii) Short selling
- (iv) Global Depository Receipts (GDR)
- (v) Zero coupons
- (vi) Interest Rate Futures

(4x 5 = 20 Marks)

PRIME ACADEMY
29TH SESSION MODEL EXAM
MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS
OLD SYLLABUS - SUGGESTED ANSWERS

1 (a) Step:1	Initial Outflow	(Rs. lacs)
	Capital Expenditure	600
	Working Capital	<u>125</u>
	Total	<u>725</u>

Step:2 In between cash flow

WN 1 Depreciation

YR	Opening WDV	Depreciation @ 25%	Closing WDV
1	600	150	450
2	450	113	337
3	337	84	253
4	253	63	190
5	190	48	142
6	142	36	106
7	106	27	79

W N 2 Tax

$$35+5\% = 36.75\%$$

It is assumed that loss of first year can be adjusted in the first year itself

$$\text{Tax saved} = 81 \text{ (220 X 36.75\%)}$$

Step:3, Statement showing computation of CFAT during project life

Details	Note	1	2	3	4	5	6	7
Volume %		25	40	50	75	100	100	100
Volume Units		5000	8000	10000	15000	20000	20000	20000
Sales (In lacs)		1000	1600	2000	3000	4000	4000	4000
Contribution @35%		350	560	700	1050	1400	1400	1400
Less: Cash Fixed Costs		(420)	(300)	(300)	(300)	(300)	(300)	(300)
Less: Depreciation	1	(150)	(113)	(84)	(63)	(48)	(36)	(27)
PBT		(220)	147	316	687	1052	1064	1073
Less: Tax @ 36.75%	2	81	(54)	(116)	(252)	(387)	(391)	(394)
PAT		(139)	93	200	435	665	673	679
Add: Depreciation		150	113	84	63	48	36	27
Less: Change in Working Capital	3	(125)	(150)	(100)	(250)	(250)	-	-
Net CFAT		(114)	56	184	248	463	709	706

W N 3

Details	Note	1	2	3	4	5	6	7
Working Capital (25% of Sales)		250	400	500	750	1000	1000	1000
Increase in working Capital		125	150	100	250	250	0	0

Step:4 **Terminal Value:**

Invoice Price x 20%	=	100
(-) WDV	=	(79)
Excess of sales Proce over WDV	=	21
Tax @ 36.75%	=	(8)
Net Sale value	=	92
Recapture of working Capital	=	<u>1000</u>
Total	=	<u>1092 Lacs</u>

Step:5, Capital Budgeting Analysis statement

Yr	CF (Rs)	DF(12%)	DCF(Rs)
0	(725)	1.000	(725)
1	(114)	0.893	(102)
2	56	0.797	45
3	184	0.712	131
4	248	0.636	158
5	463	0.567	263
6	709	0.507	359
7	(706+1092)	0.452	813
		NPV	942

Conclusion: Since NPV of the project is positive, project may be accepted

1 (b)**Step I: Compute Expected cash flow**

Year's	Net CFAT (Rs.	Probability	Amount Rs.	
Year 1	400,000	0.30	120,000	
	350,000	0.40	140,000	
	250,000	0.30	75,000	335,000
Year 2	350,000	0.25	87,500	
	450,000	0.35	157,500	
	500,000	0.40	200,000	445,000
Year 3 to 5	260,000	0.45	117,000	
	320,000	0.25	80,000	
	410,000	0.30	123,000	320,000

Step II : Compute RADR. This is given as 17%

Step III : Compute NPV using a RADR of 17%

Year	Cash Flow (Rs)	Discount Factor @ 17%	PV / Rs.
0	(12,00,000)	1.000	(12,00,000)
1	3,35,000	0.855	2,86,425
2	4,45,000	0.731	3,25,295
3	3,20,000	0.624	1,99,680
4	3,20,000	0.534	1,70,880
5	3,20,000	0.456	1,45,920
		NPV	(71,800)

Step IV:

Decision - The NPV of the project , at a RADR of 17% is negative , Hence the project should be rejected

Step V: Maximum Project cost. For Acceptance, the project cost, should be curtailed and revised downwards t Rs11,28,200 (Rs.12.00 Lacs, Less Rs.71,800).

2 (a) Step 1: Computing interest for six months:
Annual Interest rate is 3% and the amount is USD 20, 00,000
Period Involved is 6 Months
Hence interest for six months at 3% is USD 30,000
(20, 00,000 x 3/100 x 6/12)

Step 2: Determining whether the forward is at a premium or discount:
It is seen that the Ask Rate is less than the Bid rate. Hence the currency is quoted is at a discount

Step 3: Computing value of total rupee commitment:

Principal amount of Loan	USD 20, 00,000
Add Interest	—
Amount due	—
Spot Rate (Rs)	48.5275
Forward point (6months) (DEDUCT)	0.0700
Forward rate	48.4575
Commitment amount (Value x forward rate)	Rs. 9, 83, 68,725

Step 4:

Market expectations show that the dollar will depreciate. If the expectations of the firm are that the rate of depreciation will be more than what the bank has indicated, it may be worthwhile not to cover forward, and keep the exposure open.

If the firm has no specific view regarding future dollar price movements, it is advisable to protect the exchange rate risk by hedging through forward cover.

Given the interest rates and the differentials between the two countries, it may not be proper to anticipate that the dollar will depreciate on an on-going basis. USD per se is a stronger currency than INR and taken an overall view, it would be advisable to go for a forward cover

2 (b) Part (i): If dividends = Rs.5 per share

Step1: Compute P_1

$$P_1 = P_0 (1 + K_e) - D_1.$$

$$(i.e) P_1 = 100 (1 + 0.1) - 5 = Rs.105.$$

Step2: Retained earnings available:

$$= X_1 - nD_1$$

$$= 2,50,000 - (25,000 \times 5) = Rs. 1,25,000.$$

Step 3: Money required through issue of Equity Shares

$$= I_1 - (X_1 - nD_1)$$

$$(i.e) 5,00,000 - 1,25,000 = Rs.3,75,000.$$

Step 4: Raise money under step 3 by issuing shares at P_1 :

$$m = \frac{\text{step3 (i.e) } 3,75,000}{P_1 \quad 105} = 3571 \text{ shares}$$

Step5: Compute nP_0

$$nP_0 = 25,000 \times 100 = Rs.25,00,000$$

Step6: Substituting in the formula $\frac{(n+m)P_1 - 1_1 + X_1}{1 + K_e}$

$$= \frac{(28,571 \times 105) - 5,00,000 + 25,00,000}{1 + 0.1}$$

$$= Rs.25,00,000.$$

Part ii): If Dividend = 0 (i.e.,) 25,00,000

Step1: Compute P_1

$$P_1 = P_0 (1 + K_e) - D_1$$

$$(ie) P_1 = 100 (1.1) - 0 = Rs110/-$$

Step 2: Retained Earning Rs.2, 50,000.

Step 3: Money required through issue of Equity Shares = 500000-250000 = Rs.2, 50,000

Step 4:

$$m = \frac{250000}{110} = 2273 \text{ Shares}$$

Step5:

$$n P_0 = 25,000 \times 100 = 25,00,000$$

Step 6 : Substituting in the formula

$$\begin{aligned} & \frac{(n+m)P_1 - 1_1 + x_1}{1 + K_e} \\ &= \frac{(2273 \times 110 - 500000 + 250000)}{1.10} \\ &= Rs.25, 00,000 \end{aligned}$$

Conclusion:

Particulars	Dividends Declared	Dividends not declared
Market Price	105	110
m	3571	2273
nP ₀	25L	25L

3 (a) Step 1: Expected return in each security is the mean of probable returns.

Security A:

$$(0.05 \times 6) + (0.20 \times 12) + (0.50 \times 20) + (0.20 \times 24) + (0.05 \times 30) = 19.00\%$$

Security T:

$$(0.05 \times 8) + (0.20 \times 18) + (0.50 \times 28) + (0.20 \times 34) + (0.05 \times 44) = 27.00\%$$

Step 2: Expected Return from the portfolio

Investments	70/30 ratio	20/80 ratio
Aroma	19.00 x 0.7 = 13.30%	19.00 x 0.2 = 3.80%
Textures	27.00 x 0.3 = 8.10%	27.00 x 0.8 = 21.60%
Portfolio return	21.40%	25.40%

Step 3: Computation of standard deviation – Aroma

Possible Outcome R	Deviation from Mean of 19% $d = R - \bar{R}$	Square of Deviation d^2	Probability P	P d^2
6	(13)	169	0.05	8.45
12	(7)	49	0.20	9.80
20	1	1	0.50	0.50
24	5	25	0.20	5.00
30	11	121	0.05	6.05

$$\sigma^2 = (\text{variance}) = 29.80$$

$$\sigma = \text{Standard Deviation} = 5.4589 \text{ or } 5.46\%$$

Step 4: Computation of standard deviation – Textures

Possible Outcome R	Deviation from Expected Return 27% $D = R - \bar{R}$	Square of deviation d^2	Probability P	P d^2
8	(19)	361	0.05	18.05
18	(9)	81	0.20	16.20
28	1	1	0.50	0.50
34	7	49	0.20	9.80
44	17	289	0.05	14.45
$\sigma^2 = (\text{variance}) =$				59.00
$\sigma = \text{standard Deviation} =$				7.6811
Rounded off to 7.68%				

Standard deviation of security A is 5.46% and that of security B is 7.68%

Step 5: Covariance of Aroma and Textures is computed as:

Prob.P	Deviation from mean		Product	Prob Applied
	Security A	Security B	$d_A \times d_B$	$P \times d_A \times d_B$
	$d_A = R_A - \bar{R}_A$	$d_B = R_B - \bar{R}_B$		
0.05	(13)	(19)	247	12.35
0.20	(7)	(9)	63	12.60
0.50	1	1	1	0.50
0.20	5	7	35	7.00
0.05	11	17	187	9.35
Total				41.80
Covariance positive value				41.80

Step 6: Coefficient of correlation is computed as

$$\begin{aligned}
 &= (\text{Covariance}) / \sigma_A \times \sigma_T \\
 &= (+)41.80 / 5.46 \times 7.68 \\
 &= (+)41.80 / 41.9328
 \end{aligned}$$

Positive correlation between two securities = 0.9968 (very close to 1)

Part (i) Risk of the portfolio at 70/30 ratio:

$$\begin{aligned}
 &= \sqrt{[(\sigma_A)^2 (W_A)^2] + [(\sigma_B)^2 (W_B)^2] + [2 (\sigma_A) \times (\sigma_B) \times (W_A) \times (W_B) \times (C o r r_{AB})]} \\
 &= \sqrt{[(5.46)^2 (0.7)^2 + (7.68)^2 (0.3)^2 + (2 \times (5.46) \times (7.68) \times (0.7) \times (0.3) \times (0.9968))]} \\
 &= \sqrt{[(29.80)(0.49) + (59)(0.09) + (2 (8.778))]} \\
 &= \sqrt{(14.602) + (5.31) + (17.556)}
 \end{aligned}$$

$$\begin{aligned}
 \sigma^2 &= \text{Variance of Portfolio AB} = 37.468 \\
 \sigma &= 6.12\%
 \end{aligned}$$

Part (ii) Risk of the portfolio at 20/80 ratio:

$$\begin{aligned}
 &= \sqrt{[(5.46)^2 (0.2)^2 + (7.68)^2 (0.8)^2 + (2 \times (5.46) \times (7.68) \times (0.2) \times (0.8) \times (0.9968))]} \\
 &= \sqrt{(1.19) + (37.75) + (13.37)}
 \end{aligned}$$

$$\sigma^2 = \text{Variance of Portfolio AB} = 52.31 \Rightarrow \sigma = 7.23\%$$

Comments of findings: First option of 70/30 ratio provides a lower risk for the portfolio.

Variance of returns for Textures (and hence Standard Deviation) is higher at 7.23, and if the portfolio were to consist of a investment in Textures which carries a higher Standard Deviation, the over all risk of the portfolio will increase.

3 (b) Net Asset Value (NAV):

Each day, the mutual fund computes the net asset value of the unit. The NAV of a mutual fund is the amount which a unit holder would receive if the mutual fund were wound up that day. This value is obtained by deducting the total liabilities of the fund from the closing market value of the holdings and dividing it by the number of units outstanding. The NAV is the fund's single most important number. If the value of the investment in the fund's portfolio goes up, other things remaining equal, the value of the fund, and hence the net asset value of the unit, increases. Similarly if the value of the investment holdings in the fund's portfolio comes down, the value of the fund and hence the net asset value of the fund, will come down. Thus, the net asset value per unit fluctuates every time any asset experiences a change in its market price.

4(a) Part (i) since you are long on the spot market, you have to go short in the futures market. Hence you have to sell NIFTY.

- Futures to be sold = Hedge ratio x [Units of spot position requiring hedging / No of units underlying one futures contract]

$$= 0.7 \times 1200 / 200 = 4.2$$

Part (ii) Price falls

- If the price of KM falls by 10%, it means it has fallen from Rs 150 to Rs 135 ie by Rs 15. Consequently the index will fall by $15/0.7$ ie 21.429. It will fall to 1378.571 index points.
- Since your stock fell by Rs 15, on your 1200 shares you have lost $1200 \times 15 = \text{Rs } 18000$.
- You have sold 4.2 contracts in index futures. You have gained 21.429 points. You have gained $4.2 \times 200 \times 21.429 = \text{Rs } 18000$.
- Your gain is offset by your loss.

Part (iii) Price Increase

- If the price of KM goes up by 5%, it means an increase of $\text{Rs } 150 \times 0.05 = \text{Rs } 7.5$. Consequently the index will rise by $7.5/0.7$ ie 10.714 and will touch 1410.714
- Since your stock rose by 5% or Rs. 7.50, on your 1200 shares you gained $1200 \times 7.5 = \text{Rs } 9000$.
- You have bought 4.2 contracts in index futures. You lost 10.714 points. Your total loss on the futures is $4.2 \times 200 \times 10.714 = \text{Rs } 9000$
- Your gain is offset by your loss.

4 (b)

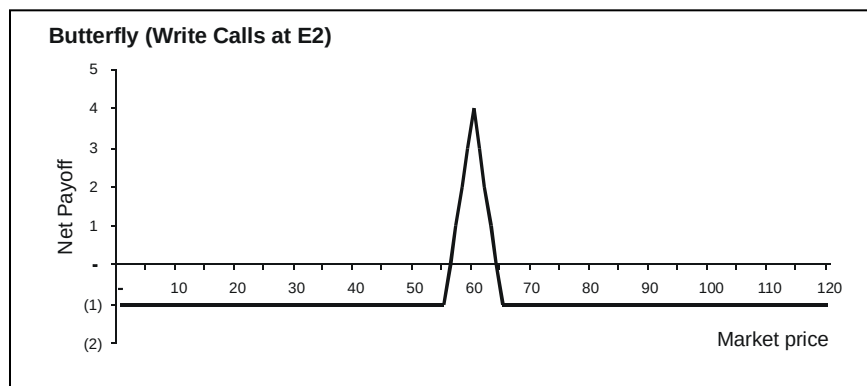
Types of options	call		
	No of calls (No's)	Ex Price (Rs.)	Premium (Rs.)
Bought	1	55	10
Sold	2	60	7
Bought	1	65	5

This is a case way 2:

- E1 = Lower Exercise Price;
 E2 = Middle Exercise Price;
 E3 = Higher Exercise Price;
 S = Spot price on maturity

		E1	E2	E3				
Number of calls		1	2	1	Premium = $-10+2(7)-5=-1$			
Holder/Writer		Holder	Writer	Holder	BEP is got by equating Net profit to zero			
Exercise Price		55	60	65				
Price (Rs.) (1)	Posbl. (2)	Action (E1) (3)	Action (E2) (4)	Action (E3) (5)	GrossP/(L) (Rs.) (6)	Premium (Rs.) (7)	NetP/(L) (Rs.) (8)=(6)+(7)	BEP
52	$S < E1$	Lapse Nil	Lapse Nil	Lapse Nil	0	-1	-1	NA
57	$E1 < S < E2$	Exercise S-E1	Lapse Nil	Lapse Nil	(S-E1)	-1	1	56
64	$E2 < S < E3$	Exercise S-E1	Exercise $2(E2-S)$	Lapse Nil	$(S-E1)+(2(E2-S))$	-1	0	64
70	$E3 < S$	Exercise S-E1	Exercise $2(E2-S)$	Exercise S-E3	$(S-E1)+(2(E2-S))+(S-E3)$	-1	-1	NA

Stock price(Rs.)	What happens
≤ 55	Constant Loss
56	BEP
57 to 60	Increasing Profit
61 to 63	Decreasing Profit
64	BEP
≥ 65	Constant Loss



4 (c) Direct Quote:

A direct quote expresses the exchange rate in terms of home currency per unit of the foreign currency. In other words, it is the number of home currency units required to buy or sell one unit of foreign currency. For example, Rs 44.20 per USD is a direct quote for USD in India.

Consider this example. Suppose you go to a shop to buy a pen. You ask for its price and the shopkeeper says. “Rs 20 per pen”. This is a direct quote for the pen. It indicates how much you have to pay to buy a pen. This brings us to Rule 3. That, “in a direct quote the price comes first, the commodity comes next.”

Tomorrow, the shopkeeper could quote Rs 25 per pen. Note, the quantity for the commodity remains the same (viz. 1 pen), the amount changes (viz. from Rs 20 to Rs 25). Today, a banker could quote Rs 45 per dollar. Tomorrow he could quote Rs 44 per dollar. The price against which the number (namely, 1 unit) doesn’t change is the commodity. This brings us to Rule 4. That, “in a direct quote the foreign currency is the commodity which is being brought and sold”. Internationally, people prefer direct quotes.

4 (d) Spread:

You will not be able to buy foreign currency from a bank at the same rate at which you can sell the same currency to it. This is because the bank whose business it is to buy and sell will have to make a margin to cover costs and make a small profit. For that matter, this is normal of any business. This difference between the banks’s buying rate (bit rate) and the bank’s selling rate (ask rate) is called the “spread”. If the bid rate for € is Rs.50 and the ask rate is 52, the spread will be Rs2.

The following two factors determine the size of the spread.

- Stability of the exchange rate: If the exchange rate is expected to be stable, the spread will be narrow. If the exchange rate is volatile, the spread will be wider.
- Depth of the market: “Depth” refers to the volume of transactions in the market. A “deep” market has a high volume of transactions with several dealers simultaneously engaged in transacting business. In this case, the spread will be narrower than for a “thin” market where there is a low volume of transactions and a few dealers.

5 (a) W.N.1: Basic information.

Theoretical ex rights price and Value of Rights		Rupees
Rights proportion	1 for 3 held	
Current market price per share	“Cum- rights”	8.00
Worth of three shares		24.00
Issue price of one share		6.40
Theoretical value of 4 shares		30.40
Theoretical ex rights price per share		7.60
Rights offer price		6.40
Value of the rights per new share		1.20
Value attached to existing share	(1.20)/3 =	0.40

Part (i)

Mr. R.A. B subscribes to the rights	existing	New
	Wealth	Wealth
450 shares at Rs.800	3600	
Rights number (450/30)	150s	
Value offer Rights issue		
450 shares at 7.60		3420
150 shares at 7.60		1140
Sub total		4560
Less fresh money invested @ 150 x 6.40		(960)
Comparative status	3600	3600

Part (ii)

Mr. R.A. B sells his rights		
450 shares at Rs.8.00	3600	
Sales of rights, for its value		
150 rights at Rs.1.20 per share (Cash)		180
450 shares at Rs.7.60 per share (after issue)		
Comparative status	3600	3600

Part (iii)

Mr. R.A. B does nothing		
450 shares at 8.00	3600	
150 shares at 7.60		3420
Comparative status	3600	3420
Loss suffered – wealth diminishes		180

Conclusion:

It is seen that when Mr. R.A. B exercises or when he renounces his rights, his total wealth does not change. However, if he does nothing, he stands to lose a sum of Rs. 180/-

5 (b) I (i) In proportion to the relative EPS of the 2 companies

Company	Number of shares	EPS	Total earnings Rs
X	300,000	4.00	1,20,000
Y	200,000	2.25	<u>4,50,000</u>
		Total earnings	16, 50,000

Number of shares post-merger

$$X = 300,000$$

$$Y = 200,000 \times \frac{2.25}{4.00} = 112500$$

Total= Rs. 4.12.500

$$\text{EPS of the merged equity} = \frac{\text{Total earnings}}{\text{New number of shares}} = \frac{16,50,000}{4,12,500} = \text{Rs. 4.}$$

(ii) Exchange ratio = 0.5:1

Total earnings = Rs. 16, 50,000

New number of shares = 300,000+(200,000x0.5) = 400,000.

New EPS = Rs. 4.125.

II Impact on EPS for the shareholders

Alternative (i)

Alternative (i)	New EPS	Old EPS	Impact
Co. X	4.00	4.00	No impact
Co. Y	4.00	2.25 x 2 = 4.50	0.50P.
Alternative (ii)	New EPS	Old EPS	Impact
Co. X	4.125	4.00	0.125P
Co. Y	4.125	4.50	0.375P

5 (c)

Spot	Forward	Explanation and Conclusion
Rs.6.02 = 1 HKD	1 m = 6.04	Direct quote. Forward > Spot. Hence foreign currency, HKD is at a premium and home currency, INR is at a discount
Rs.26.83=1 SGD	3 m = 26.73	Direct quote. Forward < Spot. Hence, foreign currency, SGD is at a discount and home currency, INR is at a premium.

6 (i) Diversifiable risk or Unsystematic risk:

This risk affects only the particular security and is hence specific to the security. It is therefore also called Specific risk. For instance, an increase in the price of bamboo (Which is the raw material for making paper) will affect the fortune of a paper manufacturing company but will have no effect on the fortunes of a cement manufacturing company. This is a risk specific to the paper industry. Specific risk is the “contribution” per se of one security to the risk of a portfolio of securities and is therefore distinct for each individual investment. Such a risk can, by careful efforts at diversification, be reduced.

Math Formula:

Since there are only two types of risks, the value for under systematic risk is “total risk” less “systematic risk”.

Non-diversifiable or systematic risk:

This risk cuts across industries and affects all companies operating in the market. It is therefore also called portfolio risk or market risk. It is the risk that an entity's cash flows may be affected by factors that are beyond the control of the management of entity. For example, changes in interest rate, inflation, taxation etc. affect all companies. Non-diversifiable risk reflects the sensitivity of an entity's revenue to changes in macro-economic factors and depends on the degree of sensitivity of costs to total revenue. An entity with low revenue- sensitivity, i.e., where the revenues are relatively stable, will carry a low- risk relative to another with high revenue sensitivity.

Math Formula:

The value of systematic risk is the product of two elements. One is the correlation between the stock and the Market. (Corr_{jm}). The other is the relationship between risk element in stock and risk element in stock market. (σ_j) This can be expressed as $\frac{\sigma_j}{\sigma_m} \times \text{Corr}_{jm}$.

- 6 (ii) “An option is a contract between two parties under which the buyer of the option buys the right and not the obligation to buy or sell, a standardized quantity (contract size) of a financial instrument (underlying asset) at or before a pre determined date (expiry date) at a price, which is decided in advance (exercise price or strike price).”

When the option gives the buyer of the option the right to buy it is called a call option. When the option gives the buyer of the option the right to sell it is called a put option. For providing the option the writer charges a price.

We now proceed to break this definition down threadbare.

- Right: An option is a derivative instrument involving a “right”.
- Holder and Writer: One party “buys” the right and the other party “Sells” the right. The one who buys the right is called the “buyer” or the “holder” of the option. The one who sells the right is called the “Seller” or the “Writer” of the option.
- Call and put option: The right can be the “right to buy” an underlying asset. Such a right is called a “Call option”. The right can be the “right to sell” an underlying asset. Such a right is called a “Put option”.
- Obligation: The holder can demand performance; he is not obliged to perform. In contrast, the writer is obliged to perform; he cannot demand performance.
- Exercise price: The price at which the underlying asset can be bought or sold, as the case may be, is called the exercise price. The exercise price is also referred to as the strike price.
- Expiry date: The date by which the right should be exercised is called the expiry date.
- Option premium: When the buyer buys a right (either the right to buy or the right to sell) he has to pay the writer a price. this is called the option premium or option price.

The Right Example: The rights offer by a company is a typical example of an option. The rights offer gives the shareholder the right to subscribe. It does not compel him to subscribe. The

shareholder buys the right to buy i.e. the right to subscribe. He is therefore the holder of the option. The company sells the option. It is therefore the writer of the option. This is a call option because the shareholder buys the right to buy shares. The rights price is the exercise price. The rights closure date is the expiry date. There is no option premium involved.

Features: The features of an option contract are very similar to that of a futures contract except that only one of the two parties is obliged to perform.

- a. Standardization: Like futures, the contract is standardized as to quantity, date and month of delivery, price, minimum amount by which price would move.
- b. Deal with the clearinghouse: The clearinghouse guarantees performance. Consequently there is no risk of default.
- c. Mark to market margin: Since the clearinghouse acts as a guarantor, it would require the parties to maintain a deposit (margin) with it.

6 (iii) Short selling:

Short selling involves selling a stock which you don't own and buying it back later to square the position. A short seller resorts to this strategy because he expects prices to fall and wants to benefit from the fall. In a falling market this is a good way to make money. Consider this example.

WIPRO is quoting at Rs 2400. You feel that the stock is overpriced and expect it to fall to Rs 2100 in a month's time. The only way to gain in a falling market is to make sale. But you do not have WIPRO shares. You therefore elect to sell now and buy it back a month later and thereby profit Rs 300 per share.

Since you don't have shares and delivery has to be made within 2 days of the transaction, your broker borrows shares on your behalf and delivers them. This is called stock lending. You are required to pay stock lending charges. The concept of short selling is central to a number of futures and options strategies which we will outline later.

6 (iv) Global Depositary Receipts ('GDRs):

Many large Indian corporate entities have been able to tap global equity market to raise foreign currency funds by way of equity, through this route of issuing GDRs. An Indian company issues ordinary equity shares. These shares are "deposited" with custodian banks (mostly domestic banks). Custodian Banks establish a link with a Depositary bank overseas. Depositary bank, in turn issues Depositary Receipts in US dollars. Funds are raised when overseas entities purchase these depositary receipts, at a agreed price. The important characteristics are:

- (a) The shares underlying the depositary receipts do not carry voting rights.
- (b) The instruments are freely traded (listed in Luxemburg or other permitted Exchanges).
- (c) They are marketed globally, without being confined to borders of any market or country (it can be traded in more than one currency).
- (d) Investors (mostly institutional investors) earn fixed income by way of dividends (dividends are paid in issuer- currency, converted into dollars by depositary and paid to investors, and hence exchange risk is with investor).

- (e) The GDRs can be converted into underlying shares, by Depository/ Custodian banks redeeming the issue, with reference to price prevailing in NSE or BSE. At times, reverse- conversion (conversion of underlying shares into GDRs) is also permitted, though this area is not yet open to Indian companies.

6 (v) **Zero-Coupons:**

1. Zero Coupon Bonds are debt instruments (in the nature of secured or unsecured debentures) evidencing loans borrowed for a given period.
2. The special feature of such bonds is that the borrower does not pay any interest during the “tenor” of the loan.
3. The bonds are issued at face value and redeemed at a premium on face value. The premium represents the compensation the investor receives over tenor of the bond by way of compounded interest.
4. From the borrower’s point of view there is no cash outflow to cover interest, while from the investor’s point of view, the instrument provides little or no liquidity unless traded in the market.
5. In a scenario of reducing interest rates, the yield on Zero coupon bonds would be higher than what the market would otherwise offer, and the converse applies when interest rates begin to rise after the issue of Zero Coupon Bonds.

6 (vi) **INTEREST RATE FUTURES (IRF):**

Meaning:

A Futures contract is, by definition, a forward contract, which trades on the exchange. IRF involves a national purchase and sale of a bond at the traded price and a notional delivery of the underlying asset on the specified expiry date. IR Futures are available in major currencies (US \$, Sterling, Yen, Euros, Sw. Franc etc). These contracts can be used in both lending and borrowing situations.

Why IRF:

A CFO is generally faced with two different situations. Having tied his company to fixed interest rate, he might now expect interest rates to fall. Alternatively having tied the company to floating rates, he might now expect interest rates to rise. Both these will put him in difficulty. To overcome them he might trade in IRF.

Central to understanding this is the principle of interest rate risk. When interest rates fall, instruments that offer higher coupon rates rise in value. When interest rates rise, instruments that offer lower coupon rates will fall in value. A couple of examples will help understand this.

1. **Have a view that interest rates will fall:** Suppose the current implied interest rate is 6%. He expects the interest rate to fall to say 5%. Suppose 1 contract = 2000 units. He buys one futures contract at say Rs 55.5. Suppose a few days later the implied interest rate falls to 5%. The IRF quotes Rs 60.8 in the market. He sells and gains Rs 60.8-55.5=5.3 per unit. On 2000 units he scores 2000 x 5.3 = Rs 10,600/-
2. **Have a view that interest rates will rise:** Suppose the current implied interest rate is 5%. The CFO expects the interest rate to climb. Suppose the current market price of a

IRF is Rs 61. He sell one futures contract at Rs 61. Suppose a few days later the implied interest rate raises to 5.3% and the IRF quotes Rs 59. He buys one IRF and pockets the difference of Rs 2 per unit or Rs 4000 in all.

This derivative instrument comes as a useful means of hedging risk against the risk of the interest rate movements.

It must be noted that when you contract for 3-month interest rate futures for Euro 1 million, You are merely laying out an interest rate at which you will either borrow or lend Euro 1 million, beginning March. Commencement of the period of notional lending or borrowing is synchronized with the maturity of IRF.

To understand that we should take a look at the following features which are relevant?

1. **Period:** IRF is standardized with reference to period. There are two types of IRF – short term and long term. The former runs for a three-month cycle, the latter for one year.
2. **Contract Size:** The Contract Size standardized and depends on the currency. For example, for a short-term 3-month contract, sizes for USD, Euros and sterling is 1 million each. For Swiss Franc the size is 500,000. /-. For the INR it is Rs 200,000 irrespective of whether it is short term or long term.
3. **Rate of interest:** The rate of interest is in built into the price of the futures contract. The price of IR- Futures is “100 minus interest rate”. If you buy an IRF quoted at 93.25, you would be dealing in an interest rate of 6.75% p.a. (100.00-93.25)
4. **Profit or loss:** The profit or loss in a futures contract is represented by a TICK. A tick means a 0.01% “interest” on the amount represented by the contract size. This is also the minimum movement in price. If the contract size is 500,000, the value of a tick for a three month contract will be 12.50.[500,000 x 0.01 % x 3/12]
5. **Obligations:** When you buy an IRF, You will be contracting to buy an “entitlement” to receive interest payment on a notional amount in a given currency Conversely, when you sell an IRF, you are making a promise to undertake an interest-payment obligation on a notional amount in a given currency Buying could be considered the equivalent of investing and selling the equivalent of borrowing.
6. **On maturity:** IRFs are closed out by the contracting party, by taking an opposite position. This part can be closed out with the following principles
 - If you have an asset portfolio and expect interest rates to fall, you will buy IRF
 - If you have an asset portfolio and expect interest rates to rise, you will sell IRF
 - If you have a liability portfolio and expect interest rates to fall, you will sell IRF
 - If you have a liability portfolio and expect interest rates to rise, you will buy IRF

Interest Rate Expectation	Asset	Liability
Down	Buy	Sell
Up	Sell	Buy

ADAT

Number of Pages : 3

Number of Questions: 8

Total Marks: 100

Time Allowed: 3 Hrs

Answer question Nos. **1** and **2** and any **four** from the rest.

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

- (a)** M/s ABC group gratuity scheme's valuation by actuary shows wide variation compared to the previous year's figures.

(4 Marks)

- (b)** S Ltd., wishes to obtain a machine tool costing Rs.20 lakhs by way of lease. The effective life of the machine tool is 12 years but the company requires it only for the first five years. It enters into an agreement with R Ltd, for a lease rental of Rs.2 lakhs p.a.

The Finance Director of S Ltd., is not sure about the treatment of these lease rentals and hence requests your assistance in proper disclosure of the same. For calculation purposes, the implicit rate of interest may be taken at 15%. Discount factors: 0.87, 0.76, 0.66, 0.57 and 0.50.

(4 Marks)

- (c)** XYZ Pvt. Ltd., is a Manufacturer of jewellery. A senior employee of the Company informed you that the Company does not properly disclose the purity of gold used on the jewellery.

(5 Marks)

- (d)** B Pvt. Ltd., was amalgamated with MNO Ltd., with effect from 1st April, 2008. As per the scheme of amalgamation approved by the High Court, the amalgamation was to be accounted by the "Pooling of Interests Method". The scheme further provided that the balance in Revaluation Reserve of B Pvt. Ltd., as on 31st March, 2008 was to be treated as a General Reserve on amalgamation. During the financial year 2008-05, MNO Ltd., issued bonus shares out of General Reserves (which included the amount of revaluation reserve of B Pvt., Ltd.,)

(5Marks)

2. Comment on the following with reference to the Chartered Accountants Act, 1949 and schedules thereto:

- (a)** A chartered accountant availed a term loan of Rs. 10 lakhs from a nationalized bank for furnishing his office. He issued two cheques for Rs.1 lakh each towards repayment of the loan. The cheques were dishonoured with the remark "Refer to Drawer". Is the chartered accountant liable to misconduct?

(4 Marks)

- (b) Mr. Praful, Chartered Accountant, in practice died in a road accident. His widow proposes to sell the practice of her husband to Mr. Vipul, Chartered Accountant, for Rs.5 lakhs. The price also includes right to use the firm name-Praful and Associates. Can widow of Praful sell the practice and can Mr. Vipul continue in that name as a proprietor?

(4 Marks)

- (c) The Cashier of a company committed a fraud and absconded with the proceeds thereof. This happened during the course of the accounting year. The Chief Accountant of the company also did not know about fraud.

In the course of the audit, at the end of the year, the auditor failed to discover the fraud. After the audit was completed, however, the fraud was discovered by the Chief Accountant. Investigation made at that time indicate the auditor did not exercise proper skill and care and performed his work in a desultory and haphazard manner. With this background, the Directors of the company intend to file disciplinary proceedings against the auditor.

Discuss the position of the auditor with regard with regard to the disciplinary proceedings.

(5 Marks)

- (d) A practicing Chartered Accountant uses a visiting card in which he designated himself, besides as Chartered Accountant, as

- (i) Tax Consultant
- (ii) Cost Accountant.

(5 Marks)

3.

- (a) Enumerate the risks and internal control characteristics in an audit conducted in Computer Information Systems (CIS) environment.

(8 Marks)

- (b) Designing an Audit Strategy is the backbone of the “Audit Planning” process. Discuss.

(8 Marks)

4.

- (a) Briefly describe the Auditor’s responsibilities regarding disqualification of Directors.

(8 Marks)

- (b) What is your understanding of the term “true and fair view” in a statutory audit report of a company?

(8 Marks)

5. A limited company having turnover of approximately Rs.50 crore uses a tailor made accounting software package. In the said package, all transactions are recorded, processed and the final accounts generated from the system. The management tells you that in view of the voluminous nature of day books, there is no need to print them and that audit can be conducted on the computer itself. The management further assures you that any 'query based reports' as required can be generated and printed. As a statutory auditor of the company, enumerate the procedures you would adopt to conduct the audit.

(16 Marks)

6.

- (a) "Like every other audit, a systematic planning for cost audit is also necessary". Indicate the matters to be included in a Cost Audit Programme.

(10 Marks)

- (b) Write short note on – Propriety Audit.

(6 Marks)

7. Write short notes on-

- (a) Principal Enactments Governing Bank Audit
- (b) Incoming and Outgoing Co-insurance
- (c) Deferred Taxation
- (d) Sauda Book

(4 x 4 = 16 Marks)

8. As the Auditor of a NBFC, which is engaged in the acquisition of securities and trading in such securities? List out the special points that may be covered in your audit.

(16 Marks)

PRIME ACADEMY
29TH SESSION MODEL EXAM
ADVANCED AUDITING – OLD SYLLABUS
SUGGESTED ANSWERS

1)

a. **Valuation by Actuary :**

Auditing and Assurance Standard 9, “using the work of an expert” states that the auditor has to evaluate the work of an expert, say, actuary before adopting the same. This becomes more crucial since M/s ABC’s group gratuity scheme’s

Valuation by actuary shows wide variation compared to previous year figures. There is no doubt that appropriateness, reasonableness, of assumption and methods used are the responsibility of the expert, but auditor has to determine whether they are reasonable based on the auditor’s knowledge of the client’s business and result of his audit procedures. In the present case, the auditor must verify the reasonableness of assumptions made and methods adopted by the actuary in the evaluation particularly with reference to factors such as rate of return on investments, retirement age, number and salary of employees, etc. Accordingly, the auditor has to satisfy himself whether valuation done by the actuary can be adopted, otherwise he may report on his finding for wide variation.

- b) The fair value of asset is Rs.20 lacs and the present value of lease rentals is 6.72 lacs. The machine is required for five years only which is less than 50% of the economic life. In view of having regard to substance of the transaction on both were courts, as per AS-19 on leases, the lease will be classified as an operating lease. As per AS-19, the following may be disclosed:

Future minimum lease payments – not later than 1 year Rs.2 lacs

Future minimum lease payments – later than 1 year and
Not later than 5 years Rs.4.98 lacs

- c) In the case of XYZ Pvt Ltd if purity of gold is not properly disclosed on the jewellery it amounts to defrauding the customers. That means the management is deceiving customers to obtain an illegal advantage. However, the auditor is concerned with fraudulent acts that cause a material misstatement in financial statements. As long as book of account are not falsified arising out of difference in the purity of gold, i.e., actual cost of the gold and sale price of the gold, it has no implication for the auditor. Further under CARO, 2003, the auditor may examine this from the view point of maintaining proper records of inventory. But even the requirement of maintaining proper a record does not necessitate that purity as such should be mentioned on the gold itself. However the purity of the gold would have implication on valuation of inventory but this aspect is not required to be reported under CARO, 2003.

Thus, from the view point of reporting on frauds under CARO, 2003, there is no implication for misstatement in the financial statements. Hence no reporting is necessary for non-proper disclosure of purity of the gold on the jewellery.

d) **Amalgamation and Revaluation Reserve:**

As per AS 14, “Accounting for Amalgamation” if the amalgamation is in the nature of merger and the ‘Pooling of Interest Method’ is followed, the identity of the reserves is preserved and it appears in the financial statements of the transferee company in the same form in which they appeared in the financial statements of the transferor company. In the instant case, B Pvt Ltd is amalgamated with MNO Ltd. and the amalgamation is in the nature of merger. Accordingly, revaluation reserves of B Pvt Ltd. would have normally continued to remain so in MNO Ltd. However, since the scheme mentions that Revaluation Reserve is to be treated as General Reserve, the scheme will override AS 14. AS 14, “Accounting for Amalgamation”, also requires that in case of any approved scheme of amalgamation if the treatment in accounting is not as per the AS, specific disclosure of the same will have to be made along with the financial effect on financial statements due to such deviation. The statutory auditor will accordingly have to ensure

that the company complies with the requirements regarding treatment of reserves and other related disclosure requirements or he may be required to modify his report.

- 2) (a) A Member is liable to disciplinary action under Section 21 of Chartered Accountants Act, 1949 if he is found guilty of any professional or “other misconduct”. “Other misconduct” has not defined the Act. This provision empowers the council to enquire into any misconduct of a member even if it does not arise out of its professional work. This is considered necessary because a chartered accountant is expected to maintain the highest: standard of integrity even in his personal affairs and any deviation from these standards even in his non-professional work, would expose him to disciplinary action.

In the absence of statutory definition of “other misconduct”, the question whether a particular act, or a omission constitutes “other misconduct” has to be decided on the facts and circumstances of each case. In this context in the case of council of the institution of chartered accountants of India and others vs. B.Mukarjee, the supreme court observed as under :

If a member of the Institute is found prima facie, guilty of conduct, which, in the opinion of Institute, even though may not attract any of the provision of the schedules, it would still be open to the Council to hold an enquiry against the member in respect of such conduct and a finding against him in such an enquiry, would justify appropriate action being taken by the High Court.

Since April, 1989 the Negotiable Instrument Act, 1881 was amended by the banking public financial institutions and Negotiable Instrument Laws(amendment) Act, 1988 providing that where any cheque drawn by a person for the discharge of any liability is returned by the bank unpaid for the reason of insufficiency of the amount of money standing to the credit of the account on which the cheque was drawn or for the reason that exceeds arrangement made by the drawer of the cheque with the bankers for the account, the drawer of such cheque shall be deemed to have committed an offence. The fact of the case state that the cheque was dishonored with the remark “Refer to Drawer”. The interpretation is susceptible to more than one and there is no reason, by way of literal construction, to restrict the interpretation of the same only to ‘dishonoring for the reason of insufficiency of funds’. therefore in case it is proved that the cheques were dishonored due to insufficiency of funds, the chartered accountant be held guilty of other misconduct.

(a) Sale Of Goodwill:

with reference to clause (2) of part I to the first schedule to Chartered Accountants’ Act 1949 the council of the Institute Of Chartered Accountants of India had an occasion to consider whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible after the death of the proprietor. It laid down that the sale is permitted subject to certain conditions. It further resolved that the legal heir of the deceased member has to obtain the permission of the Council within a year of the death of the proprietor concerned. Thus in a given case and on the facts, the widow of Mr.Praful who has sold the practice for Rs.5 lacs is nothing but sale of goodwill. Thus the act of Mrs.Praful is permissible.

(b) Failure to Exercise Reasonable Care and Skill:

Apparently, as it appears from the facts of the case that the auditor did not exercise proper skill and care and that he performed his work in a desultory and haphazard manner. In this matter, the test for auditor’s liability lies in whether he has applied reasonable care, skill and caution called for in the circumstances of the case and whether he has applied reasonable care, skill and caution called for in the circumstances of the case and he reasonably used all the information that he came across in the course of audit. Cash is a significant item in any situation and the fact that the cashier had left during the year without notice should have placed the auditor on alert as regards the cash book. In fact, the very fact that the cashier was absconding, i.e., left without any notice constituted sufficient circumstances to excite suspicion of the auditor to probe to the bottom. As per AAS 4, the auditors responsibility to consider fraud and error in audit of financial

statements”, it can be concluded that the auditor did not plan and perform the audit with an attitude of professional skepticism. Thus, having regarding to this and a fraud has actually taken place during the year, committed by absconding cashier, it is reasonable to think that *prima facie* there is a case against the auditor for gross negligence. Clause (7) of part I of second schedule to the CA Act, 1949 requires that it is duty of an auditor to bring to bear in the work he has to perform that skill, care caution as per the circumstances in an honest and reasonable manner. As it appears from the facts of the case, the auditor has been grossly negligent in performing his duties which constitute professional misconduct. Thus such instances require reference to disciplinary of the council of the institute. If a member is found guilty by the council of any of the acts of omission stated in this schedule, its finding with recommendations are to be referred to the high court for decision.

(c) Tax Consultant:

Sec 7 of the Chartered Accountant Act, 1949 read with Clause 7 of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or other than that of a chartered accountant in documents through which the professional attainments of the member would come to notice of the public. Under the Clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of university or a title indicating a membership of any other professional body recognized by the central government or the council. Thus it is improper to use designation “Tax Consultant” since neither it is a degree of a university established by law in India or recognized professional membership by the central government or the council.

Cost Accountant:

As stated in the preceding paragraph, this would also constitute misconduct under Sec 7 of the Act read with Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, 1949. a chartered accountant in practice cannot use any other designation than that of a chartered accountant. Nevertheless, a member in practice may use any other letters or descriptions indicating membership of accountancy bodies which have been approved by the Council. Thus it is improper to chartered accountant to state in his documents that he is a “Cost Accountant”. However as per Appendix 8 to the Chartered

Accountant Act, 1949 the Council has resolved that the members are permitted to use letters indicating membership of the Institute of Cost and Works Accountants but not the designation “Cost Accountant”.

3 (a) The risks and internal control characteristics in an CIS environment as per AAS 29. “Audit in a Computer Information Systems Environment” includes the following:

- *Lack of transaction trails:* Some computer information systems are designed so that a complete transaction trail that is useful for audit purposes might exist for short period of time or only in computer readable form. Where a complex application system performs a large number of processing steps, there may not be a complete trail. Accordingly, errors embedded in an applications program logic may be difficult to detect on timely basis by manual (users) procedures.
- *Uniform processing of transactions:* Computer processing uniformly process like transactions with the same processing instructions. Thus the clerical ordinarily associated with manual processing are virtually eliminated. Conversely programming errors (or any other systematic errors in hardware or software) will ordinarily result in all transactions being processed incorrectly.
- *Lack of segregation of functions:* Many control procedures that would ordinarily be performed by separate individuals in manual system may become concentrated in a CIS

environment. Thus, an individual who has access to computer programs, processing or data may be in position to perform incompatible functions.

- *Potential for errors and irregularities:* The potential for human errors in the development, maintenance and execution of computer information system may be greater than in manual systems, partially because of the level of the detail inherent in these activities. Also the potential for individuals to gain unauthorized access to data or to alter data without visible evidence may be greater in CIS than in manual systems

In addition, decreased human involvement in handling transactions processed by computer information systems can reduce the potential for observing errors and irregularities. Errors or irregularities occurring during the design or modification of application programs or systems software can remain undetected for long periods of time.

- *Initiation or execution of transactions:* Computer information system may include the capability to initiate or cause the execution of certain types of transactions, automatically. The authorization of these transactions or procedures may not be documented in the same way as that in manual system, and management authorization of these transaction may be implicit in the acceptance of the design of the computer information system and subsequent modification.
 - *Dependence of other controls over computer processing:* computer process may produce reports other output that are used in performing manual control procedures. The effectiveness of these manual control procedures can be dependent on effectiveness of controls over the completeness and accuracy of computer processing. In turn the effectiveness and consistent operation of transaction processing controls in, computer application is often dependent on the effectiveness of the general computer information systems controls.
 - *Potential for increased management supervision:* computer information system can offer a variety of analytical tools that may be used to review and supervise the operations of the entity. The availabilities of these analytical tools, if used may serve to enhance the entire internal control structure.
 - *potential for the use of computer- assisted audit techniques:* the cause of processing and analyzing large quantities of data using computer may require the auditor to apply general or specialized computer audit techniques ant tools in the execution of audit tests.
- (b) Audit strategy is concerned with designing optimized audit approaches that seeks to achieve the necessary audit assurance at the lowest cost within the constraints of the information available. The formulation of audit strategy as shall be evident from the process of as explained in the following paragraph in fact shall form the basis of audit planning to achieve the audit objectives in the most effective and efficient manner. Audit strategy generally involves the following steps.
- (i) *Obtaining Knowledge of Business:* AAS 20, “Knowledge of Business “, states that in performing an audit of financial statements, the auditor should have or obtain knowledge of the business sufficient to enable the auditor to identify and understand the events, transactions and practices that, in the auditors judgement, may have a significant effect on the financial statements or on the examination or audit report. Knowledge of the business is a frame of reference within which the auditor exercise professional judgement. Understanding business and using this information appropriately assists the auditor in assessing risks and identifying problems, planning and performing the audit effectively and efficiently. It also ensures that the audit staff assigned to an audit engagement obtains sufficient knowledge of the business to enable them to carry out the audit work delegated to them. This would also ensure that the audit staff understands need to be alert for additional information and the need to share that information with the auditor and with the other audit staff.

- (ii) *Performing Analytical Procedures*: The purpose of analytical procedures at the planning stage is attention-directing; corroboration is not normally necessary at this stage. The use of the analytical procedures during the planning stage requires the extensive use of accounting and business knowledge and experience to assess the potential for material misstatement in the financial statements as a whole, because the key aspect of the task is to identify the relevant risk indicators and to interpret them properly. Furthermore, analytical techniques applied during the planning stage are not generally as precise as the analytical techniques at the substantive stage.
- (iii) *Evaluating Inherent Risk*: To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors such as quality of accounting system, unusual pressure on management, etc. having regard to his experience of the entity from previous audit engagement of the entity, any control established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes if any which, might have taken place since his last assessment.
- (iv) *Evaluating Internal Control*: The auditor's assessment of the control environment is crucial to the decision on whether to make an extended assessment of controls. This is because a good control environment is conducive to the maintenance of a reliable system of accounting and control procedures. For strategy purposes, the auditor should obtain sufficient understanding of the control environment. The auditor needs an understanding of the accounting systems, regardless of whether the auditor strategy will involve an extended assessment of internal accounting controls this is done by:
- (a) considering the results of gathering or updating information about the client: and
 - (b) making preliminary judgements about materiality, inherent risk and control effectiveness. These will include identification of the system(s) the auditor proposes to subject to an extended assessment of controls.

Thus the audit strategy is evolved after considering the engagement objectives, the result of the business review preliminary judgement as to materiality and identify inherent risks. Audit strategy also considers main points relating to planning and controlling the audit or comments on adequacy of the existing arrangements. Thus, the overall audit plan involving determination of timing, manpower, coordination and the direction which the audit work has to proceed is dependent upon the audit strategy formulated by the audit firm.

4 (a) Auditor's Responsibilities regarding Disqualification of Directors:

Section 227(3) of the Companies Act, 1956 has recently been amended by the Companies (Amendment) Act, 2000 where by Clauses (e) and (f) have been inserted. Clause (f) now inserted requires an auditor to comment whether any director is disqualified from being appointed as director under clause (g) of sub-section (1) of section 274. The relevant extracts of section 274(1)(g) referred to in clause (f) of section 227(3), are reproduced below:

“a person shall not be capable of being appointed director of a company, if

.....

(g) such person is already a director of a public company which-

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

(B) has failed to repay its deposit or interest there on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more;

Provided that such person shall not be eligible to be appointed as director of any other public company for a period of five years from the date on which such public company in which he is a director failed to file annual accounts and annual returns under sub-clause (a) or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend referred to in clause (B).”

Section 274(1)(g) applicable to appointment of directors both in public and private companies but the reporting will be limited to those directors of a company who are also directors of any public company. It may be further noted that a person who was a director of a public company which had defaulted in terms of clause (g) of section 274(1) and ceased to be a director of that public company would not be disqualified from being appointed as a director of a private company since on the date of appointment, he is not director of such public company and moreover provision to section 274(1)(g) is only applicable to appointment of such director in another public company.

A person is disqualified from being appointed as director of a company, where any public company of which also he is a director, has not filed annual accounts and annual returns for any continuous three financial years commencing on and after 1.4.1999 or has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more. In case of a disqualification by virtue of sub-clause (A) of clause (g) of section 274(1), the period of five years would be reckoned from the date as specified in sub-clause (A), on which the public company failed to file its annual accounts and annual returns. Where the disqualification arises on the account of sub-clause (B) of clause (g) of section 274(1), the period of five years will be reckoned from the relevant due date as specified in sub-clause (B) for repayment of deposit or interest thereon or redemption of debentures or payment of dividend, as the case may be.

Section 303(1) of the companies act, 1956 requires every company to keep a register of directors, etc as it is registered office. The register contains various particulars relating to all the directors of the company including particulars in respect of the office of directors, managing director, etc. held in any other body corporate(s) by each director.

In case an Auditee company happens to be public company which has not filed the annual accounts and annual returns for any continuous three financial year commencing on and after 1st April 1999; or has failed to repay its deposit or interest there on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more; then the auditor must report that all the are disqualified from being appointed as director in terms of clause(g) of sub-section (1) of section 274 of the Act.

4 (b) Meaning of Expression “True and Fair View”:

The requirements of the Companies Act, 1956 are that the auditor should specifically express an opinion whether the published accounts give a true and fair view of the company’s state of affairs and of the profit and loss for the financial year. What constitute a ‘true and fair view’ has not been defined in the Act. Sub-section (1) and (2) of section 211 merely require that every balance sheet and profit and loss account of a company shall give a true and fair view of the state of affairs and profit or loss account of a company and shall comply with requirements of schedule VI to the Companies Act, 1956 so far as they are applicable. Sub-section (5) of this section implies that the balance sheet and profit and loss account of a company shall be deemed as not showing a true and fair view, if they do not disclose any matters which are required to be disclosed by virtue of the provisions of Schedule VI or by virtue of a notification or an order of the central government modifying the disclosure requirements. It is clear that the auditor will have to examine whether the financial statements are drawn up in conformity with the provisions of schedule VI and whether they contain the matters requires to be disclosed therein. Thus, one of the tests for determining whether or not the financial statements show a true and fair view is to check whether all relevant disclosures as required be the governing Act have been properly made.

The phrase ‘true and fair’ in the auditors report signifies that the auditor gives an opinion as to whether the financial statements represented fairly the actual financial position as at the end of the accounting period and profit or loss for that period. AAS 2 , “Objectives and Scope of the Audit of Financial Statements’ states that, “in forming his opinion on the financial statements, the auditor follows procedures designed to satisfied himself that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise. The auditor recognizes that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any system of internal control, there is unavoidable risk that some material

misstatement by management may remain undiscovered. While in many situations the discovery of a materials misstatement by management may often arise during the conduct of the audit, such discovery is not the main objective of audit nor is auditor's programme of work specifically designed for such discovery. The audit cannot, therefore, be relied upon to ensure the discovery of all frauds or errors but where the auditor has any indication that some fraud or error may have occurred which could result in material misstatement, the auditor should extend his procedures to confirm or dispel his suspicions." What constitutes a true and fair view is, thus a matter of an auditor's judgement in the particular circumstances of a case. However, the following general guidelines may be laid down in this regard.

- (a) the balance sheet and the profit and loss account should be drawn up in conformity with the requirements of the Companies Act or those of the specific Acts governing certain classes of companies.
- (b) Relevant information should be so disclosed in the balance sheet and the profit and loss account that the financial position and the working results are shown as they are, i.e. there is neither an overstatement nor an understatement. There should be no window dressing; the balance sheet and the profit and loss account should not attempt to show a better picture than what it is in reality. Similarly there should be no secret reserves (unless the statute specifically permits the creation of such reserves).
- (c) All material facts regarding expenses, revenues, assets and liabilities of the company should be disclosed. There should be no misstatement.
- (d) All unusual, exceptional, or non-recurring items should be disclosed separately.
- (e) The balance sheet and the profit and loss account should be prepared and presented in conformity with the generally accepted principles of accounting. Such principles should be consistently applied. The effect of a change in these principles should be suitably disclosed.
- (f) The auditor should examine the situation as it exists at the end of the accounting period. If certain subsequent events help the auditor in making a better assessment of the position as at the date of the balance sheet, the auditor should take such events into account.
- (g) The financial statement should convey the required information clearly. As has been held in many legal cases, information and means of information are by no means equivalent terms. A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much of information as is calculated to induce them, or some of them, to ask for more.

5. A key feature of the accounting software package used by the company definitely involves the absence of a clear audit trail. In other words, transaction cannot be easily traced or co-related from the individual supporting documents of those transactions. Moreover, the management does not wish to print the daybooks in view of the voluminous nature since it may involve extensive costs. This has naturally led to extensive dependence by management upon the "exception reporting" principle. From the auditor's point of view, it must also be conceded the exception reports in the form of 'query-based reports' which isolate above data provide him with very material that he requires for most of his verification work. The only problem which it raises, and it is a serious one, is that he cannot simply assume that the programmes which produce the exception reports are reliable in respect of the following factors:

- (i) operating accurately;
- (ii) printing out all the exceptions which exists; and
- (iii) Bound by programmed control parameters which meet the company's genuine internal control requirements.

In view of the above, whether management relies upon exception reports, it effectively eliminated the audit trail between input and output and the auditor is forced to test the invisible processes which purport to embody the controls and produce the output such as it is. These tests, which invariably involve the use by the auditor of the computer itself, are known as tests through the machine. In the 'through the machine' approach, the auditor starts by proving the accuracy of the input data, and then thoroughly examines (by applying tests) the processing procedures with a view to establishing the following that:

- (i) all input is actually entered into the computer.
- (ii) Neither the computer nor the operators can cause undetected irregularities in the final reports.
- (iii) The programmes appear, on the evidence of rejection and exception routines, to be functioning correctly.
- (iv) All operator intervention during processing is logged and scrutinized by the DP manager.

The auditor in such circumstances will have to first evaluate the existing controls. For the same, he has to do the following:

- (i) Evaluate the internal control system especially the controls and checks existing for recording the transactions, i.e., he has to verify at what level transactions can be entered into the system and what checks are available to prevent any unauthorized data entry and for rectifying errors/omissions in the transactions entered.
- (ii) Evaluate at what level there is authority given for modification of transactions already entered. Is there any authority given only to a senior employee to carry out modification? Or is it that once transactions are entered and validated no further modifications possible thereto.
- (iii) Whether there is provision for in the software for carrying out an on line audit of transactions, i.e., whether there is a separate module in the package where a separate password given to the auditor and once he has seen and approved a particular transaction/set of transaction, the same would be locked and no modification would be possible by anyone (including senior most employee) in the company.
- (iv) Whether there are proper procedures for backup of data on a regular basis and whether said procedures are being strictly followed.
- (v) In case of any loss of data whether there is a clear defined recovery procedure to minimize the loss of data due to power failures or any human errors.
- (vi) The auditor may introduce some dummy data into the system and see the results obtained. After the auditor has evaluated above procedures, he has to prepare audit plan depending on the results obtained from his earlier evaluation. Since daybooks not being printed, the plan can contain procedures wherein data is verified directly on the computer from the vouchers/invoices, etc. the auditor plan will also require a lot of analytical procedures to be performed. Depending on the importance of various expense heads and other important account heads, the auditor will also obtain various from the system depending on various queries that he would have to identify. Some illustrative reports can be:
 - (i) To check whether proper classification is done for revenue/capital – report can be obtained of all purchases (not being raw materials or other routine purchases) exceeding Rs.one lakh.
 - (ii) To check whether all freight outward bills are accounted for a report containing a month wise co-relation between goods despatched and freight amount paid. The same can be further co-related with the freight rates obtained from the bills.

Once auditor has performed above procedure, he would be able to form an opinion whether reliance can be placed on the accounting systems and the data recorded. If the auditor finds that reliance cannot be placed on the system he can inform the management about the fact and also that the daybooks, etc., will need to be printed to allow him to conduct the audit. The finalization procedures to be followed even under this system would remain more or less similar to other accounting systems. The auditor can obtain reports of depreciation on fixed assets, inventory valuation using the normal

procedures find out whether reliance can be placed on them, e.g., if while valuing stocks the system is using the LIFO method, the same would not be acceptable and will need to be modified. Similarly depreciation calculations will have to verify on a random basis to find out its reliability.

6 (a) Matters to be included in Cost Audit Programme: it is a true statement that like any other audit a systematic planning for cost audit is also necessary. Therefore, the cost audit programmes should include all the usual broad steps that a financial auditor includes in his audit programme. This would require that the various aspects like what to be done, when to be done and by whom to be done are adequately takes care of. However, looking to the basic difference in cost audit and financial audit as allocation and apportionment of expensed, statutory requirement etc. should be complete at one time as far as practicable. Based on above factors a set of procedures and instructions are evolved which may be termed the cost audit programme. Matters to be included in the cost audit programme may be divided into following tow stages:

- (i) Review of cost accounting record: this will include:
 - Method of costing in use.
 - Method of accounting for raw material, stores and spares; wastage
 - System of recording wages, salary, etc.
 - Basic of allocation of overheads to cost centers and absorption by product and services
 - Treatment of expenses on finance, R&D, royalty, etc.
 - Method of depreciation accounting
 - Method of stock taking and valuation
 - System of budgetary control
- (ii) verification of cost statement and other data: this will mainly cover:
 - Licensed, installed and utilized capacity
 - Operating and financial ratio
 - Production data
 - Consumption of material and actual expenses
 - Sales realization
 - Abnormal non-recurring and special cost
 - Reconciliation with financial books

Some other factors which need to be bought into cost audit programme includes system of cost accounting range of products, areas to be covered etc. indicating allocation of manpower and the time to be taken for computing the audit.

(b) Propriety Audit:

Propriety audit stands for verification transactions on the tests of public interest commonly accepted customs and standards of conduct. E.L.Kohler has defined the term property as “that which meets the tests of public interest, commonly accepted customs and standards of conduct, and particularly as applied to professional performances, requirements of law, government regulations and professional codes”. Instead of too much dependence on documents, voucher and evidence, it shifts the emphasis to the substance of the transactions and looks into the appropriateness thereof on a consideration of financial prudence public interest and prevention of wasteful expenditure. Thus propriety audit is concerned with scrutiny of executive actions and decisions bearing on financial and profit and loss situation of the company with special regard to public interest and commonly accepted customs and standards of conduct. It is also seen whether every offer has exercised the same vigilance in respect of expenditure incurred from public money, as person of ordinary prudence would exercise in respect of expenditure of his own money under similar circumstances. Propriety requires the transaction, and more particularly expenditure, to conform to certain general principles. These principles are:

- (i) That the expenditure is not *prima facie* more than the occasion demands and that every Official exercises the same degree of vigilance in respect of expenditure as a person of Ordinary prudence would exercise in respect of his own money;

- (ii) That the authority exercises its power of sanctioning expenditure to pass an order which will not directly or indirectly accrue to its own advantage;
- (iii) That funds are not utilized for the benefit of a particular person or group of persons and (iv) That, apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.

The Parliament and Government, with a view to knowing the standards of efficiency, propriety, cost consciousness and economy, have already come up with some provisions in the Companies Act, 1956 having direct or indirect bearing on propriety; some of these provisions are:

- (i) Section 209(1) (d) relating to Cost Accounting Records.
- (ii) Section 227(1A) requiring enquiry into certain specified matters.
- (iii) Section 227(4A) requiring a supplementary statement on matters specified in the manufacturing and other companies (auditor's) report order.
- (iv) Section 223B – requirement of Cost Audit.
- (v) Section 619(3)(a) requiring a supplementary statement in respect of the government companies on matters specified.
- (vi) Additional information is schedule VI, part II.

Problems in propriety audit, however, arise mainly because of its distinct nature. The expression “propriety” is a moral term and can be understood by reference to the concept of morality accepted by the society at a given time. In any auditing, the essential test lies in formulation of auditing propositions. In the audit of financial accounts by reference to financial and legal requirements, proposition are built up about happening of events, existence, accuracy, title, ownership, compliance with law and internal regulations, etc., which are all verifiable. Propriety audit has an inherent element of subjectivity because it is very difficult to establish standards of public interest, commonly accepted customs, standards for conduct which are not firm basis for audit evolution. To care of the situation, the C&AG has developed the norms of propriety for expenditure of public funds in our country and this has been discussed in the study above. By laying down the standards of propriety for government expenditure the C&AG has really tried to tackle in a particular way the complex problem of subjectivity inherent in a situation calling for proprietary consideration. The element of subjectivity has caused proper discharge of duty very delicate and demands discretion, but wisdom of taking commercial decision under dynamic environment (the economic, social, and political) must be evaluated with reference to the circumstance in which these are taken and therefore, the auditor in his field must reconstruct such circumstances. The judgement of auditor must be objective as otherwise it would dampen the initiative of management and others in taking commercial decision and propriety audit would prove itself to be counter productive.

7 (a) Principal Enactments Governing Bank Audit:

There is an elaborate framework governing the functioning of banks in India. The whole of banking sector can be categories into several sectors such as commercial banks, cooperative banks, foreign banks, etc. the principle enactments which govern the functioning of various types of bank are as under:

- I. Banking Regulation Act, 1949;
- II. Banking Companies (acquisition of transfer of undertakings) Act, 1970;
- III. Banking Companies (acquisition of transfer of undertakings) Act, 1980;
- IV. State Bank of India Act, 1955;
- V. State Bank of India (Subsidiary Banks) Act, 1959
- VI. Regional Rural Banks Act, 1976;
- VII. Companies Act, 1956;
- VIII. Corporative Societies Act, 1912 or the relevant State Corporative Societies Acts.

Besides the above enactments, the provisions of Reserve Bank of India Act, 1934 also affect the functioning of banks. The act gives wide power to Reserve Bank of India to give directions to banks; such directions also have consideration effect on the functioning of banks.

(b) Incoming and Outgoing Co-insurance:

In cases of large risks, the business is shared between more than one insurer under co-insurance arrangements at agreed percentages. The leading insurer issues documents, collects premium and settles claims. Statements of accounts are rendered by the leading insurer to the other co-insurers. The auditor should verify incoming co-insurance and outgoing co-insurance as follows:

(i) Incoming Co-Insurance:

The auditor should see that the premium account is credited on the basis of statements received from the leading insurer. In case, the statement not received, the premium is accounted for on the basis of advices to ensure that all premiums in respect of risks assumed in any year is booked in the same year. It would be advisable of the auditor to scrutinize the communication in the post-audit period and obtain a written confirmation to the effect that all incoming advices have been accounted for. The auditor should also verify claims provisions and claims paid with reference to advice received from the leading insurer.

(ii) Outgoing Co-Insurance:

The auditor should scrutinize the transaction relating to the outgoing business, i.e. where the company is the leader. These should be checked with reference to the relevant risks assumed under policies and correspondingly for debits arising to the co-insurer on account of their share of claims.

(c) Deferred Taxation:

AS 22, Accounting for Taxes on income, prescribes the accounting treatment for taxes on income. The amount of taxable income for a period and the amount of profit (or loss) as shown by the profit and loss account for that period are seldom the same. The difference between accounting income and taxable income arises due to the fact that taxable income is calculated in accordance with tax laws whose requirements regarding computation of taxable income differ from the accounting policies applied to determine accounting income. The difference between taxable income and accounting income can be classified into 'permanent differences' and 'timing differences'. 'Permanent differences' are the difference between taxable income and accounting income for a period that originate in one period and do not reverse subsequently. Timing differences on the other hand, are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. The standard requires that deferred tax should be recognized for all timing difference, subject to consideration of prudence in respect of deferred tax assets. Deferred tax represents the future tax effects of timing differences. Some timing differences are such that their reversal in future year(s) would result in the taxable income for the year(s) of reversal being higher than the accounting income for that year (or those years).

(d) Sauda Book:

All members of stock exchange are required to maintain a 'Sauda Book', which contains details of all deals transacted by them on a day to day basis. This is a basic record which each member is required to maintain regularly on day-to-day basis. It contains details regarding the name of the code of the client on whose behalf the deals have been done, rate and quantity of bought or sold. These details mentioned date wise. This register contains all the transactions which may be any of the kind mentioned below:

- Member's own business on the Exchange,
- Member's business on the exchange on behalf of clients,
- Member's business with the clients on principal-to-principal basis,
- Member's business with the members of the other Stock Exchanges, and
- Spot transactions, etc.

8. Special Points in Audit of NBFCs:

As per RBI Act, 1934, NBFC is one whose principal business is that of receiving deposits or that of a financial institutions, such as lending, investment in securities, hire purchase finance or equipment leasing. A company which is engaged in acquisition and trading in such securities to earn profit falls in the category of Investment Company. First of all it is quite important to ascertain the principal business of company since based on the classification of a company, such a company shall have to comply with various positions relating to limits of public deposits, etc. second most important point would be ensure that the NBFC has complied with registration requirements and a certification of registration should be seen by the auditor. In case of an investment company, the following special points would also have to be given due to attention.

- (i) *Physical Verification:* Physical verification of all the shares and securities held by a NBFC. When any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified. Necessary certificates from depositories, etc. shall also have to be seen.
- (ii) *Compliance with prudential norms:* NBFC prudential norms stipulate that NBFCs should not lend more than 15% of its owned funds to any single borrow and not more than 25% to any single group of borrower. The ceiling on investments in a single group of entities has been fixed at 15% and 25 % respectively. Moreover, a composite limit of credit to and investment in a single entity/ group of entities has been fixed at 25% and 40% respectively of the owned fund of the concerned NBFC.
- (iii) *Income from investments:* Dividend income wherever declared by company has been duly received by NBFC and interest wherever due (except in case of NPAs) has been duly accounted for. NBFC prudential norms directions requires dividend income on shares of companies and units of mutual funds to be recognized on cash basis. However, the NBFC has an option to account for dividend income on accrual basis, if the same has been declared by the body corporate in its Annual General meeting and its right receive the payment has been established. Income from bonds/debentures of corporates bodies are to be accounted on accrual basis only if the interest rates on these instruments is predetermined and interest is serviced regularly and not in arrears.
- (iv) *Classification of valuation of investments:* Classification of investments as to whether the same are current investments or long term investments. The application of NBFC prudential norms directions and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the directions application of the requirement of AS 13 “ Accounting for Investments” (to the extent they are not inconsistent with the directions) have been duly complied with by the NBFC.
- (v) A list of subsidiary/ group companies from the management and the investment made in such companies during the year as also ascertain the basis for arriving at the price paid for the acquisition of such shares.
- (vi) In terms of NBFC directions on prudential norms, the NBFCs accepting / holding public deposits have to ensure maintenance of minimum prescribed CRAR at all times. The requirement of CRAR is applicable not only on the reporting dates but also on an on-going basis. The compliance with CRAR and other prudential norms is monitored through the half-yearly returns on reporting dates (March 31 & September 30). The return is required to be certified by the Managing Director / Chief Executive Officer of NBFC accepting / holding public deposits stating, inter alia, that the company has complied with prudential norms and that the CRAR as disclosed in the return

has been correctly determined. The statutory auditors of a company append a report to support the veracity of the certificate given by the company.

- (vii) In the case of securities lent/borrowed under the securities lending scheme of SEBI, verify the agreement entered into with the approved intermediary (i.e., the person through the whom the lender will deposit and the borrower will borrow the securities for lending/borrowing) with regard to the period of depositing/lending securities, fees for depositing/lending, collateral securities any provision for the return including pre-mature return of the securities deposited/lent.
- (viii) Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon.

CWSE

Number of Pages : 3

Total Marks: 100

Number of questions: 11

Time Allowed: 3 Hrs

Question Nos. **1, 2 and 3** are compulsory

Answer any **four** from the rest

- 1.** Answer any **TWO** of the following: (2 x 6 = 12 Marks)
- a)** Confirm whether the following two companies can amalgamate under the Companies Act, 1956?
- (i) Fast Foods Private Limited incorporated on 23rd July 2009 and Slow Foods Private Limited incorporated on 7th October 2008
 - (ii) XYZ Limited, a company carrying on the business of shares and ABC Limited, a company carrying on the business of transport.
- b)**
- (i) X Ltd sent notice for its Board Meeting to be held on 18th June 2009. Few directors were present for the meeting; however, the meeting could not be held for want of quorum. Is sitting fees, travelling allowance payable to the directors who were present at the meeting though no business could be transacted at that meeting?
 - (ii) Section 174 (1) of the Companies Act, 1956 sets down a quorum for general meetings which is as follows:

Public limited company – five members personally present

Private limited company – two members personally present

Is a preference shareholder personally present at a general meeting included for the purpose of a quorum?
- c)**
- (i) X pvt Ltd is a private limited company incorporated in India. The entire share capital of this company is held by a Y, a Body Corporate incorporated outside India. The Holding company Y would be a public company if it was incorporated in India. Is X pvt Ltd. a private limited or a subsidiary of a public limited company under the Companies Act, 1956?
 - (ii) H is a Non-resident Indian (NRI). He wants to apply for a Directors Identification Number (DIN). Give a list of documents that are required for obtaining DIN by a NRI.

2. Answer any **TWO** of the following: (2 x 6=12 Marks)

- a) Fine Limited held their Annual General Meeting for the year 2005-06 on April 17, 2007 and on June 17, 2008 for the year 2006-07. In a petition under section 167, the Company Law Board passed an order directing the company to hold the annual general meeting for the year 2006-07 within 90 days from 20.11.2007. Is the order of the Company Law Board maintainable? Justify your answer with decided case law.
- b) The requirement under Section 209 of the Companies Act, 1956, that a company must keep its books of account on accrual basis and according to the double entry system, does not apply to certain categories of companies. What are they?
- c) What are the documents that can be inspected under Section 209A of the Companies Act, 1956?

3. Answer any **TWO** of the following: (2 x 6=12 Marks)

- a) A company wants to elect three directors. The number of candidates is five: A, B, C, D and E. The total number of votes cast is 100. The candidates secure first preference votes as follows:

A – 30, B – 12, C – 26, D – 24, E – 8 = Total – 100

Who will become the directors of the company using the method of single transferable vote?

- b) What is the procedure for conversion of a Partnership Firm into a Limited Liability Partnership under the LLP Act?
- c) Is Companies Act applicable to Limited Liability Partnerships?

4. a) Section 209 requires that a company must keep 'proper books of account'. What does 'proper books of account' mean? (8 Marks)

b) What are the obligations of a Foreign Company regarding its Accounts? (8 Marks)

5. In which circumstances can the Company Law Board prevent change in Board of Directors? (16 Marks)

6. Which are the provisions of the Companies Act, 1956 concerning appointment of Managerial Personnel which apply to and which do not apply to private companies? Elaborate?

(16 Marks)

7. What are the compliances envisaged under Clause 41 of the Listing Agreement?

(16 Marks)

- 8. a)** What are the latest guidelines under FEMA regarding Loans to Non-residents / third party against security of Non Resident (External) Rupee Accounts / Foreign Currency Non Resident (Bank) Accounts Deposits?

(8 Marks)

- b)** What are the latest guidelines under FEMA regarding Buyback/prepayment of Foreign Currency Convertible Bonds?

(8 Marks)

- 9.** What is a producer company? What are its objects and salient features?

(16 Marks)

- 10.** In a scheme of compromise or arrangement, what is the procedure for seeking High Court Directions to convene meetings?

(16 Marks)

- 11.** What are the specific requirements regarding Inter-Corporate guarantees and securities under Section 372A of the Companies Act, 1956?

(16 Marks)

PRIME ACADEMY
29TH SESSION MODEL EXAM
CORPORATE LAWS AND SECRETARIAL PRACTICE – OLD SYLLABUS
SUGGESTED ANSWERS

1(a)

- (i) There is no bar to a company amalgamating with a 15-day old company having no assets and business. Apco Industries Ltd (1996) 86 Comp CAS 457 (Guj)
- (ii) There is nothing in law to prevent a company carrying on business in shares from amalgamating with one engaged in transport. EITA India Ltd. (1997) 24 CLA 37 Cal

(b)

- i) DCA Circular 2/94 dated 10th February 1994.
- ii) Section 174 does not, qualify the word “member” by the expression ‘entitled to attend and vote’. On a plain reading, therefore, the section does not specifically exclude preference shareholder personally present at a general meeting for the purpose of a quorum. The MCA, however, is of the view that if any business to be transacted at a general meeting does not include any item or resolution which directly affects the rights of the preference shareholders, their presence should not be taken into account for the purpose of determining the quorum, but if the subject-matter includes any resolution in which the rights of preference shareholders are directly affected, their presence should be taken into account for the purpose of quorum. DCA Circular, Company News & Notes, dated 16th June 1964.

(c)

- i) As per section 4(7), a private company which is a subsidiary of a body corporate incorporated outside India is to be treated as a subsidiary of a public company for the purposes of the Companies Act, if two conditions are satisfied:

- That body corporate would be a public company if it was incorporated in India
- The entire share capital in the private company is not held by that body corporate (whether alone or together) with one or more other bodies corporate incorporated outside India.

In the instant case, since the entire share capital of X Ltd. Is held by Y Ltd., X Limited is a private limited company only under the Companies Act, 1956.

ii) LIST OF DOCUMENTS FOR NRI DIN

1. Passport in English. If the Passport is not in English, the English translation has to be obtained.
2. The passport and the translation of the passport if any, has to be certified by the notary in the home country of the applicant. If the applicant is holding an Indian passport, the passport along with the VISA should be attested by the Indian embassy in the country of the applicant.
3. The passport has to contain the following:

Name of the applicant

Father's Name

Date of birth in proof of the date of birth

Address in proof of the address

Photograph in proof of the identity

4. In case the passport does not contain one or more of the above referred particulars then apart from the attested copy of the passport, the copies of the following duly attested by the notary of the home country of the applicant are required

- Date of birth proof (such as driving licence, voters identity card etc)

- Identity proof (such as driving licence, voters identity card etc)

- Address proof (such as driving licence, voter's identity card, telephone bill, electricity bill etc).

5. Name of the applicant in the following order (should be the same as it is appearing in the passport, address proof and identity proof)

First Name

Last Name

Middle name

6. Father's Name of the applicant in the following order (should be the same as it is appearing in the passport, address proof and identity proof)

First Name

Last Name

Middle Name

7. If the address proof, identity proof and proof of date of birth are not in English, translation of the same into English duly certified by the notary of the home country of the applicant should be obtained.
8. Two passport size photographs
9. Bio data of the proposed director (should also contain the email id, phone no's, fax nos. and address.
10. Directorship/partner/proprietor in other companies, partnership firms and proprietorship concerns respectively.
11. Consent letter

All attestation (copy of passport, id proof, address proof, photograph on the DIN application) in the case of NRI holding Indian passport should be by the Indian embassy abroad.

2 (a) The company had held the annual general meeting for the year 2005-06 on April 17, 2007 and therefore the annual general meeting for the year 2006-07 became due to be held on or before July 17, 2008. The petitioner had no cause of action in November, 2007 to file a petition under section 167 seeking directions for conducting of meeting for the year 2006-07. The company had not committed default. The order passed by the Board on November 19, 2007 was without jurisdiction as it had been passed without ascertaining whether default had taken place in holding the annual general meeting for the year 2006-07. The order dated November 19, 2007 was to be recalled and the petition was to be dismissed as not maintainable in terms of section 167 of the Act.

(b) The requirement under Section 209 of the Companies Act, 1956, that a company must keep its books of account on accrual basis and according to the double entry system, does not apply to certain categories of companies.

The requirement under section 209 (3) (b), that a company must keep its books of account on accrual basis and according to the double entry system does not apply to a government company engaged in the business of financing industrial projects and approved by the Central Government under Section 36(1)(viii) of the Income tax Act, 1961 to the extent it relates to income from loans and advances, provided that such accrued income, which is not accounted for in the books of account, is disclosed by way of note in the annual accounts.

The provision also does not apply to a government company engaged in the promotion and development of industries, to the extent it relates to income from:

- (a) Interest on seed money, loans or bridge loans
- (b) Interest on instalments due on cost of industrial plots or allotted to entrepreneurs
- (c) Claims from the Central Government or state governments in relation to special rebate on the sale of handloom clothes as declared by the Ministry of Textiles from time to time as a special measure for boosting the sale of handloom clothes produced in different parts of the country. However, such accrued income, which is not accounted for in the books of account is to be disclosed by way of a note in the company's annual accounts.

(c) WHAT ARE THE BOOKS THAT CAN BE INSPECTED

The inspecting officer under Section 209A can inspect any books of account and other books and papers. 'Books and papers' include accounts, deeds, vouchers, writings and documents. 'Documents' include summons, notice, requisition, order, other legal process and registers, whether issued, sent or kept in pursuance of this or any other Act or otherwise.

It has, however, been held that books and papers referred to in section 209A (1) must have the character of books of account – CV Karuppunni v Joint Director, Inspection, Company Law Board (1986) 59 Comp Cas 814 (Ker)

The inspecting office can seek information about the company's joint ventures with other bodies corporate that are not companies.

Where the company is a partner in a firm, it has a right to get the accounts of the firm and to make them available to the inspecting officer under section 209A. The inspecting officer has the right to examine any officer of the company and to ascertain such information.

3 (a) METHOD OF SINGLE TRANSFERABLE VOTE:

Using the method of single transferable vote, the appointment will be made in the following manner:

$$\begin{array}{rcl} \text{Quota} & = & 100 \\ & & \text{-----} + 1 = 26 \text{ votes} \\ & & 3+1 \end{array}$$

As A and C have secured first preferences more than and equal to quota, both of them will be elected in the first count. However, A has secured four surplus votes. These will be transferred to B, D and E in the ratio of second preference shown on his 30 ballot papers. Suppose, the second preference shown by these are as follows:

In favour of B – 15

In favour of D – 0

In favour of E – 15

Total 30

Therefore, B and E will get two votes each. After such transfer, the position is as follows:

B= 14 votes

D = 24 votes

E = 10 votes

Now, the process of elimination will be employed. As E has secured the least first preferences, he will be eliminated. His first preferences will be transferred to B and D in the ratio of second preferences shown on his 10 votes. Suppose, these second preferences are as follows:

In favour of B – 8

In favour of D – 2

Such transfer elects D, as he obtains votes equal to the quota. Therefore, A, C and D will become the directors of the company.

- (b) Section 55 of the LLP Act, 2008 provides that a firm may convert to limited liability partnership in accordance to the provisions of the Chapter X and the Second Schedule.

Sl.no	Particulars	Procedure
1	Essential conditions for conversion	The firm may apply to convert into a limited liability partnership in accordance to the Second Schedule if and only if the partners of the limited liability partnership into which the firm is to be converted comprise all the partners of the firm and no one else.
2	Statements to be filed with the Registrar	1. A statement by all its partners in Part B of Form 17 accompanied by fee containing the name and registration number and the date on which the firm was registered under the Indian Partnership Act, 1932 or under any

		other law 2. Incorporation document and statement referred to in section 11
3	Registration of Conversion	The registrar shall register the documents and issue a certificate of registration under his seal in Form 19 specifying the date of registration
4	Information to be conveyed	The limited liability partnership shall inform the concerned Registrar of firms about conversion of firm into limited partnership in Form 14 within fifteen days of date of registration
5	Refusal of registration by Registrar	If registrar refuses to register the LLP, the applicant firm may appeal to the Tribunal within 60 days from the date of receipt of such intimation of such refusal.
6	Effect of registration	On and from the date of registration specified in the certificate of registration issue – (i) A LLP by the name specified in the certificate of registration registered under this Act comes into existence (ii) All tangible(movable and immovable) property as well as intangible property vested in the firm, all assets, interests, rights, privileges, liabilities, obligations relating to the firm and the whole of the undertaking of the firm shall be transferred to and shall vest in the LLP without further assurance, act or deed (iii) The firm shall be deemed

		to be dissolved and if earlier registered under the Indian Partnership Act, 1932 removed from the records maintained under that Act.
7	Notice of conversion in correspondence	Every official correspondence of the LLP for the period of twelve months commencing not later than fourteen days after the date of registration, shall bear a statement that it was, as from the date of registration converted, from a firm into a LLP and the name and registration number, if applicable of the firm from which it was converted.

- (c) As per the LLP Act, the Central Government may, at any time, direct the application of the provisions of the Companies Act, 1956 to LLPs. This proposition, however, may not be easily acceptable to those who wish to convert from a company or a partnership firm to an LLP for the simple reason that procedures required under the Companies Act, 1956 are cumbersome and highly technical and the primary object of LLP is to avoid such technical procedures.

Secondly, the basis on which the Central Government can issue such directions has not been spelt out. This uncontrolled discretion vested with the government is likely to be misused in the absence of proper guidelines. Suitable provisions in this regard in the LLP Act itself with thus help in reducing this free hand discretion of the government.

4 (a) PROPER BOOKS OF ACCOUNT

Section 209 requires that a company must keep proper books of account. But the section does not spell out as to what is a proper book of account. The term proper means adapted or appropriate to the purpose or circumstances, fit, suitable, strict, accurate, complete or thorough.

Section 541(2) throws some light on the connotation of proper books of account.

According to the said section, proper books of account means

- (a) Such books or accounts as are necessary to exhibit and explain the transactions and financial position of the business of the company, including books containing entries made from day to day in sufficient detail of all cash received and all cash paid, and

- (b) Where the business of the company has involved dealings in goods, statements of the annual stock takings and of all goods sold and purchased showing the goods and the buyers and the sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified.

Section 209 (3) declares that in the following two circumstances, proper books of account is not deemed to be kept with respect to the matters specified in Section 209 (1) and (2):

- a) Such books are not kept as are necessary to give a true and fair view of the state of the affairs of the company or branch office and to explain its transactions and
- b) Such books are not kept on accrual basis and according to the double entry system of accounting.

Thus proper books of account is deemed to be kept with respect to the matters specified in Section 209 (1) and (2) if

- a) Such books are kept as are necessary to give a true and fair view of the state of the affairs of the company or branch office and to explain its transactions and
- b) Such books are kept on accrual basis and according to the double entry system of accounting.

The books of account cannot be written in pencil. They must be written in indelible ink for giving a proper and adequate meaning to the words proper books of account.

(b) OBLIGATIONS OF A FOREIGN COMPANY REGARDING ITS ACCOUNTS

Section 594 imposes the following obligations regarding accounts:

- (i) Every foreign company shall, in every calendar year, prepare a balance sheet and profit and loss account
- (ii) The balance sheet and profit and loss account shall be made out in the same form, containing the same particulars and including or having annexed or attached thereto the same documents (including in particular, documents relating to every subsidiary of the foreign company) as are required under the provisions of this Act, as if the company had been a company within the meaning of the Companies Act.
- (iii) However, any requirements exempted or modified by the Central Government by notifications shall not apply, or shall apply, subject to such exceptions and modifications as may be specified in the notification, to the balance sheet and profit and loss account.
- (iv) If any such document as is mentioned in (i) above is not in the English language, there shall be annexed to it a certified translation thereof. The translation of the document into English should be done in the manner prescribed under Rule 19 of the Companies

(Central Government's) General Rules and Forms 1956, subject to the relaxation, if any, granted by the Central Government under Rule 21.

- (v) Every foreign company shall deliver three copies of the balance sheet and profit and loss account to the Registrar within a period of nine months of the close of the financial year of the foreign company to which the documents relate. The Registrar may, for any special reason, and on application made in writing by the foreign company concerned, extend the said period by a period not exceeding three months.
- (vi) Every foreign company shall send to the Registrar along with the balance sheet and profit and loss account, three copies of a list in the prescribed form of all places of business established by the company in India as at the date with reference to which the balance sheet is made out. This list will be delivered along with e-Form 52 and the filing fee.

5. Section 409 of the Companies Act gives the CLB, the power to prevent a change in the Board of directors of a company if it is satisfied that:

- (a) a change in the ownership of any shares held in the company has taken place or is likely to take place
- (b) as a result of such change, a change in the Board of directors of the company is likely to take place
- (c) such change would affect prejudicially the affairs of the company
- (d) it is satisfied that it is just and proper to pass an order preventing the change in the Board

The CLB can exercise this power only on a complaint made to it by:

- (a) the managing director of the company or
- (b) any other director of the company or
- (c) The manger of the company.

A complaint to the CLB shall be made in accordance with the CLB regulations. The complaint lies to the Principal Bench of the CLB.

The CLB can pass such preventive order only after such inquiry as it thinks fit to make, including an order to the effect that no resolution passed, or that may be passed, or no action taken, or that may be taken, to effect a change in the Board of directors after the date of complaint, shall have effect unless confirmed by the CLB.

The CLB also has the power to make an interim order to the effect set out in sub section (1) before making or completing the inquiry aforesaid.

The CLB power under Section 409 is unaffected by any contrary provision in any other provision of

- (a) the Companies Act, 1956 or
- (b) the memorandum or articles of the company or
- (c) any agreement with company or
- (d) any resolution passed in the general meeting of the company or
- (e) Any resolution passed by the Board of directors of the company.

The CLB has no power to pass any order under section 409 in the case of a private company, unless it is a subsidiary of a public company.

6. PROVISIONS RELATING TO MANAGERIAL PERSONNEL THAT APPLY AND DO NOT APPLY TO PRIVATE LIMITED COMPANIES.

Regarding the appointment and remuneration of a Managing director or whole time director, a private company, which is not a subsidiary of a public company, stands on a different footing than a public company and a private company, which is a subsidiary of a public company. Such a company is not governed by most of the provisions of the Companies Act regarding the appointment and remuneration of a managing director or whole time director or the manager.

The following provisions of the Act, which are applicable to a public company and a private company, which is a subsidiary of a public company, are not applicable to a private company, which is not a subsidiary of a public company:

- a) Sec.198 – Overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits.
- b) Sec.268 – Amendment of provision relating to managing director or whole time director to require government approval.
- c) Sec.269 – Appointment of managing director or whole time director or manager to require government approval only in certain cases.
- d) Sec.309 – Remuneration of directors
- e) Sec.310 – Increase in remuneration of managing director or whole time director on reappointment to require government approval.
- f) Sec.316 – Number of companies of which one person may be appointed as managing director
- g) Sec.317 – Managing director not to be appointed for more than five years at a time.

- h) Sec.349, 350- Determination of net profits for computation of managerial remuneration
- i) Sec.386 – Number of companies of which a person may be appointed as manager.
- j) Sec.387 – Remuneration of manager
- k) Schedule XIII – Government approval not required for the appointment of managing director or whole time director or manager in certain cases.

On the contrary, the following provisions of the Act are applicable to a private company which is not a subsidiary of a public company:

- a) Sec. 2(24) – Definition of manager
- b) Sec.2(26) – Definition of managing director
- c) Sec.197A – Company not to appoint or employ certain different categories of managerial personnel at the same time.
- d) Sec.267 – Certain persons not to be appointed as managing directors or whole time directors.
- e) Sec 312, 388 – Prohibition of assignment of office by director or manager.
- f) Sec.314 – Restrictions on the holding of office or place of profit by directors and their associates.
- g) Sec.384 – Firm or body corporate not to be appointed manager.

7. COMPLIANCE UNDER CLAUSE 41 of the Listing Agreement

Clause	Particulars of Compliance	Due date
41 (I)(c)	The company has an option either to submit audited or un audited quarterly and year to date financial results to the stock exchange within one month of end of each quarter (other than the last quarter), subject to the following: Quarter Ended 30th June Quarter Ended 30th September Quarter Ended 31st December	31st Jul 31st Oct 31st Jan
	(i) In case the company opts to submit un-audited financial results, a copy of Limited Review Report from statutory auditor shall be furnished to the stock	

	exchange within 2 months from the end of the quarter. Quarter Ended 30th June Quarter Ended 30th September Quarter Ended 31st December	31st Aug 30th Nov 28th Feb
	(ii) And in case the company opts to submit audited financial results, they shall be accompanied by the audit report. Quarter Ended 30th June Quarter Ended 30th September Quarter Ended 31st December	31st Jul 31st Oct 31st Jan
41 (I) (d)	In respect of the last quarter, the company has an option either to submit un audited financial results for the quarter within one month of end of the financial year or to submit audited financial results for the entire financial year within three months of end of the financial subject to the following:	Un audited 30th April or Audited 30th June
	(i) In case the company opts to submit unaudited financial results for the last quarter, it shall also submit audited financial results for the entire financial year, as soon as they are approved by the Board. Such un audited financial results for the last quarter shall also be subjected to limited review by the statutory auditors of the company and a copy of the limited review report shall be furnished to the stock exchange within two months from the end of the quarter	Limited Review report by 31st May
	(ii) In case the company opts to submit audited financial results for the entire financial year, it shall intimate the stock exchange in writing within one month of end of the financial year, about such exercise of option.	30th April
41(I)(e)	If the company has subsidiaries (i) It may, in addition to submitting quarterly and year to date stand alone financial results to the stock exchange i.e., within one month of the end of the	

	quarter, also submit quarterly and year to date consolidated financial results within two months from the end of the quarter and Quarter Ended 30th June Quarter Ended 30th September Quarter Ended 31st December	31st July & 31st August 31st oct and 30th Nov 31st Jan and 28th Feb
	(ii) While submitting annual audited financial results prepared on stand-alone basis, it shall also submit annual audited consolidated financial results to the stock exchange	31 st May
41(I)(f)	Financial results (signed by Chairman or Managing Director or Whole time Director) shall be submitted to the stock exchange within 15 minutes of conclusion of the meeting of the Board or Committee in which they were approved pursuant to the sub-clause (II) of the said clause Year Ended 31st March Quarter Ended 30th June Quarter Ended 30th September Quarter Ended 31st December	Within 15 minutes of conclusion of Board Meeting Within 15 minutes of conclusion of Board Meeting Within 15 minutes of conclusion of Board Meeting Within 15 minutes of

		conclusion of Board Meeting
41(II)(b)	The quarterly financial results shall be approved by the Board of Directors or by a ?Committee thereof (other than audit committee) and shall consist of not less than one third of the directors and shall include the managing director and at least one independent director	
41(ii)(c)	The financial results submitted to the stock exchange shall be signed by the Chairman or Managing Director or a whole time director. IN the absence of all of them, it shall be signed by any other director of the company who is duly authorized by the Board to sign the financial results	
41(II)(d)	The limited review report shall be placed before the Board of Directors or the Committee (other than audit committee), before being submitted to the stock exchange where the variation between un audited financials and financials amended pursuant to limited review for the same period, exceeds 10%. Provided that when the limited review report is placed before the Committee they shall also be placed before the Board at its next meeting	
41(II)(e)	The annual audited financial results shall be approved by the Board of Directors of the company and shall be signed by the Chairman or Managing director, or a whole time director	
41(III)(a)	Notice to Stock Exchange (SE) for holding Board Meeting (BM) to approve unaudited financial Results (UAFR) subject to Limited Review Report(LRR) by Statutory auditors (excluding the date of the intimation and date of the meeting)	
	Year Ended 31 st March	7 clear calendar days prior to meeting 7 clear

	Quarter Ended 30th June Quarter Ended 30th September Quarter Ended 31st December	calendar days prior to meeting 7 clear calendar days prior to meeting 7 clear calendar days prior to meeting
41(III)(b)	Publication of Notice in 2 Newspapers (one in English daily newspaper circulating in substantially whole of India and in one Regional Language daily newspaper of the State in which Registered Office of the Company is situated) Quarter Ended 31st March Quarter Ended 30th June Quarter Ended 30th September Quarter Ended 31st December	7 clear calendar days prior to meeting 7 clear calendar days prior to meeting 7 clear calendar days prior to meeting 7 clear calendar days prior to meeting
41(IV)(a)	Where there is a variation in net profit/loss after tax in excess of 10% or Rs.10 lakhs between the un audited quarterly or year to date financial results and the results amended pursuant to limited review for the same period then the Company shall submit tot he stock exchange an explanation of the reasons for variations (approved by	

	Board of Directors)	
41(IV)(c)	If the auditor has expressed any qualification or other reservation in his audit report or limited review report in respect of the financial results of any previous financial year or quarter which has an impact on the profit or loss of the reportable period, the company shall include as a note to the financial results (i) How the qualification or other reservation has been resolved or (ii) If it has not been resolved, the reason therefor and the steps which the company intends to take in the matter	
41(VI) (a) & (b)	Publish approved UAFR within 48 hours of BM held. Where the Company has submitted consolidated financial results in addition to standalone financial results, it shall publish only consolidated financial results in the newspaper. Quarter Ended 31st March Quarter Ended 30th June Quarter Ended 30th September Quarter Ended 31st December	With 48 hours of BM held With 48 hours of BM held With 48 hours of BM held With 48 hours of BM held

8 (a) FEMA 2000 – Loans to Non Residents/third party against security of NR(E) Rupee Accounts / FCNR(B) Accounts – Deposits

The Reserve Bank of India, vide AP (DIR Series) Circular No.66 dated 28.04.09 has

- a) enhanced the existing cap of Rs.20 lac to Rs.100 lacs on loans against security of funds held in NR(E) and FCNR(B) deposits, either to the depositors or third parties.
- b) Accordingly, banks may now grant loans against NR(E)RA and FCNR(B) deposits either to the depositors or third parties up to a maximum limit of Rs.100 lakhs
- c) Banks are also advised not to undertake artificial slicing of the loan amount to circumvent the aforesaid ceiling.

(b) BUYBACK/PREPAYMENT OF FCCSs

The Reserve Bank of India, vide AP (DIR Series) Circular No.65 dated 28.04.2009 has

- a) Increased the total amount of permissible buyback of FCCBs, out of internal accruals, from USD 50 million of the redemption value per company to USD 100 million, under the approval route by linking the higher amount of buyback to larger discounts.
- b) Accordingly, Indian companies may henceforth be permitted to buyback FCCBs up to USD 100 million of the redemption value per company, out of internal accruals, with the prior approval of the Reserve Bank, subject to a:
 - (i) Minimum discount of 25% of book value for redemption value up to USD 50 million
 - (ii) Minimum discount of 35% of book value for the redemption value over USD 50 million and up to USD 75 million and
 - (iii) Minimum discount of 50% of book value for the redemption value of USD 75 million and up to USD 100 million.

9 1. PRODUCER COMPANY

A producer company is one whose main objects should contain one or more of the objects given under Sec.581B. Such objects pertain to dealing with production and harvesting of crops and other activities relating to such objects.

OBJECTS

581B deals with the objects of Producer Company.

The Producer Company may carry on any of the activities specified in this clause either by itself or through other institution.

The objects of the Producer Company shall relate to all or any of the following matters, viz.,

- a) Activities relating to production, harvesting and marketing of primary produce
- b) Activities relating to processing of produce of its Members
- c) Activities relating to manufacture and supply of machinery, equipment or consumables mainly to its members
- d) Activities relating to
- e) Activities relating to rendering technical, consultancy, training, research and development services and all other activities for the promoting of the interests of its Members
- f) Generation, transmission and distribution of power, revitalisation of land and water resources, their use, conservation and communication relatable to primary produce.
- g) Insurance of producers or their primary produce
- h) Promoting techniques of mutuality and mutual assistance
- i) Welfare measures or facilities for the benefit of Members as may be decided by the Board
- j) Any other activity, ancillary or incidental to any of the activities given above which may promote the principles of mutuality and mutual assistance amongst the Members in any other manner
- k) Financing for promotion of the above activities including extension of credit facilities or any other financial services to its Members

SALIENT FEATURES

- The liability of the Members of the new company shall be limited to the amount, if any unpaid on the shares held by them
- The new company shall be a company limited by shares
- All direct costs associated with the promotion and registration of the company will be reimbursed to the promoters by the company
- This shall be subject to the approval at its first general meeting of the Members
- Once registration is completed, the Producer Company shall become a body corporate as if it is a private limited company
- There shall be no limit to the number of Members of the producer company.

- Under no circumstance can it become or be deemed to become a public limited under this Act.

10. In a scheme of compromise or arrangement, the procedure for seeking High Court Directions to convene meetings.

To get the approval of the members and/or creditors to a scheme of compromise or arrangement, the following procedure is involved:

1. Board approval:

To propose any scheme at a general meeting of a company, the Board of directors of the company will first approve the scheme at a Board meeting and pass resolutions:

- To approve the scheme
- To authorise a director/company secretary/other officer to make an application/petition to the court
- To authorise a director/company secretary/other officer to sign the application, petition, affidavit, notice of the meeting and other document in connection therewith; and
- To do such other things, acts and deeds as may be necessary or expedient in connection therewith, including changes in the scheme

2. Application to court for directions to convene meetings:

Members' and Creditors' approval to the scheme of compromise or arrangement is a pre condition for court's sanction. Without that, court will not proceed with the scheme. This approval is to be obtained at meetings held as per court's directions. However court may dispense with meetings of members/creditors. Normally, creditors' meetings are dispensed with subject to certain conditions. Members' meeting may also be dispensed with if all members' individual consent is obtained. The scheme of compromise or arrangement has to be approved as directed by the high court, by

- Members of the company
- The members of each class, if the company has different classes of shares
- The creditors
- Each class of creditors, if the company has different classes of creditors.

The approval of the members and creditors has to be obtained at specially convened meetings as per high court directions. An application seeking directions to call, hold and conduct meetings is made to the high court, which has jurisdiction having regard to the location of the registered office of the company. An application under section 391(1) for an

order convening meetings of creditors and/or members or any class of them shall be made by a judge's Bench officer's summons supported by an affidavit in Form no.33 prescribed under the Companies (Court) Rules. A copy of the proposed scheme of compromise or arrangement shall be annexed to the affidavit as exhibit thereto.

If the applicant is not the company, a copy of the summons and of the affidavit shall be served on the company at least 14 days before the date fixed for the hearing of the summons. If the company is being wound up, it shall be served on the liquidator. In such a case, the facts will have to be disclosed by the applicant in the affidavit. The court may give directions for the following matters:

- (i) To determine the class/classes of members and/or creditors whose meetings have to be held for considering the proposed compromise or arrangement.
- (ii) To fix time and place of the meetings
- (iii) To appoint chairman for the meetings
- (iv) To determine the values of the members/creditors whose meetings have to be held
- (v) Notice of the meeting and the manner in which it should be given
- (vi) Time within which the chairman should file a report of the meeting
- (vii) Any other matter the court may deem necessary

3. Notice of the meeting:

Notice of the meeting must be given to the members or any class of them and the creditors or any class of them at least 21 clear days before the meeting as per the court's directions. The notice must be accompanied by:

- (i) The scheme of compromise or arrangement
- (ii) A statement under sec 393
- (iii) Proxy in Form no.37 prescribed under Court rules

The notice must be sent individually to each member and creditor by:

- (i) The chairman appointed for the meeting by the court
- (ii) If the court so directs, by the company
- (iii) The liquidator
- (iv) Any other person as the court may direct

The notice must be sent by post under certificate of posting to the last known addresses of the members/creditors. The notice must be published in newspapers as directed by the court, at least 21 clear days before the date fixed for the meeting.

The company must furnish to every creditor or member entitled to attend the meeting, free of charge and within 24 hours of a requisition being made for the same, a copy of the proposed compromise or arrangement together with a copy of the statement, required to be furnished under sec.393, unless the same had been already furnished.

4. Chairman's Affidavit as to notice:

The chairman appointed for the meeting or the company or any other person, who is directed by the court to send notice of the meeting and issue advertisement must file an affidavit regarding compliance with the court's directions regarding individual and public notices. This affidavit has to be filed within seven days before the date fixed for the meeting.

5. Proceedings of meetings:

It is the responsibility of the petitioners to see that the class meetings are properly constituted, and if they fail the court has no jurisdiction to sanction the scheme. These meetings are to be held as per the court's directions under the chairmanship of a person nominated by the court. The court may appoint the chairman of the company as the chairman of the meeting convened by the court.

6. Scheme to be approved by special majority:

The scheme must be approved by a resolution passed with the special majority stipulated in Sec.391(2), namely a majority in number representing three-fourths in value of the creditors, or class of creditors, or members, or class of members, as the case may be, present and voting either in person or by proxy.

7. Chairman's report:

The chairman of the meeting must file in the court a report of proceedings of the meeting within seven days of the meeting or such other time as fixed by the court. The report must state accurately:

- The number of creditors or class of creditors or the number of members or class of members, as the case may be, who were present at the meeting
- The number of creditors or class of creditors or the number of members or class of members, as the case may be, who voted at the meeting either in person or by proxy
- Their individual values and
- The way they voted.

8. Requirements under Listing Agreement:

In the case of a listed company, the following requirements under Listing agreement must be complied with in respect of all stock exchanges on which the company's shares are listed:

- a) Intimation of the Board's decision approving the scheme of compromise or arrangement will be given to the stock exchange immediately after the Board meeting on the same day
- b) Intimation of the resolution passed at the general meeting approving the scheme of compromise or arrangement will be given to the stock exchange immediately after the Board on the same day
- c) Copies of notices, circulars, etc. issued/advertised concerning amalgamation will be forwarded to the stock exchange.

11. Specific requirements regarding Inter-Corporate guarantees and securities under Section 372A of the Companies Act, 1956?

Section 372A stipulates the following requirements regarding inter-corporate guarantees and securities, i.e., guarantees provided and securities given by a company in connection with a loan given

- (a) By any person to any body corporate or
- (b) By any body corporate to any person

The section would not apply unless either:

- (a) The borrower of money on whose behalf a guarantee or security is given is a body corporate or
- (b) The lender of money is a body corporate regardless of whether the borrower on whose behalf a guarantee or security is given is a body corporate or not.

In other words, a guarantee or security given by a company on behalf of or in favour of any party which is not a body corporate would not attract this section.

In order for a transaction to fall under sec.372A, the guarantee or security must be in connection with a loan. This section would not apply unless the guarantee or security is in connection with a loan. For example, the following types of guarantee or security will attract this section:

- a) A guarantee given in respect of an inter corporate loan or deposit
- b) A counter guarantees in respect of loans obtained by any body corporate
- c) A guarantee given by the company to any body corporate in connection with a loan given by it to the company's employee.

Any guarantee or security, which does not involve the transaction of lending and borrowing of money between a body corporate and a third party would not attract the provisions of this section. For example, the following types of guarantees will not come under the purview of this section:

- a) Performance guarantees given to third parties on behalf of other companies
- b) Guarantees against advance received in respect of a contract for supply of goods or a project
- c) Guarantees on behalf of or in favour of a person not being a body guarantee
- d) Bank guarantees given in connection with business transactions which do not involve lending of money but some other obligation.

The requirements under sec.372A need not be complied with unless the security provided by the company is in connection with a loan. In its ordinary meaning the term 'security' means something given or deposited as surety for the fulfilment of a promise or an obligation, the payment of a debt, etc. It is an asset or assets to which a lender can have recourse if the borrower defaults on his loan repayment. In the case of loans by banks and other money lenders, the security is sometimes referred to as collateral. The term security is usually applied to an obligation, pledge, mortgage, deposit, lien, etc, given by a debtor in order to assure the payment or performance of his debt, by furnishing the creditor with recourse to be used in case of failure in the principal obligation.

Only those securities which are in connection with loans given by or to bodies corporate, i.e., securities which guarantee repayment of loans given by or to bodies corporate come within the purview of this section.