REVISIONARY TEST PAPER

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GROUP III

PAPER - 11 : CAPITAL MARKET ANALYSIS & CORPORATE LAWS

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COST AND WORKS ACCOUNTANTS OF INDIA

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FINAL EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - III

Paper-11 : CAPITAL MARKET ANALYSIS & CORPORATE LAWS

Section I : Capital Market Analysis

Q. 1. In each of the cases given below one out of four is correct. Indicate the correct answer and give your workings/ reasons briefly.

(i) You have invested Rs. 1,00,000, 30% of which is invested in Company X, which has a expected rate of return of 15%, and 70% of which is invested in Company Y, with an expected return of 12%. What is the return on your portfolio?

A. Rs. 12,000

B. Rs. 6,450

C. Rs. 12,900

D. Rs. 12,500

(ii) Determine the beta for the following portfolio :

Stock	% of portfolio	Beta
1	45	1.20
2	20	0.75
3	35	1.00

A. 1.05

B. 1.04

C. 1.40

D. 1.50

(iii) Maruti has a beta of 0.865. If the expected market return is 17.50 and the risk free rate of return is 8.50%, what is the appropriate required return of Maruti (using the CAPM) ?

A. 16.825%

B. 16.582%

C. 16.285%

D. 16.258%

(iv) If the sale price of an open ended fund is Rs. 12.30 per unit and the fund is sold with a front end load of 5%, what is the NAV?

A. Rs. 10.00

B. Rs. 9.75

C. Rs. 11.70

D. Rs. 11.07

(v) If the face value of a 364-day T-Bill is Rs. 100 and if the purchase price is Rs. 91.35 for a treasury bill, what is the yield on such a bill?

A. 9.495%

B. 9.594%

C. 9.695%

D. Insufficient information

(vi) Calculate the price of 3-month RIL futures, if RIL (FV Rs. 10) quotes Rs. 520 on NSE, and the 3 month futures price quotes at Rs. 532, and the one month borrowing rate is given as 15% and the expected annual dividend yield is 25% p.a. payable before expiry.

A. 540.00

B. 542.00

C. 530.00

D. 537.00

(vii) Nifty Index is currently quoting at 1329.78. Each lot is 250. Mr. A purchases a February contract at 1364. He has been asked to pay 10% initial margin. What is the amount of initial margin?

A. Rs. 34,100.00

B. Rs. 33,244.00

C. Rs. 136.40

D. Rs. 132.97

(viii) What will be the capital gains on a 3 year 12% annual coupon bond of face value Rs. 1,000 if interest rates go down from 12% to 10%? Assume that the bond is redeemable in one year from now at face value.

A. Rs. 181.18

B. Rs. 18.18

C. Rs. Rs. 20.00

D. Nil

(ix) Stock A has an expected return of 18% and a standard deviation of 30%. Stock B has an expected return of 12% and a standard deviation of 36%. The correlation between the two stocks is 0.25. If you form a portfolio where you put 40% of your money in A and 60% in B, what is the standard deviation for the portfolio?

A. 27.206%

B. 25.416%

C. 23.312%

D. 28.913%

(x) The correlation coefficient of Megamart with market portfolio is +0.7, $ó_s$ = 0.35 and $ó_m$ = 0.20. What is the Megamart's Beta ?

A. 6.125

B. 1.225

C. 1.750

D. Insufficient information

Q. 1. (b) Choose the most appropriate one from the stated options and write it down. (only indicate A, B, C, D as you think correct) :

(i) A special contract under which the owner of the contract enjoys the right to buy or sell without the obligation to do so is called

A. Forward

B. Option

C. Spot

D. Future

(ii) The fixed price at which the option holder can buy or sell the underlying asset is called the —

A. Strike price

B. Spot price

C. Market price

D. Future price

(iii) The security market line depicts the expected return for

A. A single portfolio

B. All portfolios and assets

C. Only the efficient portfolio

D. Only the inefficient portfolio

(iv) In an arbitrage portfolio, the change in the proportions of different securities will add upto

A. One

B. Zero

C. Less than one

D. Greater than one

(v) An issue where an allotment is made to less than 50 persons

A. Rights Issue

B. Bonus Issue

C. Bought out deal

D. Private Placement

(vi) An option allowing the Issuing Company to issue additional shares when the demand is high for the shares when the flotation is on

A. Follow on Offer

B. Green Shoe Option

C. Call Option

D. Put Option

(vii) Bond issued at a discount and repaid at a face value is called

A. Zero –coupon bond

B. Eurobond

C. Yankee bond

D. Income bond

(viii) An aggressive portfolio consists of bonds : stock in the ratio of

A. 10:90

B. 60:40

C. 50:50

D. 30:70

(ix) Lead Manager stipulates the floor price or a price band and leave it to market forces to determine the final price.

A. Remutualisation

B. Book building

C. Fixed price

D. IPO

(x) Father of modern portfolio theory

A. John Litner

B. Harry Markowitz

C. Jensen

D. William F. Sharpe

Q. 1. (c) Fill up the blanks with appropriate answers :

(i) ______________ analysis is based on past information of prices and trading volume of stocks.

(ii) ______________ identified long-term business cycles with a period of 50-60 years.

(iii) A company with an issued equity share capital of more than ______________ will be eligible for listing on the OTCEI.

(iv) OTCEI stands for ______________ .

(v) A ______________ is like a bank wherein the deposits are securities viz. shares, debentures, bonds, government securities, units etc. in electronic form.

(vi) The security market line shows the linear relationship between the expected returns and ______________ .

(vii) Financial instruments that have the characteristics of both debt and equity are called ______________ .

(viii) Operators, who intentionally take the risk from hedgers in pursuit of profit are called ______________ .

(ix) ______________ are the future contracts for which underlying is the cash market index.

(x) ______________ Option can be exercised only on maturity date.

Answer 1. (a)

(i) C.

Company X – 30% of total with 15% rate of return

= 0.30 × Rs. 1,00,000 × 0.15 = Rs. 4,500

Company Y – 70% with a 12% rate of return

= 0.70 x Rs. 1,00,000 x 0.12 = Rs. 8,400

The total return is Rs. 12,900 (i.e., Rs. 4,500 + Rs. 8,400)

(ii) B.

Portfolio beta :

(0.45 × 1.20) + (0.20 × 0.75) + (0.35 × 1.00) = 1.04

(iii) C.

Required rate of return :

= 8.50% + (17.5% - 8.5%) × 0.865

= 8.50% + 9.0% × 0.865

= 8.50% + 7.785%

= 16.285%

(iv) C.

Sale Price = NAV (1 + Load%)

Therefore NAV = Sale Price / (1 + Load%) = 12.30/1.05 = Rs. 11.70 Approx.

(v) A.

Yield = [(100-91.35)/91.35] × (365/364) × 100

= 9.495%

(vi) D.

Future's Price = Spot + Cost of Carry – Dividend

= 520 + 520 × 0.15 × 0.25 – 2.50 (25% of FV Rs. 10)

= 537.00

(vii) A.

The closing price for the spot index was 1329.78. The rupee value of stocks is thus 250 × 1329.78 = Rs. 3,32,445.00

The closing futures price for the February contract was 1364.00, which has a rupee value of 1364 × 250 = Rs. 3,41,000.00 and therefore requires a margin of Rs. 34,100.

(viii) B.

Value of the bond at 12% interest rate = Rs. 1120/1.12 = Rs. 1,000

Value of the bond at 10% interest rate = Rs. 1120/1.1 = Rs. 1,018.18

Capital gains = 1,018.18 – 1,000 = Rs. 18.18

(ix) A

$\sigma_p^2 = 0.4^2 \times 0.3^2 + 0.6^2 \times 0.36^2 + 2 \times 0.4 \times 0.6 \times 0.3 \times 0.36 \times 0.25$

$= 0.0740$

$\sigma_p = \sqrt{0.0740} = 27.206\%$

(x) B.

$b = s_{sm} / s_m^2 = r_{sm}\, s_s\, s_m / s_m^2$

$= (0.7 \times 0.35)/0.20 = 1.225$

Answer 1. (b)

(i) B – Option

(ii) A- Strike price

(iii) B - All portfolios and assets

(iv) B – Zero

(v) D – Private Placement

(vi) B – Green Shoe Option

(vii) A- Zero-coupon Bond

(viii) A- 10:90

(ix) B – Book Building

(x) B - Harry Markowitz

Answer 1. (c)

(i) Fundamental

(ii) Kondratev.

(iii) Rs. 25 crore

(iv) Over The Counter Exchange of India

(v) Depository

(vi) Betas of the securities

(vii) Mezzanine Finance

(viii) Speculators

(ix) Index futures

(x) European.

Q. 2. (a) What are advantages of share repurchase over dividends?

(b) Is share buyback is a financing decision or an investment decision?

(c) A prospective investor has collected the following information pertaining to returns on stocks A & B.

Stock	Correlation Coefficient (with market)	Standard Deviation	Expected Return
A	0.6	0.3	0.12
B	0.4	0.2	0.11

Expected market return = 0.10

Risk free rate of return = 0.06

Variance of market return = 0.01

You are required to find out :

(i) The beta for an equally weighted portfolio of stocks A & B.

(ii) The required rate of return as per CAPM for portfolio of 50% each of A & B.

(iii) Are A & B are under-priced, overpriced or correctly priced according to CAPM?

Answer 2. (a)

The advantages of share repurchase over dividends are as follows :

(i) Cash dividend implies a commitment on the part of company to continue payments in future, as investors keep expecting them. However, share repurchase is an one time affair.

(ii) The decision to repurchase the shares offers a company more flexibility as to number of shares, the period etc.

(iii) Share repurchase are more focused in terms of paying out cash only to those shareholders who need it. However, dividends are paid to all.

(iv) Share buy back provide a way of increasing control in the firm. If only outsiders tender their shares, automatically insiders control increases.

Answer 2. (b)

When the shares are undervalued in the market and the firm does not have an alternate business opportunity, then the excess cash is returned to shareholders and thus the management prefers to invest in its own business by buying back their shares. In this case, the management has more faith in its own business. Thus it can be argued as an **investment decision** even though excess cash with the firm is given to shareholders in a different form.

Secondly, share buy back reduces the equity portion of the firm, thereby increasing the debt portion in the overall capital structure. Moreover, for further expansion the firm may borrow thereby further increasing the leverage and risk. Thus share repurchase is a kind of financing decision too.

Answer 2. (c)

(i) Beta of a stock is given by $b_i = r_{im} \times \frac{s_i \, s_m}{s_m^2}$

Were, r_{im} = Correlation coefficient of the stock with the market

s_i = Standard deviation of the stock returns

s_m = Standard deviation of market returns

Let b_A, b_B and b_{AB} be the beta of stock A, stock B and portfolio of stock A & B in equal proportion.

$$b_A = 0.6 \cdot \frac{0.3}{\sqrt{0.01}} = 1.8$$

$$b_B = 0.4 \cdot \frac{0.2}{\sqrt{0.01}} = 0.8$$

$$\begin{aligned} b_{AB} &= 0.5\, b_A + 0.5\, b_B \\ &= 0.5 \times 1.8 + 0.5 \times 0.8 \\ &= 1.3 \end{aligned}$$

(ii) According to CAPM the equilibrium required rate of return is given by

$$R_P = R_f + b_P (R_m - R_f)$$

Here, $R_m = 0.10$

$b_P = b_{AB} = 1.3$

$R_f = 0.06$

$$\begin{aligned} R_P &= 0.06 + 1.3(0.10 - 0.06) \\ &= 0.112 \\ &= 11.2\% \end{aligned}$$

(iii) Required rate of return for stock A

$$R_A = R_f + b_A (R_m - R_f)$$
$$= 0.06 + 1.8\ (0.10 - 0.06)$$
$$= 0.132$$
$$= 13.2\%$$

The expected rate of return from stock A is 12% therefore security is overpriced.

Required rate of return for Stock B

$$R_B = R_f + b_B (R_m - R_f)$$
$$= 0.06 + 0.8\ (0.10 - 0.06)$$
$$= 0.092$$
$$= 9.2\%$$

The expected rate of return from B is 11%, therefore security is under priced.

Q. 3. (a) What is clientele effect?

(b) Write short notes on – Green Shoe Option.

(c) Mehta is interested in purchasing a European call option on Dabur Ltd. a non-dividend paying stock, with a strike price of Rs. 100 and two years until expiration. Dabur Ltd. is currently trading at Rs. 100 per share and the annual variance of its continuously compounded rate of return is 0.04. the treasury bill that matures in two years yield a continuously compounded interest rate of 5% per annum.

(i) Use the Black Scholes Model to calculate the price of the call option that Mehta is interested in buying?

(ii) What does the put call parity imply about the price of the put, with the strike price of Rs. 100 and two years until expiration?

Answer 3. (a)

Investors have diverse preferences. Some want more dividend income; others want more capital gains; still others want a balanced mix of dividend income and capital gains. Over a period of time, investors naturally migrate to firms which have a dividend policy that matches their preferences. The concentration of investors in companies with dividend policies that are matched to their preferences is called the clientele effect. The existence of a clientele effect implies that (a) firms get investors they deserve and (b) it will be difficult for a firm to change an established dividend policy.

Answer 3. (b)

Green Shoe Option denotes 'an option of allocating shares in excess of the shares included in the public issue'. It is an option allowing the Issuing Company to issue additional shares when the demand is high for the shares when the flotation is on. SEBI guidelines allows the Issuing company to accept oversubscription, subject to a ceiling, say 15% of the offer made to public. In certain cases, the Green Shoe Option can be even more than 15%. It is extensively used in international IPOs to stabilise the post listing price of new issued shares. The concept has been introduced in the Indian capital market and is used in initial public offerings through book building process. SEBI has allowed the use of the option with a view to boost the investors' confidence and to put a check for speculative practices causing short-term volatility in post listing price. The Green Shoe Option facility would bring in price stability of initial public offerings.

Answer 3. (c)

(i) The inputs to the Black-Scholes model are the current price of the underlying asset (S), the strike price of the option (K), the time to expiration of the option in fractions of a year (t), the variance of the underlying asset (s^2), and the continuously – compounded risk-free interest rate (r).

In this problem, the inputs are : S= Rs. 100; s^2 = 0.04; K = Rs. 100; r = 0.05; t = 2

After identifying the inputs, solve for d_1 and d_2.

$d_1 = [1_n(S/K) + (r + ½\, s^2)(t)]/(s^2t)^{1/2}$

$= [1_n\,(100/100) + \{0.05 + ½\,(0.04)\}\,(2)]\,/\,(0.04 \times 2)^{1/2}$

$= 0.4950$

$d_2 = d_1 - (s^2t)^{1/2}$

$= 0.4950 - (0.04 \times 2)^{1/2}$

$= 0.2122$

Find $N(d_1)$ and $N(d_2)$, the area under the normal curve from negative infinity to d_1 and negative infinity to d_2, respectively.

$N(d_1) = N(0.4950) = 0.6897$

$N(d_2) = N\,(0.2122) = 0.5840$

According to the Black-Scholes formula, the price of a European call option (C) on a non-dividend paying common stock is :

$C = S\,N(d_1) - Ke^{-rt}\,N(d_2)$

$= (100)(0.6897) - (100)\,e^{-(0.05)(2)}(0.5840)$

= Rs. 16.13

The Black-Scholes Price of the call option is Rs. 16.13.

(ii) Put-call parity implies that the cost of a European call option (C) must equal the cost of a European put option with the same strike price and time to expiration (P) plus the current stock price (S) minus the present value of the strike price [PV(K)].

In this problem : C = Rs. 16.13; S = Rs. 100 ; PV(K) = Rs. 100/$e^{(0.05 \times 2)}$ = Rs. 90.48

Rearranging the Put-Call Parity formula :

P = C – S + PV(K)

= Rs. 16.13 – Rs. 100 + Rs. 90.48

= Rs. 6.61

Therefore, Put-Call Parity implies that the Black-Scholes price of a European put option with a strike price of Rs. 100 and 2 years until expiration should be Rs. 6.61.

Q. 4. (a) What are the risks relevant while investing?

(b) Define a Portfolio Manager as per SEBI Rules & state the functions of a portfolio manager.

(c) Tamal has invested in three mutual fund schemes as per details given below :

	MF A	**MF B**	**MF C**
Date of investment	**01.12.09**	**01.01.2010**	**01.03.2010**
Amount of investment	**Rs. 50,000**	**Rs. 1 lakh**	**Rs. 50,000**
NAV at entry date	**Rs. 10.50**	**Rs. 10.00**	**Rs. 10.00**
Dividend received upto 31.03.2010	**Rs. 950**	**Rs. 1,500**	**Nil**
NAV as on 31.03.2010	**Rs. 10.40**	**Rs. 10.10**	**Rs. 9.80**

Required :

(i) What is the effective yield on per annum basis in respect of each of the three schemes to Mr. Tamal up to 31.03.2010?

Answer 4. (a)

The relevant risks are as follows :

(i) Interest rate risk – Interest rates and prices vary inversely

(ii) Purchasing power risk – Inflation tend to reduce the returns generated.

(iii) Business Risk – Change in business cycles & bull/bear market phase affect

(iv) Financial risk – Decision of company to alter the capital structure etc. affect.

Answer 4. (b)

As defined under SEBI (Portfolio Managers) Rules 1993, a portfolio manager is a person who pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of a client the management or administration of a portfolio of securities of the funds of the client as the case may be.

Functions of a Portfolio Manager :

(i) Study Economic Environment

(ii) Study Securities Market

(iii) Maintain complete data of top companies

(iv) Keep track of latest policies and guidelines of GOI

(v) Study problems of Industry affecting securities market

(vi) Study attitude of investors

(vii) Study the financial behaviour of major players in the market

(viii) Counsel prospective investor on share market

(ix) Carry out investment in securities to attain maximum profit at lesser risk.

Answer 4. (c)

	MF A	**MF B**	**MF C**
Date of investment	01.12.2009	01.01.2010	01.03.2010
Amount of investment	Rs. 50,000	Rs. 1 lakh	Rs. 50,000
NAV at entry date	Rs. 10.50	Rs. 10.00	Rs. 10.00
Dividend received upto 31.03.2010	Rs. 950	Rs. 1,500	Nil
Number of units issued	50,000/10.5 = 4,762	1,00,000/10 = 10000	50,000/10 = 5,000
Dividend per unit	950 / 4,762 = 0.20	1,500/10,000 = 0.15	Nil
Capital gains per unit	(10.4 – 10.5) = – 0.10	(10.10 – 10.00) = 0.10	(9.80 – 10.00) = – 0.20
Total	0.10	0.25	-0.20
Yield	0.10 / 10.5 = 0.95%	0.25 / 10 = 2.5%	-0.2 / 10 = -2%
Yield per annum =Yield × (12/ months of investment)	0.95 × 12/4 = 2.85%	2.5 × (12/3) = 10%	– 2 × 12/1 = -24%

Q. 5. (a) Mr Rakesh, a Fund Manager, has some liquidity in his fund. He wishes to purchase NTPC shares. The current market price is Rs. 95. he would be happy if he is able to purchase them at Rs. 90. Rakesh is keen to use simple option strategies for this purpose. Suggest at least two strategies for Rakesh under the following condition :

(i) Rakesh feels that Maruti would fall i.e. he is bullish.

(b) State the important distinction between a futures and option contract.

(c) What is the provision for lock-in period of pre-issue share capital of an unlisted company?

Answer 5. (a)

If Mr. Rakesh wants to use options, he can either buy a call or write a put, given that he is bullish.

Choice 1 :

Mr. Rakesh can buy a call option on NTPC at a strike price of Rs. 90. This would ensure the following :

(i) He would pay premium to the writer of the call.

(ii) Since he is bullish the chances of exercising would be high. He would not be exercising unless the share prices goes below the exercise price i.e. Rs. 90.

(iii) He would make unlimited profit if before expiry the share price rises substantially and he has not sold the shares acquired via exercising.

(iv) His returns would be reduced to the extent of premium paid to purchase the call.

Choice 2 :

Mr. Rakesh can write a put option on NTPC at a strike price of Rs. 95. This would ensure the following :

(i) He would receive premium for the buyer of the put.

(ii) Since he is bullish the chances the buyer exercising would be remote. If buyer exercises, he would not be buying the shares above the exercise price, i.e. Rs. 90.

(iii) However, the only opportunity loss could be if the share starts moving down. In that case he must be aware that his losses are unlimited and losses would begin once the stock price crosses Rs. 90 – premium received.

Answer 5. (b)

The important distinction between a futures contract and an options contract is that the futures contract is an obligation. When an investor purchases or sells a futures contract, the investor has an obligation to accept or deliver, respectively, the underlying commodity on the expiration date. In contrast, the buyer of an option contract is not obligated to accept or deliver the underlying commodity but instead has the right, or choice, to accept delivery (for call holders) or make delivery (for put holders) of the underlying commodity anytime during the life of the contract.

Futures and options modify a portfolio's risk in different ways. Buying or selling a futures contract affects a portfolio's upside risk and downside risk by a similar magnitude. This is commonly referred to as symmetrical impact. On the other hand, the addition of a call or put option to a portfolio does not affect a portfolio's upside risk and downside risk to a similar magnitude. Unlike futures contracts, the impact of options on the risk profile of a portfolio is asymmetrical.

Answer 5. (c)

Lock-in of Pre-issue Share Capital of an Unlisted Company

- The entire pre-issue share capital, other than that locked in as promoters contribution, shall be locked-in for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later.

- The above provision is not applicable to the pre-issue share capital held by venture capital funds and foreign venture capital investors.
- The above provision is also not applicable if shares are held for a period of at least one year at the time of filing draft offer document with SEBI and being offered to the public through offer for sale.

Q. 6. (a) What is Technical Analysis ? What are the basic assumptions regarding technical analysis?

(b) What are the provisions regarding e-mail and digital signature as per IT Act, 2000?

(c) What are the features of option contracts?

(d) What are the different phases of portfolio management?

Answer 6. (a)

Technical analysis is a method of evaluating securities by analyzing the statistics generated by market activity, such as past prices and volume. Technical analysts do not attempt to measure a security's intrinsic value, but instead use charts and other tools to identify patterns that can suggest future activity.

Just as there are many investment styles on the fundamental side, there are also many different types of technical traders. Some rely on chart patterns, others use technical indicators and oscillators, and most use some combination of the two. In any case, technical analysts' exclusive use of historical price and volume data is what separates them from their fundamental counterparts. Unlike fundamental analysts, technical analysts don't care whether a stock is undervalued - the only thing that matters is a security's past trading data and what information this data can provide about where the security might move in the future.

The basic and necessary assumptions regarding the technical analysis :

1. The Market Discounts Everything
2. Price Moves in trends
3. History tends to repeat itself

Answer 6. (b)

The IT Act 2000, the cyber law of India legalizes the e-mail and gives it the status of being valid form of carrying out communication in India. This implies that e-mails can be duly produced and approved in a court of law, thus can be regarded as substantial document to carry out legal proceedings.

The act also talks about digital signatures and digital records . These have been also awarded the status of being legal and valid means that can form strong basis for launching litigation in a court of law. It invites the corporate companies in the business of being Certifying Authorities for issuing secure Digital Signatures Certificates.

Answer 6. (c)

The important features of options contracts are as follows :

- The option is exercisable only by the owner, namely the buyer of the option.
- The owner has limited liability.
- Owners of options have no right affordable to shareholders such as voting right and dividend right.
- Options have high degree of risk to the option writers.
- Options are popular because they allow the buyer profits from favourable movements in exchange rate.
- Options involve buying counter positions by the option sellers.
- Flexibility in investors needs.
- No certificates are issued by the company.
- An investor who writes a call option against stock held in his portfolio is said to be selling 'covered options'. Options sold without the stock to back them up are called 'naked options'.

Answer 6. (d)

Phases of portfolio management :

1. Specification of investment objectives and constraints
2. Choice of asset mix
3. Formulation of portfolio strategy
4. Selection of securities
5. Portfolio execution
6. Portfolio revision
7. Portfolio evaluation

Q. 7. (a) What are zero coupon bonds?

(b) What is yield to maturity?

(c) How to estimate the equity beta of a private firm?

(d) What are the criticism of DOW theory?

Answer 7. (a)

Zero coupon bonds are issued at a discount and redeemed at par. No interest is paid on such bonds before maturity. Zero coupon bonds are issued by means of auction, with a face value of say Rs. 100. The bidders need to clearly specify the purchase price expressed upto two decimal points in the application. An applicant needs to submit more than one bid at different prices through separate applications for each bid (but the aggregate amount of bids submitted by a person should not exceed the aggregate amount of bonds offered for sale).

The RBI will determine the cut-off price at which it tenders for purchase of zero coupon bonds will be accepted at the auction.

All the bids at prices higher than the cut-off price will receive full allotment, while the bids at prices lower than the cut-off price will be rejected. The bids at the cut-off price may receive full or partial allotment depending on the total amount of bids and the notified amount.

Answer 7. (b)

The yield or the return on the instrument is held till its maturity is known as the Yield-to-maturity (YTM). It basically measures the total income earned by the investor over the entire life of the Security.

The total income consists of the following :

(i) **Coupon income :** The fixed rate of return that accrues from the instrument.

(ii) **Interest-on-interest at the coupon rate :** Compound interest earned on the coupon income

(iii) **Capital gains/ losses :** The profit or loss arising on account of the difference between the price paid for the security and the proceeds received on redemption/ maturity.

Answer 7. (c)

To obtain an estimate for the cost of equity of a private firm, we can use the CAPM. To do so, we need an estimate of the company's equity beta. Since this is not available, given that the firm is not publicly traded, we can use information from comparable firms. Obtaining a sample of comparable firms, we can use each firm's equity beta and un-lever it to obtain the firm's asset beta. We use the average asset beta of the comparable firms as an estimate of the asset beta for the private firm. To take into account the impact of financial leverage, we re-lever the asset beta using the private firm's debt-equity ratio. The re-levered beta is the estimate of the private firm's equity beta. In order to obtain an estimate of the cost of debt, given that the firm has no publicly –traded debt, we could either examine the firm's borrowing history or obtain a synthetic rating by comparing the private firm's financial ratios to those of comparable firms that are rated.

Answer 7. (d)

Several criticisms are levelled against the Dow theory.

1. It is not a theory but an interpretation of known data. A theory should be able to explain why a phenomenon occurs. No attempt was made by Dow or his followers to explain why the two averages should be able to forecast future stock prices.
2. It is not acceptable in its forecast. There was considerable lag between the actual turning points and those indicated by the forecast.
3. It has poor predictive power. According to Rosenberg, the Dow theory could not forecast the bull market which had preceded the 1929 crash. It gave bearish indication in early 1926. The 31/2 years which followed the forecast of Hamilton's editorials for the 26-year period, from 1904 to 1929. Of the 90 recommendations Hamilton made for a change in attitude towards the market (55% were bullish, 18% bearish and 29% doubtful) only 45 were correct. Such a result an investor may get by flipping a coin).

Q. 8. (a) Given the following risky portfolios

	A	B	C	D	E	F	G	H
Return %	**10**	**12.5**	**15**	**16**	**17**	**18**	**18**	**20**
s %	**23**	**21**	**25**	**29**	**29**	**32**	**35**	**45**

(i) Which of these portfolios are efficient? Which are inefficient?

(ii) Suppose one can tolerate a risk of 25%, what is the maximum return one can achieve if no borrowing or lending is resorted to?

(iii) Suppose one can tolerate a risk of 25%, which is the maximum return one can achieve if borrowing or lending at the rate of 12% is resorted to?

(b) What are risks of an option holder?

(c) What is SEBI's role in a right issue of a listed company?

Answer 8. (a)

(i) Using the risk-return tradeoff, an investor would prefer B to A (B gives higher return for lower risk, hence dominant); would prefer C; would prefer E to D (E gives higher return for same risk and hence dominant); would prefer F to G (F is dominant because it offers 18% at lower risk); and H; Hence portfolios B, C, E & F are efficient. Portfolios A,D & G are inefficient.

(ii) As seen from the table, if the maximum risk of 25% can be tolerated, then portfolio C can be chosen to give a maximum return of 15%.

(iii) However, if borrowing/ lending can be resorted @ 12%, then one can borrow in such a manner that the total risk does not exceed 25%. As we know higher returns can be obtained by borrowing at the risk free rate and investing in a risky portfolio. Obviously risk too would increase. Now we need to find that portion on investment in risky portfolio, which will give us maximum return for a risk not greater than 25%. Therefore let us assume weight of investment in risky portfolio be 'x'. Therefore (1-x) would be the weight in risk free asset. It is clear that since s of risk free asset is zero, we need to find just that proportion in risky security to get 25%.

Thus we have for Portfolio A investment in proportion of 25/23 and -2/23 in risk free instrument (indicating borrowing) to arrive at a total risk of 25%. We simply used the below formula. [Note substitute s of Risk free portfolio = 0].

x * s of risky portfolio + (1-x) * s of risk free portfolio = 25%

'x' found above, would be used to find total return.

Total return = x * Return of risky portfolio + (1-x) * 12

Thus we get the table given below.

	A	B	C	D	E	F	G	H
Proportion in risky security	25/23	25/21	25/25	25/29	25/29	25/32	25/35	25/45
To get risk	25	25	25	25	25	25	25	25
Return	9.83	12.60	15.00	15.45	16.31	16.69	16.29	16.44

We see from the table that a maximum return of 16.69% is obtained for portfolio F, when we invest in a proportion of 25/32 in portfolio F & balance 7/32 in risk free asset.

Answer 8. (b)

Risk of Option holders

1. An option holder runs the risk of losing the entire amount paid for the option in a relatively short period of time. This risk reflects the nature of an option as a wasting asset which becomes worthless when it expires. An option holder who neither sells his option in the secondary market nor exercises it prior to its expiration will necessarily lose his entire investment in the option. If the price of the underlying asset does not change in the anticipated direction before the option expires to an extent sufficient to cover the cost of the option, the investor may lose all or a significant part of his investment in the option.
2. The Exchange may impose exercise restrictions and have authority to restrict the exercise of options at certain times in specified circumstances.

Answer 8. (c)

A listed company making a rights issue of value of more than Rs 50 lakh is required to file a draft offer document with SEBI for its observations. The company can proceed further on the issue only after getting observations from SEBI. The validity period of SEBI's observation letter is three months only i.e. the company has to open its issue within three months period. SEBI does not recommend any issue nor does take any responsibility either for the financial soundness of any scheme or the project for which the issue is proposed for or for the correctness of the statements made or opinions expressed in the offer document. It is to be distinctly understood that submission of offer document to SEBI should not in any way be deemed or construed that the same has been cleared or approved by SEBI. The Lead manager certifies that the disclosures made in the offer document are generally adequate and are in conformity with SEBI guidelines for disclosures and investor protection in force for the time being. This requirement is to facilitate investors to take an informed decision for making investment in the proposed issue.

Q. 9. (a) What are the rules regarding payment of dividend?

(b) The beta coefficient of Target Ltd. is 1.4. The company has been maintaining 8% rate of growth in dividends and earnings. The last dividend paid was Rs. 4 per share. Return on GOI Securities is 10%. Return on Market Portfolio is 15%. The current market price of one share of Target Ltd. is Rs. 36.

(i) What will be the equilibrium price per share of Target Ltd.?

(ii) Would you advise purchasing the share?

(c) A mutual fund has a NAV of Rs. 8.50 at the beginning of the year. At the end of the year NAV increases to Rs. 9.10. Meanwhile fund distributes Rs. 0.90 as dividend and Re. 0.75 as capital gains.

(i) What is the fund's return during the year?

(ii) Had these distributions been re-invested at an average NAV of Rs. 8.75, what is the return for 200 units?

Answer 9. (a)

The power to pay dividend is subject to the following two fundamental rules :

(1) Dividend must not be paid out of capital.

(2) Dividend should be paid out of profits. Company law provisions regarding dividend Section 205 of the Act provides as under

No dividend shall be declared or paid by a company for any financial year except :

(1) Out of the profits for that year arrived at after providing for depreciation in accordance with subsection (2) ; or

(2) Out of the profits of the company for any previous year or years arrived at after providing depreciation in the prescribed manner and remaining undistributed or out of both;

(3) Out of (1) and (2) above ;

(4) Out of moneys provided by the Central or State Government for this purpose in pursuance of a guarantee given by that Government.

Answer 9. (b)

(i) The expected return of Target Ltd. as per CAPM is given by

$R_{Target} = R_f + b(R_m - R_f)$

Given, R_m = 15%, b_{Target} = 1.4, R_f = 10%

Therefore, R_{Target} = 0.1 + 1.4 × 0.05 = 17%

Substituting, this for K_e in the dividend discount model formula $P = \frac{D_0 (1+g)}{K_e - g}$

We get the equilibrium price

P = (4 · 1.08)/ (0.17 – 0.08) = Rs. 48

(ii) As the current price is Rs. 36, which is less than the calculated equilibrium / Fair price, it is worth purchasing the share.

Answer 9. (c)

(i) Return for the year (all changes on a per unit basis) :

Change in price (Rs. 9.10 – Rs. 8.50) =	Rs.	0.60	
Dividends received		0.90	
Capital gains distributions		0.75	
Total return	Rs.	2.25	
Holding period return	Rs.	2.25 / Rs. 8.50	= 26.47%

(ii) When all dividends and capital gains distributions are reinvested into additional units of the fund (Rs. 8.75/unit) :

Dividends and capital gains per unit :	Rs. 0.90 + Rs. 0.75 = Rs. 1.65
Total received from 200 units	Rs. 1.65 · 200 = Rs. 330.00
Additional units acquired :	Rs. 330/Rs. 8.75 = 37.7 units

Value of 237.7 units held at end of year = 237.7 units · Rs. 9.10 = Rs. 2,163

Price paid for 200 units at beginning of year 200 units · Rs. 8.50 = Rs. 1,700

Thus, the holding period return would be = (2163 – 1700)/1700 = 27.24%

Q. 10. (a) What are the various risks associated with derivatives?

(b) On January 1, 2010, an investor has a portfolio consisting of eight securities as under :

Security	Price	No. of Shares	b
A	29.40	400	0.59
B	318.70	800	1.32
C	660.20	150	0.87
D	5.20	300	0.35
E	281.90	400	1.16
F	275.40	750	1.24
G	514.60	300	1.05
H	170.50	900	0.76

The cost of the capital for investor is 20% p.a. The investor fears a fall in the prices of the shares in near future. Also given that :

Current Nifty value is 986; Tradable units of Nifty = 50

Feb futures are currently quoted at 1010 and March futures are quoted at 1019.

Find :

(i) Options available to the investor to protect his portfolio.

(ii) Beta of the portfolio.

(iii) Theoretical value of Future contracts expiring in Feb and March.

(iv) Calculate number of units of NIFTY that he would have to sell if he desires to hedge until March (a) his total portfolio, (b) 90% of his portfolio and (c) 120% of his portfolio.

(v) Determine the number of futures contracts the investor should trade if he desires to reduce the beta of his portfolio to 0.9.

Answer 10. (a)

Various risks associated with derivatives are as follows :

(i) Market Risk – Price sensitivity to fluctuations in interest rates and foreign exchange rates.

(ii) Liquidity Risk – Most derivatives are customized instruments, hence may exhibit substantial liquidity risk.

(iii) Credit Risk – Derivatives trades not traded on exchange are traded in the Over the Counter (OTC) markets. OTC contracts are subject to counter party defaults.

(iv) Hedging Risk – Derivatives are used as hedges to reduce specific risks. If the anticipated risks do not develop, the hedge may limit the funds total return.

(v) Regulatory Risk – Owing to the high risk characteristics inherent in the derivatives market, the regulatory controls is sometimes too oppressive for market participants.

Answer 10. (b)

Security	Price	Shares (N)	b	Value	Proportion N/SN	Product = (N/SN) · b
A	29.40	400	0.59	11,760	0.1	0.06
B	318.70	800	1.32	2,54,960	0.2	0.26
C	660.20	150	0.87	99,030	0.04	0.03
D	5.20	300	0.35	1,560	0.08	0.03
E	281.90	400	1.16	1,12,760	0.1	0.12
F	275.40	750	1.24	2,06,550	0.19	0.24
G	514.60	300	1.05	1,54,380	0.08	0.08
H	170.50	900	0.76	1,53,450	0.23	0.17
	TOTAL	**4000**		**9,94,450**		**0.99**

(i) He can hedge his portfolio by shorting index futures of an equivalent value of his portfolio i.e. approximately Rs. 9,95,000.

(ii) Beta of the portfolio (See the Table) = 0.99

(iii) Theoretical value of future expiring in February i.e. 2 months from today.
= 986 + 986 × 0.20 × 2/12 = 1019

Theoretical value of future expiring in March i.e. 3 months from today.
= 986 + 986 × 0.20 × 3/12 = 1035.30

(iv) One lot of Nifty = 50 and March futures are quoting at 1019.

(a) Thus to hedge 100% of his portfolio the investor has to hedge 1.0 × 994950 = Rs. 9,94,950. Therefore the number of contracts would be = 994950 ÷ (1019 × 50) = 19.52 = 20 contracts approx.

(b) Thus to hedge 90% of his portfolio the investor has to hedge 0.9 × 994950 = Rs. 895455. Therefore, the number of contracts would be = 895455 ÷ (1019 × 50) = 17.58 = 18 contracts approx.

(c) Thus to hedge 120% of his portfolio the investor has to hedge 1.2 × 994950 = Rs. 11,93,940. Therefore, the number of contracts would be = 1193940 ÷ (1019 × 50) = 23.43 = 23 contracts approx.

(v) The fund manager has to sell index futures to reduce the beta from 0.99 to 0.90. He would sell (994950 × 0.99) – (986 x 50 × N) = 994950 × 0.9

Solving the above equation gives N = 1.82 or approximately 2 contracts.

The investor would sell 2 contracts i.e. 2 × 986 × 50 = Rs. 98,600 of Index Futures and accomplish his goal of reducing the beta to 0.9.

Q. 11. (a) What is an Index and Index Future?

(b) What is At-The-Money, In-The-Money and Out-Of-The-Money?

(c) Find whether holder of the following options would exercise the respective calls/puts.

Strike price	Price on expiry	Holding
190	**210**	**CALL**
460	**460**	**PUT**
540	**450**	**CALL**
450	**400**	**PUT**
175	**200**	**CALL**
750	**800**	**PUT**
450	**450**	**CALL**

Answer 11. (a)

An Index is a number used to represent the changes in a set of values between a base time period and the current time. A stock index represents change in the value of a set of stocks which constitute the index over a base year.

An index future is a derivative whose value is dependent on the value of the underlying asset (e.g. BSE Sensex, S&P CNX NIFTY). While trading on index futures, an investor is basically buying and selling the basket of securities comprising an index in their relative weights. Unlike commodity and other futures contracts, Index Future contracts are settled in cash.

Answer 11. (b)

There are three different terms for describing where an option is trading in relation to the price of the underlying security. These terms are 'at-the-money', 'in-the-money', and 'out-of-the-money'. An option is in-the-money if the exercising of option will bring about gain and an option is out-of-the-money if the exercising of option will bring about loss.

The following summarizes the relationship between an option's strike price and the market price of the underlying asset.

Market scenario	Call option	Put option
Market price > Strike price	In-the-money	Out-of-the-money
Market price < Strike price	Out-of-the-money	In-the-money
Market price = Strike price	At-the-money	At-the-money

Answer 11. (c)

Strike price	Price on expiry	Holding	Exercise / Lapse?
190	210	CALL	He will exercise, as he is able to buy shares at 190 when the price is 210. Payoff = 210 – Premium paid.
460	460	PUT	He will allow it to lapse, as even the ruling price is 460. He can as well sell in the cash market. Payoff = -1 × premium paid.
540	450	CALL	He will allow it to lapse, as the ruling price is 450. He can buy in the cash market, 90 cheaper. Payoff = -1 × premium paid.
450	400	PUT	He will exercise, as he is able to sell shares at 450 when the price is 400. payoff = 450 – premium paid.
175	200	CALL	He will exercise, as he is able to buy shares at 175 when the price is 200. payoff = 200 – premium paid.
750	800	PUT	He will allow it to lapse, as the ruling price is 800. payoff = -1 × premium paid.
450	450	CALL	He will allow it to lapse, as even the ruling price is 450. He can as well as buy in the cash market. Payoff = -1 × premium paid.

Q. 12. (a) What is a futures contract?

(b) What are the drawbacks of Mutual Funds?

(c) An investor has the following position on options of ONGC.

(i) Long one call option with a premium of Rs. 25 per stock at an exercise price of Rs. 400.

(ii) Long one put option with a premium of Rs. 5 per stock at an exercise price of Rs. 300.

The prevailing market price of the ONGC is Rs. 350. Options are European options with expiration period of 3 months.

You are required to find out the profit or loss to the investor in the following market situations :

(i) At expiration if the price of the ONGC remained at present level.

(ii) At expiration if the price of the ONGC rises to Rs. 500.

(iii) At expiration if the price of the ONGC falls to Rs. 250.

(d) A call option on Fag Bearing, a non dividend paying stock, currently trades for Rs. 4. The expiration date of the option is February 25 of next year. The exercise price of the option is Rs. 45.

(i) If this is an American option, on what dates can the option be exercised?

(ii) If this is European option on what dates can the option be exercised ?

(iii) Suppose the current price of Fag Bearings is Rs. 35 per share, is this option worthless?

Answer 12. (a)

A futures contract enables an investor to buy the cash equivalent of an asset at the expiration date. The purchase price is specified on the day of purchase but settlement is deferred. Thus, at first glance, the futures price represents the market estimate of the asset value at expiration. The asset value is arrived at by incorporating the cost of carry into the spot value. On the other hand, since futures are marked to market, settlement of the purchase price is not exactly made in one lump sum at the expiration date; it is made in successive daily installments called margin variation payments.

The difference between the cash and the futures index prices hinges on the difference in dividend payments and on the fact that the spot value is a present value while the futures price is value derived for the future by calculating the cost of carry.

Answer 12. (b)

Mutual funds have their drawbacks and may not be for everyone :

- No Guarantees: No investment is risk free. If the entire stock market declines in value, the value of mutual fund shares will go down as well, no matter how balanced the portfolio. Investors encounter fewer risks when they invest in mutual funds than when they buy and sell stocks on their own. However, anyone who invests through a mutual fund runs the risk of losing money.
- Fees and commissions: All funds charge administrative fees to cover their day-to-day expenses. Some funds also charge sales commissions or "loads" to compensate brokers, financial consultants, or financial planners. Even if you don't use a broker or other financial adviser, you will pay a sales commission if you buy shares in a Load Fund.
- Taxes: During a typical year, most actively managed mutual funds sell anywhere from 20 to 70 percent of the securities in their portfolios. If your fund makes a profit on its sales, you will pay taxes on the income you receive, even if you reinvest the money you made.
- Management risk: When you invest in a mutual fund, you depend on the fund's manager to make the right decisions regarding the fund's portfolio. If the manager does not perform as well as you had hoped, you might not make as much money on your investment as you expected. Of course, if you invest in Index Funds, you forego management risk, because these funds do not employ managers.

Answer 12. (c)

Long Call – Will be exercised if stock price increases above strike price.

Long Put : Will be exercised if stock price decreases below strike price.

ONGC Stock price	Action by the buyer	Investor's	
		Payoff	**Profit in Rs.**
Rs. 350	Call: Not exercised Put: Exercised	Rs. 0 + Rs. 50	- Rs. 25 - Rs. 5 + Rs. 50 = Rs. 20
Rs. 500	Call: Exercised Put: Not exercised	Rs. 100 + Rs. 0	- Rs. 25 + Rs. 100 - Rs. 5 = Rs. 70
Rs. 250	Call: Not exercised Put: Exercised	Rs. 0 + Rs. 100	- Rs. 25 - Rs. 5 + Rs. 100 = Rs. 70

Answer 12. (d)

(i) If the option is American, it can be exercised on any date upto and including its expiration on February 25.

(ii) If the option is European, it can only be exercised on its expiration date, February 25.

(iii) The option is not worthless. There is a chance that the stock price of Fag Bearings will rise above Rs. 45 sometime before the option's expiration on February 25. In this case, a call option with a strike price of Rs. 45 would be valuable at expiration. The probability of such an vent happening is built into the current price of the option.

Q. 13. (a)

Consider the following on three stocks :

State of economy	Probability	Rate of return is state occurs		
		Stock A	**Stock B**	**Stock C**
Boom	**20%**	**40%**	**2%**	**60%**
Normal	**70%**	**15%**	**10%**	**5%**
Bust	**10%**	**-5%**	**15%**	**-75%**

(i) If your portfolio is invested in 40% each in stock A and Stock B and 20% in stock C, what is the portfolio expected return? The variance? The standard Deviation?

(ii) If the expected T-bill rate is 4.8%, what is the expected risk premium on the portfolio?

(iii) If the expected inflation rate is 4.5%, what are the approximate and exact expected real returns on the portfolio? What are the exact expected real risk premiums on the portfolio?

Q. 13. (b) Write short notes on :

(i) Junk Bond

(ii) Convertible debenture

(iii) Exchange rate risk

Answer 13. (a)

(i) Boom : $E[R_p] = 0.4(0.40) + 0.4(0.02) + 0.2(0.6) = 0.2880$

Normal : $E[R_p] = 0.4(0.15) + 0.4(0.10) + 0.2(0.05) = 0.1100$

Bust: $E[R_p] = 0.4(-0.05) + 0.4(0.15) + 0.2(-0.75) = -0.1100$

$E[R_p] = 0.20(0.2880) + 0.70(0.1100) + 0.1(-0.1100) = 0.1236$

$\sigma^2_p = 0.20(0.2880 - 0.1236)^2 + 0.70(0.1100-0.1236)^2 + 0.10(-0.110 -0.1236)^2$

$= 0.01099$

$\sigma_p = [0.01099]^{1/2} = 0.1048$

(ii) $RP_i = E[R_i] - R_f = 0.1236 - 0.048 = 0.0756$

(iii) Exact expected real return = [1.1236/1.045] – 1 = 0.0752

Exact expected real risk premium = [1.1236 / 1.045] – 1 – [1.0480/1.0450] +1 = 0.0723

Answer 13. (b)

(i) Junk bonds are corporate bonds with low ratings from a major credit rating agencies. Highrated bonds are called investment grade bonds, low rated bonds are called speculative-grade bonds or less formally called as 'Junk bonds'. A bond may receive a low rating for a number of reasons. If the financial condition or business outlook of the company is poor, bonds are rated speculative-grade. Bonds are also rated speculative-grade if the issuing company' already has large amounts of debt outstanding. Some bonds are rated speculative-grade; because they are subordinated to other debt i.e. their legal claim on the firm's assets in the event of default stands behind the other claim, so called senior debt. Junk bonds are traded in a dealer market rather than being traded in stock exchanges. Institutional investors hold the largest share of junk bonds. Firms with low credit ratings are willing to pay 3 to 5 percent more than the investment grade corporate debt to compensate for greater risk. Junk bonds are a high yield security, because of this reason junk bonds are widely used as a source of finance in takeovers and leveraged buy-outs. Junk bonds lie between conventional investment as equities and investment- grade bonds. Junk bonds are riskier than investment-grade bonds but less risky than equity. Junk bonds may have cost or tax advantage that allow for some marginal increase in debt. But these advantages are not likely to induce bondholders to invest in junk bonds more recklessly than other safer debt instruments.

(ii) In Convertible Debentures (CDs) an option is given to the debentureholders to convert them into equity or preference shares at stated rates of exchange, after a certain period. Such debentures once converted into shares cannot be reconverted into debentures. CDs may be fully or partly convertible. In case of fully convertible debentures, the entire face value is converted into shares at the expiry of specified period(s). In case of partly convertible debentures only the convertible portion is converted into shares at the end of the specified period and non-convertible portion is redeemed at the end of certain specified period. Non-convertible debentures do not confer any option on the holder to convert the debentures into shares and are redeemed at the expiry of specified period(s). CDs, whether fully or partly convertible, may be converted into shares at the end of specified period or periods in one or more stages. The company should get a credit rating of debentures done by credit rating agency. CDs are listed on stock exchanges. The Partly Convertible Debentures (PCDs) offers more flexibility to both companies and investors. It has been claimed to be better than fully convertible debentures as it does not automatically entail a large equity base, particularly in case of new companies. Experience shows that servicing of a large base of capital is not easy in case of new projects, especially if the company runs into rough weather due to marketing difficulties.

(iii) All investors who invest internationally in today's increasingly global investment arena face the prospect of uncertainty in the returns after they convert the foreign gains back to their own currency. Unlike the past when most U.S. investors ignored international investing alternatives, investors today must recognize and understand exchange rate risk, which can be defined as the variability in returns on securities caused by currency fluctuations. Exchange rate risk is sometimes called currency risk. For example, a U.S. investor who buys a German stock denominated in marks must ultimately convert the returns from this stock back to dollars. If the exchange rate has moved against the investor, losses from these exchange rate movements can partially or totally negate the original return earned. Obviously, U.S. investors who invest only in U.S. stocks on U.S. markets do not face this risk, but in today's global environment where investors increasingly consider alternatives from other countries, this factor has become important. Currency risk affects international mutual funds, global mutual funds, closed-end single country funds, American Depository Receipts, foreign stocks, and foreign bonds.

Q. 14. (a) What are factors that affect a value of a call option?

(b) What is mark to market margin?

(c) What is exactly meant by the term secured redeemable debenture?

(d) R. D Gupta recently purchased a bond with Rs. 1,000 face value, a 10% coupon rate, and four years to maturity. The bond makes annual interest payments, the first to be received one year from today. Mr. Gupta paid Rs. 1,032.40 for the bond.

(i) What is the bond's yield-to-maturity ?

(ii) If the bond can be called two years from now at a price of Rs. 1,100, what is its yield-to-call ?

Answer 14. (a)

The factors that affect the value of a Call option are :

(i) An increase in stock price causes an increase in the value of a call option.

(ii) An increase in exercise price causes a decrease in the value of a call option.

(iii) An increase in the time to expiration causes an increase in the value of a call option.

(iv) An increase in the risk-free rate causes an increase in the value of a call option.

(v) An increase in variance of stock return causes an increase in the value of a call option.

Answer 14. (b)

The mark-to-market (MTM) margin is collected by the stock exchange in addition to the daily margin. While calculating MTM all notional profits of the members are ignored and all notional losses are collected on a daily basis. The members are, thus, required to pay the higher of daily margin or MTM margin. By introducing MTM margin, the management of risk on the outstanding position of the members has considerably improved. The margins are debited to the members bank accounts on the next day of the trade (i.e.,T+1). In case of delay in payment of daily margin, a late fee @ 1% of the amount involved is imposed. Mark to market margin is calculated by marking each transaction in a scrip to the closing price of the scrip at the end of trading. In case the security has not been traded on a particular day, the latest available closing price at the NSE is considered as the closing price. In the event of the net outstanding position of a member in any security being nil, the difference between the buy and sell values would be considered as notional loss for the purpose of calculating the mark to market margin payable. In case of a net loss, the same is collected as the MTM margin over and above the daily VaR margin and if there is a profit the same is ignored for the purpose of computing the MTM margin.

Answer 14. (c)

Secured refers to the security given by the issuer for the loan transaction represented by the debenture. This is usually in the form of a first mortgage or charge on the fixed assets of the company on a pari passu basis with other first charge holders like financial institutions etc. Sometimes, the charge can also be a second charge instead of a first charge. Most of the times the charge is created on behalf of the entire pool of debenture holders by a trustee specifically appointed for the purpose.

Redeemable refers to the process whereby the debenture is extinguished on payment of all the obligations due to the holder after the repayment of the last installment of the principal amount of the debenture.

Answer 14. (d)

(i) A bond YTM is that interest rate that equates the bond's price to the discounted value of its promised cash flows. In this case :

$$\text{Rs. } 1{,}032.40 = \frac{\text{Rs. } 100}{(1+\text{YTM})} + \frac{\text{Rs. } 100}{(1+\text{YTM})^2} + \frac{\text{Rs. } 10}{(1+\text{YT}}$$

YTM = 9%.

(ii) If the bond can be called in two years for Rs. 1,100 its yield-to-call is found by solving for the YTM assuming the receipt of only two coupon payments and a call price of Rs. 1,100. That is :

$$\text{Rs. } 1{,}032.40 = \frac{\text{Rs. }100}{(1+\text{YTC})} + \frac{\text{Rs. }100}{(1+\text{YTC})^2}$$

Where, YTC = Yield-to-call

By solving : YTC = 125%

Q. 15. (a) Given the following information about two securities on joint probability distribution of returns for investments in the security of XYZ Co. and ABC Co., calculate the covariance and correlation coefficient between two investments :

Probability	XYZ Co. (%)	ABC Co. (%)
0.10	-12	15
0.15	-7	15
0.20	5	20
0.25	10	10
0.30	12	5

(b) Assume that two securities X and Y constitutes the market portfolio. Their proportions and variances are 0.49, 150, and 0.51, 324 respectively. The covariances of two securities is 175. Calculate the betas of the two securities.

Answer 15. (a)

The covariance between two securities is given by :

$$s_{XY} = \sum_{i=1}^{n} (R_X - R_X)\cdot(R_Y - R_Y)$$

In the case of XYZ Co. and ABC Co. stocks, their expected returns are :

R_{XYZ} = (0.10 × –12%) + (0.15 × –7%) + (0.20 × 5%) + (0.25 × 10%) + (0.30 × 12%)

= –1.2 – 1.05 + 1.00 +2.50 + 3.60

= 4.85%

R_{ABC} = (0.10 × 12%) + (0.15 × 15%) + (0.20 × 20%) + (0.25 × 10%) + (0.30 × 5%)

= 1.2 + 2.25 + 4.0 +2.50 +1.50

= 11.45%

Therefore,

$s_{XYZ.ABC}$ = [0.10 × (–12% – 4.85%) × (12% – 11.45%)] + [0.15 × (–7% – 4.85%) × (15% – 11.45%] + [0.20 × (5% – 4.85%) × (20% – 11.45%)] + [0.25 × (10% – 4.85%) × (10% – 11.45%)] + [0.30 × (12% – 4.85%) × (5% – 11.45%)]

= – 0.92675 – 6.310125 + 0.2565 – 1.8669 – 13.8353

= – 22.68%

The correlation coefficient between two securities is :

$r_{XY} = s_{XY} / (s_X \times s_Y)$

In the case of XYZ and ABC stocks, their standard deviations are :

$$s_{XYZ} = \{[0.10 \times (-12\% - 4.85\%)^2] + [1.5 \times (-7\% - 4.85\%)^2] + [0.20 \times (5\% - 4.85\%)^2] + [0.25 \times (10\% - 4.85\%)^2] + [0.30 \times (12\% - 4.85\%)^2]\}^{1/2}$$

$$= 16.16\%$$

$$s_{ABC} = \{[0.10 \times (-12\% - 11.45\%)^2] + [1.5 \times (15\% - 11.45\%)^2] + [0.20 \times (20\% - 11.45\%)^2] + [0.25 \times (10\% - 11.45\%)^2] + [0.30 \times (5\% - 11.45\%)^2]\}^{1/2}$$

$$= 10.08\%$$

Therefore,

$$r_{XYZ.\,ABC} = -22.68 / (16.16 \times 10.08)$$

$$= -0.14$$

Answer 15. (b)

Given the two securities' market model, its variance is :

$$s^2_m = X^2_A\, s^2_A + X^2_B\, s^2_B + 2X_A X_B C_{AB}$$

$$= (0.49)^2(150) + (0.51)^2(324) + 2(0.49)(0.51)(175)$$

$$= 207.75$$

Further, the covariance of a security with the market portfolio equals

$$s_{im} = \sum_{i=1}^{n} X_i\, s_{ij}$$

In the two-security market model case :

$$s_{AM} = 0.49 \times 150 + 0.51 \times 175$$

$$= 73.50 + 89.25$$

$$= 162.75$$

$$s_{BM} = 0.51 \times 324 + 0.49 \times 175$$

$$= 165.24 + 85.75$$

$$= 250.99$$

The beta of the security is defined as :

$$b_i = s_{im} / s^2_m$$

Therefore,

$$b_A = 162.75 / 207.75 = 0.78$$

$$b_B = 250.99 / 207.75 = 1.21$$

Q. 16. (a) Suppose we have following information :

Security	Amount invested (Rs.)	Expected return (%)	Beta
Stock A	1,000	8	0.80
Stock B	2,000	12	0.95
Stock C	3,000	15	1.10
Stock D	4,000	18	1.40

What is the expected return on this portfolio? What is the beta of this portfolio ? Does the portfolio have more or less systematic risk than an average asset?

Q. 16. (b) Consider the following data :

The market price of the option	**Rs. 36**
The exercise price of the call option	**Rs. 40**
The current annualized market interest rate for T-bills	**10%**
The time remaining before expiration	**90 days (.25 years)**
Historical standard deviation	**0.40**
Expected standard deviation	**0.50 (analysts to expect an increase in stock beta because of a new debt issue)**

Apply the Black-Scholes formula developed for deriving the value of American call option.

Answer 16. (a)

First, calculate the portfolio weights. Since the total amount invested is Rs. 10,000, of this Rs. 1,000/Rs. 10,000 = 10% is invested in Stock A. Similarly, 20% is invested in Stock B, 30% is invested in Stock C, and 40% is invested in Stock D. The expected returns, $E(R_P)$, is thus :

$$E(R_P) = 0.10 \times E(R_A) + 0.20 \times E(R_B) + 0.30 \times E(R_C) + 0.40 \times E(R_D)$$
$$= 0.10 \times 8\% + 0.20 \times 12\% + 0.30 \times 15\% + 0.40 \times 18\%$$
$$= 14.90\%$$

Similarly, the portfolio beta, b_P, is :

$$b_P = 0.10 \times b_A + 0.20 \times b_B + 0.30 \times b_C + 0.40 \times b_D$$
$$= 0.10 \times 0.80 + 0.20 \times 0.95 + 0.30 \times 1.10 + 0.40 \times 1.40$$
$$= 1.16$$

This portfolio thus has an expected return of 14.9% and a beta of 1.16. Because the beta is larger than 1, this portfolio has greater systematic risk than an average asset.

Answer 16. (b)

First calculating the option value assuming the historical volatility $s = 0.40$;

$$d_1 = [\ln (36/40) + (0.10 - 0.5(0.4)^2\ 0.25] / [(0.4)\ (0.25)^{0.5}]$$
$$= [-0.1054 + 0.045]/ 0.2$$
$$= -0.302$$
$$d_2 = -0.302 - [0.4(0.25)^{0.5}] = -0.502$$

$N(d_1) = 0.3814$

$N(d_2) = 0.3079$

Option value :

$$[36(0.3814) - (40)(\text{anti } \ln (0.25))](0.3079)$$
$$= 13.7304 - (40)(0.0253)(0.3079)$$
$$= 13.7304 - 12.6276$$
$$= 1.103$$

Finally, calculating the option value assuming the expected volatility is higher $s = 0.50$;

$$d_1 = [\ln (30/40) + (0.10 - 0.5(0.5)^2\ 0.25] / [(0.5)\ (0.25)^{0.5}]$$
$$= [-0.1054 + 0.05625]/ 0.25$$
$$= -0.1966$$
$$d_2 = -0.1966 - [0.5(0.25)^{0.5}] = -0.4466$$

N (d_1) = 0.4199

N (d_2) = 0.3275

Option value :

[36(0.4199) – (40) (anti In (0.25))](0.3275)
= 15.1164 – (40)(1.0253)(0.3275)
= 15.1164 – 13.4314
= 1.685

The result indicates the importance of estimating stock price volatility (from 0.40 to 0.50). There is a 53% increase in the value of the option.

Q. 17. (a) An investor has the following portfolio :

	Number of shares	Share price (Rs.)	Share Beta
Andhra Auto	**1,000**	**30**	**0.9**
Bombay Cement	**1,500**	**12**	**1.2**
Kolkata Cotton	**1,200**	**25**	**1.5**
Delhi Tax	**2,000**	**40**	**0.6**

It is 15th February and the March ABC 100 future price is Rs. 300.

(i) How can the investor hedge the portfolio, with futures? (Assume Rs. 25 per index point).

(ii) What factors might reduce the effectiveness of the measures taken in (a)?

Q. 17. (b) Suppose you are asked to analyse two portfolios having the following characteristics :

	Observed return	Beta	Residual variance
Portfolio A	**0.18**	**2.0**	**0.03**
Portfolio B	**0.12**	**1.5**	**0.00**

The risk-free rate is 0.07. The return on the market portfolio is 0.15. The standard deviation of the market is 0.06.

(i) Compute the Jensen Index for portfolio A and B.

(ii) Compute the Sharpe Index for the market portfolio

(iii) Compute the Sharpe Index for portfolios A and B.

(iv) Compute the Treynor Index for the portfolios A and B.

Answer 17. (a)

(i) Calculate the market exposure of the portfolio by summing the market exposures of individual stocks (market exposure = number of shares × share price × beta).

1,000 × Rs. 30 × 0.9 = Rs. 27,000
1,500 × Rs. 12 × 1.2 = Rs. 21,600
1,200 × Rs. 25 × 1.5 = Rs. 45,000
2,000 × Rs. 40 × 0.6 = Rs. 48,000
Rs. 1,41,600

The total market exposure is Rs. 1,41,600. The market exposure provided by one future contract is :

300 × Rs. 25 = Rs. 7,500

Hedging the portfolio with futures would involve selling :

Rs. 1,41,600 / Rs. 7,500

= 18.88 contracts

Since futures contracts are indivisible, this would indicate 18 contracts.

(ii) Factors that could reduce hedge effectiveness include basis risk, the indivisibility of contracts, instability of beta and the presence of firm – or – sector – specific risk (i.e., non-systematic risk).

Answer 17. (b)

(i) Jensen Index :

Portfolio A :

= 18% – [7% + (15% – 7%) 2.0]

= 18% – [7% + (8%) 2.0]

= – 5%

Portfolio B :

= 12% – [7% + (15% – 7%) 1.5]

= 12% – [7% + 12%]

= –7%

(ii) Sharpe Index for market :

$$= \frac{15\% - 7\%}{6\%}$$

= 1.33%

(iii) Sharpe Index for portfolios :

Standard deviation of Portfolio A :

$$s_P = [b^2_P\, s^2_m + s^2_{ei}]^{1/2}$$

$$= [(2.0)^2(0.00036 + 0.03)]^{1/2}$$

$$= 34.98\%$$

Sharpe index for portfolio A :

$$= \frac{18\% - 7\%}{34.98\%} = 0.315$$

Standard deviation for Portfolio B :

$$s_P = [(1.5)^2(0.00036 + 0.00)]^{1/2}$$

$$= 9\%$$

Sharpe Index for Portfolio B :

$$= \frac{12\% - 7\%}{9\%} = 0.55$$

(iv) Treynor Index :

Portfolio A : $\frac{18\% - 7\%}{2.0} = 5.5$

Portfolio B : $\frac{12\% - 7\%}{1.5} = 3.33$

Q. 18. (a) "Investment is well grounded and carefully planned speculation".

In the light of the above statement, explain and differentiate between 'investment' and 'speculation'. How do they differ from 'gambling'?

(b) What are the differences between merchant banks and commercial banks?

(c) Write short note on – Secured Debenture.

Answer 18. (a)

Investment usually involves putting money into an asset which is not necessarily marketable in the short run in order to enjoy a series of returns the investment is expected to yield. On the other hand, speculation is usually a more short-run phenomenon. Speculators tend to buy assets with the expectation that a profit can be earned from a subsequent price change and sale. Accordingly, they buy marketable assets which they do not plan to own for very long.

Probably the best way to make a distinction between investment and speculation is by considering the role of expectations. Investments are usually made the expectation that a certain stream of income or a certain price which has existed will not change in the future. Speculation, on the other hand, are usually based on the expectation that some change will occur. An expected change is a basis for speculation but not for an investment.

A gamble is usually a very short-term investment in a game of chance. Speculation typically lasts longer than gambles but are briefer than investment. There is no precise dividing line with respect to the length of investment holding periods that could be used to separate gambles from speculations and speculations from investments. At its best, investment is well grounded and carefully planned speculation whereas it is an ostrich-like form of involuntary and unconscious speculation at its worst.

Answer 18. (b)

The differences between merchant banks and commercial banks are summarized below:

1. Commercial banks basically deal in debt related finance and their activities are appropriately arrayed around credit proposal, credit appraisal and loan sanctions. On the other hand, the area of activities of merchant bankers is "equity and equity related". They deal with mainly funds raised through money market and capital market.
2. Commercial banks are asset oriented and their lending decisions are based on detailed credit analysis of loan proposals and the value of security offered against loans. They generally avoid risks. The merchant bankers are management oriented. They are willing to accept risk of business.
3. Commercial bankers are merely financiers. The activities of merchant bankers include project counselling, corporate counselling in areas of capital restructuring, amalgamations, mergers, takeover etc, discounting and rediscounting of short term paper in money markets, managing, underwriting and supporting public issues in new issue market and acting as brokers and advisers on portfolio management in stocks exchange. Merchant banking activities have impact on growth, stability and liquidity of money markets.

Answer 18. (c)

When any particular or specified property of the company is offered as security to the debenture holders and when the company can deal with it only subject to the prior right of the debenture holders, fixed charge is said to have been created. On the other hand, when the debenture holders have a charge on the undertaking of the company i.e., on the whole of the property of the company, both present and future, and when it can deal with the property in the ordinary course of business until the charge crystallises i.e., when the company goes into liquidation or when a receiver is appointed, the charge is said to be a floating charge. When the floating charge crystallises, the debenture holders have a right to be paid out of the sale proceeds of the assets subject to the right of the preferential creditor but prior to making any payment to unsecured creditors.

Section II : Corporate Law & Corporate Governance

Q. 1. Choose the most appropriate one from the stated options and write it down (only indicate A,B,C,D as you think correct) :

(i) As per Section 205(1A) of the Companies Act, 1956 the amount of interim dividend shall have to be deposited from the date of declaration of such dividend in a separate bank account within

A. Three Days

B. Five Days

C. Seven Days

D. None of the above

(ii) According to section 63, where a prospectus contains an untrue statement, every person authorizing its issue shall be punishable with fine upto

A. Rs. 5,000

B. Rs. 20,000

C. Rs. 30,000

D. RS. 50,000

(iii) Shareholders are empowered to transfer their shares by

A. Section 82

B. Section 108

C. Section 77

D. Section 113

(iv) The Board may appoint additional directors only if it is authorized by

A. Memorandum of Association

B. Articles of Association

C. Company Law Board

D. Shareholders in the AGM

(v) An auditor other than the retiring one can be appointed by

A. Ordinary Resolution

B. Special Resolution

C. Resolution requiring special notice

D. Resolution by circulation

(vi) The minutes of the Board Meeting should be entered in the minutes book within

A. 30 days from the conclusion of the meeting

B. 30 days from the circulation thereof

C. 30 days from the signing of the same

D. 30 days from the date of the notice

(vii) A listed company is required to furnish to the Stock Exchange(s) unaudited financial results on a

A. Annual basis

B. Half-yearly basis

C. Quarterly basis

D. Monthly basis

(viii) Section 224(3) of the Act provides that where at an AGM no auditor (s) are appointed or re-appointed, the auditor can be appointed by

A. The Company Law Board

B. The Board of Directors

C. The State Government

D. The Central Government

(ix) A report by the accountants on the profits or losses of the business should be included in the Prospectus for the preceding

A. 5 financial years

B. 5 accounting years

C. 3 financial years

D. 3 accounting years

(x) Buy back of equity shares in a financial year shall not exceed

A. 25% of authorized capital

B. 25% of paid up capital

C. 25% of called-up capital

D. 25% of subscribed capital

Answer 1.

(i) B

(ii) D

(iii) A

(iv) B

(v) C

(vi) A

(vii) C

(viii) D

(ix) A

(x) B

Q. 2. State whether each of the following statements is True (T) or False (F).

(i) The shares of a private limited company are freely transferable.

(ii) Minimum number of members in case of private limited company is 5.

(iii) After a company has received Certificate of Incorporation it can start the process of raising capital.

(iv) It is essential to pass a special resolution to alter the articles of association of a company.

(v) Statutory report should be sent to members at least 14 days before the date of the meeting.

(vi) Buy back of equity shares in a financial year shall not exceed 30% of its total paid up equity capital in the financial year.

(vii) The amount payable on application of each share shall not be less than 5% of the nominal value of the share.

(viii) Reserve capital cannot be turned into uncalled capital without the sanction of the Court.

(ix) If within an hour from the time appointed for holding a meeting of the company, a quorum is not present, the meeting, if called upon the requisition of members, shall stand dissolved.

(x) Independent director can not be an executive of the company in the last five years.

Answer 2.

(i) **False** - The shares of a public limited company are freely transferable.

(ii) **False** - Minimum number of members in case of private limited company is 7.

(iii) **True** – The statement is true.

(iv) **True** - The statement is true.

(v) **False** - Statutory report should be sent to members at least 21 days before the date of the meeting.

(vi) **False** - Buy back of equity shares in a financial year shall not exceed 25% of its total paid up equity capital in the financial year.

(vii) **True** – The statement is true.

(viii) **True** – The statement is true.

(ix) **False** - If within half an hour from the time appointed for holding a meeting of the company, a quorum is not present, the meeting, if called upon the requisition of members, shall stand dissolved.

(x) **False** - Independent director can not be an executive of the company in the last three years.

Q. 3. (a) Can a limited liability company become a partner of a partnership firm?

(b) Can a company hold two AGMs on the same day?

(c) State the provision of restriction on employment of Chairperson and other Members under The Competition Act, 2002.

(d) Who can not be appointed as Cost Auditors? What are the additional disqualifications notified by ICWAI regarding cost auditor?

Answer 3. (a)

A company being a juristic person is capable of contracting in its own name. Since partnership, as per section 4 of the Partnership Act, 1932, is a contractual relationship between persons, there should be no objection to a partnership being created with or by a company. The only doubt that may arise is that the liability of a partner being unlimited, can a limited liability company become a partner? To this the simple reply shall be that it is the liability of the members of a limited company which is limited and not that of the company itself. Thus, there should be no objection to a limited company becoming a partner of a partnership firm. However, the Department of Company Affairs, in this regard has opined that the objects clause must contain a facilitating provision in this regard. Thus, in the opinion of the Department of Company Affairs, a company may become a partner only if the Memorandum of Association thereof specifically allows it.

Answer 3. (b)

There is no provision in the Companies Act prohibiting the holding of two AGMs on the same day. If the Articles do not contain any provision to the contrary, AGM for the current year as also for the previous year can be held on the same day. There should, however, be separate notices for each meeting and they should be held at different timings.

Answer 3. (c)

The Chairperson and other Members shall not, for a period of one year from the ' date on which they cease to hold office, accept any employment in, or connected with the management or administration of, any enterprise which has been a party to a proceeding before the Commission under this Act:

Provided that nothing contained in this section shall apply to any employment under the Central Government or a State Government or local authority or in any statutory authority or any corporation established by or under any Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956).

Answer 3. (d)

A person cannot be appointed as a cost auditor of a company if he attracts any of the disqualifications listed in sub-sections (3) and (4) of section 226 of the Act. Thus, the following cannot be appointed as cost auditors :

(i) A body corporate;

(ii) An officer or employee of the company;

(iii) A person who is a partner or who is in the employment of an officer or employee of the company;

(iv) A person who is indebted to the company for an amount exceeding Rs. 1,000 or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding Rs. 1,000;

(v) A person holding any vote carrying security of the company;

(vi) A person who is disqualified to be the cost auditor of its subsidiary or holding company or of another subsidiary of its holding company;

(vii) A person appointed under section 224 as an auditor of a company [Section 233B (5)(b)].

If a person appointed for conducting the audit of cost accounts of a company becomes subject, after his appointment to any of the aforesaid disqualifications, he shall on and from the date on which he becomes so subject, cease to conduct the audit of the cost accounts of the company [Section 233B(5)(c)].

Additional disqualification – In addition to the aforesaid disqualifications the Institute of Cost and Works Accountants of India has notified that any cost accountant who accepts an appointment as the cost auditor of a company in the following situations shall be deemed to be guilty of professional misconduct :

(i) If he is an employee of the company's auditor appointed under section 224;

(ii) If he is an employee of any of the partners of a firm of chartered accountants which is appointed as company's auditor under section 224.

Q. 4. (a) A shareholder living in Kolkata sent a transfer deed for registration of transfer of shares in a company having its registered office in Mumbai. The share certificates duly endorsed in his name were not received by him even after the expiry of four months from the date of lodgment. He lodged a criminal complaint before the appropriate court dealing with economic offences at Kolkata. Can the Court in Kolkata entertain the complaint?

(b) Annual general meeting of a public Ltd. company was scheduled to be held on 20-02-2010. Mr. Anil, a shareholder, issued two proxies in respect of the shares held by him in favour of Mr. Tarun

and Mr. Barun. The proxy in favour of Mr. Barun was lodged on 17-02-2010 and the one in favour of Mr. Tarun waqs lodged on 20-02-2010. The company rejected the proxy in favour of Mr. Barun as the proxy was dated 17-02-2010 and that in favour of Mr. Tarun was dated 20-02-2010. Is the rejection by the company in order?

(c) A company has 11 directors –

A and B	**-**	**Nominees of IFCI and ICICI respectively**
C, D, E	**-**	**Appointed as directors in June, 2008 (AGM)**
G and H	**-**	**Appointed as directors in June, 2009 (AGM)**
I	**-**	**Appointed as additional director in January, 2010**
J	**-**	**Appointed as director in place of F who died in January, 2010 (F was appointed in June, 2009)**
K	**-**	**Managing Director (appointed in June, 2009 for 5 years)**
L	**-**	**Additional director appointed in February, 2010.**

Advise the Board on the directors who are to vacate their office in the general meeting to be held in June, 2010.

Answer 4. (a)

According to section 113(1) of the Companies Act, 1956, every company, unless prohibited by any provision of law or any order of court, tribunal or other authority, shall within two months after the application for the registration of transfer of any such shares, deliver the certificates of all shares transferred. In the case of a listed company under the listing agreement this period has been reduced to 30 days.

The facts of the given case are similar to *H.V. Jaya Ram v. ICICI Ltd. 1998 (7) Scale 481*. In this case the special court for Economic Offences in the State of Karnataka rejected the appellant's complaint against the respondent company on the ground that since the company had its registered office at Mumbai it is only the court which has territorial jurisdiction over the registered office of the company that can entertain the petition and not the court located in the State of Karnataka where the shareholder is residing. The High Court also upheld the order of the Special Court. On appeal Supreme Court held the cause of action for failure to deliver share certificate arises where the registered office of the company is situated and not in the jurisdiction of the Court located in the place where the complainant resides.

Accordingly in the present case also, the court in Kolkata cannot entertain the complaint against a company having its registered office in Mumbai.

Answer 4. (b)

In case more than one proxies have been appointed by a member in respect of the same meeting, one which is later in time shall prevail and the earlier one shall be deemed to have been revoked. Thus, in the normal course, the proxy in favour of Mr. Tarun, being later in time, should be upheld as valid. But as per section 176, a proxy should be deposited 48 hours before the time of the meeting. In this case, the proxies should have, therefore, been deposited on or before 18-02-2010 (the date of the meeting being 20-02-2010). But Mr. Tarun deposited the proxy on 20-02-2010. Therefore, proxy in favour of Mr. Tarun has become invalid. Thus, rejecting the proxy in favour of Mr. Barun is unsustainable. Proxy in favour of Mr. Barun is valid since it is deposited in time (on 17-02-2010).

Answer 4. (c)

Section 255 of the Companies Act, 1956, provides that unless the Articles provide for retirement of all the directors at every general meeting, not less than two-thirds of the total number of directors of a public company, or of a private company which is a subsidiary of a public company, shall retire by rotation. In terms of section 256 of the Act, one-third of the directors liable to retire by rotation, shall retire at the Annual General Meeting of the Company. If the number of directors liable to retire by rotation is not three or a multiple of three, then the number nearest to one-third shall retire from the office of director.

In order to determine the directors who shall retire by rotation at every general meeting, it is provided that the persons who have been longest in office since their last appointment shall be liable to retire. As between the persons who became directors on the same day, the directors who shall retire may be determined by agreement among themselves. In the absence of any such agreement the persons liable to retire shall be chosen by lot.

Of the 11 directors mentioned in the question, A and B who are nominees of IFCI and ICICI, respectively, are non-rotational directors and are not liable to retire. 'K' being the Managing Director, is also not liable to retire. The position in regard to the remaining 8 directors is as under :

(i) 'I' & 'L' who were appointed as Additional Directors in January 2010 and February 2010, respectively, shall vacate office on the date of Annual General Meeting to be held in June 2010.

(ii) 'J' was appointed in place of 'F' who died and will, therefore, hold office till the date 'F' would have held office.

(iii) Of the 6 rotational directors, [viz. C,D,E,G,H and J] 2 directors who constitute one-third, and who have been longest in office are liable to vacate office. Accordingly, two amongst, 'C', 'D' and 'E' who were appointed in June 2008 AGM and have been longest in office, shall vacate office. Amongst themselves, either they can decide by mutual consent or by draw of lots.

Q. 5. (a) Can a general meeting properly convened be cancelled or its holding deferred?

(b) The Official Liquidator of a public company in liquidation instituted misfeasance proceedings against the Managing Director of the Company. During the pendency of the proceedings, the Managing Director passed away.

What is meant by misfeasance? Can the legal representatives of the Managing Director be impleaded and the proceedings continued against him?

(c) A petition (in English) is filed by the required number of members alleging oppression and mismanagement against a company and directors, accompanied by consent letters of some members in Hindi. Discuss whether the petition in maintainable.

(d) A, an employee of XYZ Ltd., was appointed as an alternate director. In the meantime, the original director returned and wanted to attend the board meeting. Advise.

Answer 5. (a)

The Act is silent on these issues. However, the Secretarial Standard (DD) – 4 issued by the ICSI contains a view on these. The Standard states that, if, for reasons beyond the control of the Board, a meeting cannot be held on the date originally fixed, the Board may defer the meeting. The meeting should be reconvened after giving not less than seven days fresh notice published in a newspaper having a wide circulation within such State/ States of India where more than one thousand members reside. This sufficiently implies that a meeting duly convened cannot be cancelled but can be deferred for overriding reasons. It may be preferable that the Board fixes a fresh date not far from the date originally fixed and issues to the members and others eligible to receive notice, a fresh notice for holding the meeting. This notice shall also accompany information that the originally fixed meeting had to be deferred for reason(s) beyond the control of the Board. A listed company should also inform SEBI about the deferment and the fresh date.

Answer 5. (b)

The facts of the case in question are similar to the case *Official Liquidator v. Parthasarthi Sinha* [1983] 53 Comp. Cas. 163 (SC), wherein it was held that misfeasance proceedings initiated under section 543, against a director of a company in winding-up can be continued on his death against his heirs and legal representatives for the purpose of determining and declaring the loss or damage caused to the company. The expression 'misfeasance' means grave breach of duty or abuse of power usually associated with taking undue benefit or advantage at the cost of the company. However, any decision to recover money for the act of misfeasance will remain restricted to the value of the properties of the Managing Director in the hands of the legal representatives.

Answer 5. (c)

CLB in *Gian Gupta v. Siel Ltd.* [2004] 56 SCL 560 has held that a petition written in English for which consent support signature of some of the consent givers was in Hindi, is not maintainable as the consents of those who signed in Hindi have to be ignored as it is to be presumed that they did not understand the writings in the Petition. When signatures in Hindi are ignored the number of petitioners along with consent givers fell below 100 and the aggregate shareholding also did not reach 10% of the subscribed share capital.

Answer 5. (d)

In terms of section 313 of the Act, an alternate director can act on behalf of the original director during the latter's absence for a period of not less than three months from the State in which the meetings of the company are held. But, in any case he has to vacate office when the original director returns to the State in which the Board meetings are held.

Accordingly, in the present case if the original director returned to the State in which the meetings of the company are held, Mr. A, who was appointed as alternate director has to vacate his office.

Q. 6. (a) Can shares be held in the name of a trade union?

(b) What is the distinction between transfer and transmission of shares?

(c) A company induced the prospective investors to subscribe by publishing the promise of subscription of a substantial amount by some renowned persons in its prospectus. One applicant who was allotted 100 shares alleged material misrepresentation. Advise.

(d) In the context of Court rulings in the matter of merger, answer the following:

(i) Whether exchange ratio approved by shareholders of merging companies can be questioned by a small group of dissenting shareholders?

(ii) Whether transferor company is justified in excluding assets held on lease and licence arrangement, from those transferred to the transferee company?

Answer 6. (a)

In *All India Bank Officers' Confederation v. The Dhanalakshmi Bank Ltd.* (decided on 3-4-1997), the CLB held that a registered trade union is a body corporate and, thus, can sue and be sued and enter into contracts in its own name.

CLB further observed that section 14 of the Trade Unions Act which prohibits trade unions from spending money for objects other than what were stated in the section had no relevance in this case because investment in shares would not be an expenditure but was only an investment. Section 14 dealt only with expenditure of a revenue nature and not investments or expenditure of a capital nature. Under section 13, a trade union had power to acquire and hold both movable and immovable properties.

Answer 6. (b)

The points of difference between transfer and transmission of shares are as follows :

(i) Transfer takes place by a voluntary and deliberate act of the transferor, while transmission is the result of operation of law.

(ii) In case of transfer, the transferor and the transferee have to execute an instrument of transfer, while the shares are transmitted on the death, insolvency of a member, any instrument of transfer is not required; only a proof of his title to the share is required.

(iii) Transfer is the normal method of transferring property in the shares, whereas transmission of shares takes place only on death or insolvency of a shareholder.

Answer 6. (c)

The Companies Act charges the company as well as every officer who may be guilty of inducing the members of the public to subscribe for its shares or debentures by including material misrepresentations as to a matter of fact. In such cases not only the party defrauded shall have a right to return the shares and claim his money back but damages can also be claimed. Besides these civil remedies, section 63 imposes criminal liability on every person who authorizes the issue of such a prospectus. Liability under this section may be imprisonment up to 2 years or fine up to Rs. 5,000 or both. Further, section 68 imposes a penalty on every person responsible for inducing public to subscribe for the shares or debentures of a company by making false statement. Under section 68, the liability may be punishment with imprisonment for a term up to 5 years or with fine up to Rs. 10,000 or with both.

Answer 6. (d)

(i) No; *Hindustan Lever Employees' Union v. Hindustan Lever Ltd. [1994]* 4 Comp. LJ 228 (Bom.), the Bombay High Court held that where the exchange ratio has been approved by an overwhelming majority of shareholders and there is no basis to doubt their judgment and the valuation having been also confirmed to be fair by the firm of auditors, the objections of the same cannot be sustained.

(ii) Yes; the Supreme Court in *Hindustan Lever Employees' Union v. Hindustan Lever Ltd. [1995]* 83 Comp. Cas. 30 held that the leasehold assets and properties held by a company were neither transferable nor heritable; they are in the nature of a personal privilege. Accordingly, the transferor – company was justified in excluding them.

Q. 7. (a) 'As per Section 31, a company may, by special resolution alter or add to its articles.' Discuss the limits upon the powers of a company to alter or add to the articles of association.

(b) Though six, out of the seven signatures to the Memorandum of Association were forged, the company was registered and the Certificate of Incorporation issued. Can the registration of the company be challenged subsequently on the ground of forged signature?

(c) Whether a company can appoint an alternate director in place of a managing director? Give reasons.

Answer 7. (a)

In spite of the power to alter its articles, a company can exercise this power subject only to certain limitations. These are :

(i) The alteration must not exceed the powers given by the memorandum or be in conflict with any provisions of the memorandum.

(ii) The alteration must not be inconsistent with any provisions of the Companies Act or any other statute.

(iii) The altered articles must not include anything which is illegal or opposed to public policy or unlawful.

(iv) The alteration must be bona fide for the benefit of the company as a whole.

(v) The alteration must not constitute a fraud on the minority by a majority.

(vi) There cannot be alteration of the articles so as to compel an existing member to take or subscribe for more shares or in any way increase his liability to contribute to the share capital, unless he gives his consent in writing.

(vii) A company cannot justify breach of contract with third parties or avoid a contractual liability by altering articles.

(viii) An alteration of articles to effect a conversion of a public company into a private company cannot be made without the approval of the Central Government.

(ix) The amended regulation in the articles of association cannot operate retrospectively, but only from the date of amendment.

Answer 7. (b)

According to section 35 of the Act, the certificate of incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorized to be registered and duly registered under the Act. Accordingly, if memorandum is found to be materially altered after signature but before registration, or is signed by only one person for all the seven subscribers or the signatories be all infants, the certificate would be nevertheless conclusive and would not affect the status and existence of the company as a legal person although such irregularities might give rise to claims between the subscribers.

So, in the present case, registration cannot be challenged on the ground of forged signature.

Answer 7. (c)

In the first instance, a company does not appoint al alternate director. It is the Board of directors of a company, which has the power to appoint an alternate director.

Section 313 of the Companies Act, 1956 provides that the Board of directors of a company may, if so authorized by its Articles or by a resolution passed by the company in general meeting, appoint an alternate director to act for a director (hereinafter called the original director) during his absence for a period of not less than three months from the State in which meetings of the Board are ordinarily held.

An alternate director is like any other director. In respect of compliance with the provisions of the Act, he is in the same position as any other director with respect to his rights, duties and liabilities as a director. Taking this statutory position of an alternate director into consideration, an alternate director may be appointed in place of a managing director.

However, another view has also been expressed according to which an alternate director shall not be appointed in place of a managing director, because the appointment of a managing director is a contractual appointment and is very much related to his qualifications, experience, specialized knowledge and expertise relating to the principal business of the company for which he has been so appointed. However, during his absence, the Board may appoint a committee of directors to lookafter the day-to-day business and affairs of the company.

Q. 8. (a) Write short notes on :

i. Investor Education and Protection Fund

ii. Audit Committee

(b) What is directors' responsibility statement? State its contents.

Answer 8. (a)

(i) **Investor Education and Protection Fund (IEPF)** is for promotion of investors' awareness and protection of the interests of investors. There shall be credited to the Fund the following amounts, namely:-

(i) Amounts in the unpaid dividend accounts of companies;

(ii) The application moneys received by companies for allotment of any securities and due for refund;

(iii) Matured deposits with companies;

(iv) Matured debentures with companies;

(v) The interest accrued on the amounts referred in clause (i) to (iv);

(vi) Grants and donations given to the Fund by the Central Government, State Governments, companies or any other institutions for the purposes of the Fund; and

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

The Fund shall be utilized for promotion of investors' awareness and protection of the interests of investors in accordance with such rules as may be prescribed.

The Central Government shall, by notification in the Official Gazette, specify an authority or committee, with such members as the Central Government may appoint, to administer the Fund, and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed in consultation with the Comptroller and Auditor-General of India.

It shall be competent for the authority or Committee appointed under sub-section (4) to spend moneys out of the Fund for carrying out the objects for which the Fund has been established.

(ii) An **audit committee** is an operating committee of the ***Board of Directors*** charged with oversight of financial reporting and disclosure. Section 292A of the Act requires every public company having paid-up capital of not less than rupees five crores to constitute an audit committee as a committee of the Board of Directors. This Committee shall consist of such number of directors as its members, as may be determined by the Board. However, the number shall not be less than three. Audit committees are typically empowered to acquire the consulting resources and expertise deemed necessary to perform their responsibilities. The role of audit committees continues to evolve as a result of the passage of the ***Sarbanes-Oxley Act*** of 2002. Many audit committees also have oversight of regulatory compliance and ***risk management*** activities. ***Not for profit*** entities may also have an audit committee.

Responsibilities of the audit committee typically include:

- Overseeing the financial reporting and disclosure process.
- Monitoring choice of accounting policies and principles.
- Overseeing hiring, performance and independence of the external auditors.
- Oversight of regulatory compliance, ethics, and whistleblower hotlines.
- Monitoring the internal control process.
- Overseeing the performance of the internal audit function.
- Discussing risk management policies and practices with management.

Answer 8. (b)

Companies (Amendment) Act, 2000 has introduced sub-section (2AA) in section 217 of the Act, requiring inclusion of "Directors' Responsibility Statement" in the Boards' Report. This requirement is a result of thoughts given on "Corporate Governance", a matter engaging the attention of Regulators, company management and persons having stakes in the company. This statement shall indicate that –

(i) In the preparation of the annual accounts, the applicable accounting standards had been followed, (if applicable accounting standards had not been followed, proper explanation relating to material departures should be given.)

(ii) The directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period.

(iii) The directors have taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provision of the Companies Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

Q. 9. (a) What do you understand by the expression 'corporate governance'?

(b) State the applicability of the revised clause 49 of the listing agreement.

(c) Why an auditor must consider the going concern status of an entity while preparing the audit report? How it is connected with risk management?

(d) State the provision of the Power of Central Government to supersede Commission in respect of the Competition Act, 2000.

Answer 9. (a)

The Cadbury Committee Report (1991) defines corporate governance as "a system by which the corporates are directed and controlled."

Corporate governance means the idea of ensuring proper management of companies through the institutions and mechanisms available to the shareholder. According to Kumarmangalam Birla, the principal objective of good corporate governance is to enhance shareholder value.

A system of good corporate governance focuses on the relationship of accountability between the principal factors of sound financial reporting – the Board, the Management and the Auditor. It holds the management accountable to the board, and the board accountable to the shareholders, and in the process, audit acts as a catalyst for effective financial reporting.

Good corporate governance should ensure :

(i) Clear responsibility and functional authorities,

(ii) Precise distinction between direction and management, and

(iii) Total transparency in respect of all actions of management.

Answer 9. (b)

The revised clause 49 is applicable to the listed companies. However, for other listed entities, which are not companies, but body corporates (e.g. private and public sector banks, financial institutions, insurance companies etc.) incorporated under other statutes, the revised clause will apply to the extent that it does not violate their respective statutes, and guidelines or directives issued by the relevant regulatory authorities. The revised clause is not applicable to the Mutual Fund Schemes.

Answer 9. (c)

Financial statements are prepared on the assumption that the entity is a going concern, meaning it will continue in operation for the foreseeable future and will be able to realize assets and discharge liabilities in the normal course of operations. Different bases of measurement may be appropriate when the entity is not expected to continue in operation for the foreseeable future. Where a company is not a going concern, the break-up basis is used where all assets and liabilities are stated at Net Realizable Value.

The company's auditor must consider whether the use of the going concern assumption is appropriate, and whether there are material uncertainties about the entity's ability to continue to operate as a going concern that need to be disclosed in the financial statements. An auditor who concludes that substantial doubt exists with regard to the appropriateness of the going concern assumption is required to issue an opinion reflecting this; a modified opinion if the company has appropriately disclosed the doubt and risks; and a qualified opinion if the company has not made appropriate disclosures. These are called "going concern" opinions (such opinions are issued because the company is NOT expected to remain a going concern).

If a public company reports that its auditors have doubts about its ability to continue as a going concern, investors may take that as a sign of increased risk, although an emphasis of matter paragraph in an audit report does not necessarily indicate that a company is on the verge of insolvency. Despite this, some fund managers may be required to sell the stock to maintain an appropriate level of risk in their portfolios. A negative judgment may also result in the breach of bank loan covenants or lead a debt rating firm to lower the rating on the company's debt, making the cost of existing debt increase and/or preventing the company from obtaining additional debt financing.

Answer 9. (d)

Power of Central Government to supersede Commission. — (1) If at any time the Central Government is of the opinion- (a) that on account of circumstances beyond the control of the Commission, it is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or (b) that the Commission has persistently made default in complying with any direction given by the Central Government under this Act or in the discharge of the functions or performance of the duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Commission or the administration of the Commission has suffered; or (c) that circumstances exist which render it necessary in the public interest so to do, the Central Government may, by notification and for reasons to be specified therein, supersede the Commission for such period, not exceeding six months, as may be specified in the notification: Provided that before issuing any such notification, the Central Government shall give a reasonable opportunity to the Commission to make representations against the proposed supersession and shall consider representations, if any, of the Commission.

Q. 10. (a) Define the term ' independent director'.

(b) As per AS 18 who are not deemed to be related party?

(c) What is Project Governance ? What are the benefits of Project Governance?

Answer 10. (a)

The expression 'independent director' mean non-executive director of the company who —

(a) apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;

(b) is not related to promoters or management at the board level or at one level below the board;

(c) has not been an executive of the company in the immediately preceding three financial years;

(d) is not a partner or an executive of the statutory audit firm or the internal audit firm that is associated with the company, and has not been a partner or an executive of any such firm for the last three years. This will also apply to legal firm(s) and consulting firm(s) that have a material association with the entity.

(e) is not a supplier, service provider or customer of the company. This should include lessor-lessee type relationships also; and

(f) is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

It has been clarified that the Institutional Directors on the boards of companies are independent directors whether the institution is an investing institution or a lending institution.

Answer 10. (b)

As per As 18, the following are deemed not to be related parties :

(a) two companies simply because they have a director in common, notwithstanding paragraph 3(d) or (e) above (unless the director is able to affect the policies of both companies in their mutual dealings);

(b) a single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence; and

(c) the parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings (although they may circumscribe the freedom of action of the enterprise or participate in its decision-making process):

(i) providers of finance;
(ii) trade unions;
(iii) public utilities;
(iv) government departments and government agencies including government sponsored bodies.

Answer 10. (c)

Project Governance extends the principle of Governance into both the management of individual projects via Governance structures, and the management of projects at the business level, for example via Business Reviews of Projects. Today, many organisations are developing models for 'Project Governance Structures', which can be different to a traditional Organisation Structure in that it defines accountabilities and responsibilities for strategic decision-making across the project. This can be particularly useful to project management processes such as change control and strategic (project) decision-making. When implemented well, it can have a significantly positive effect on the quality and speed of decision making on significant issues on projects.

Benefits of Project governance

Project governance will :

1) Outline the relationships between all internal and external groups involved in the project.
2) Describe the proper flow of information regarding the project to all stakeholders.
3) Ensure the appropriate review of issues encountered within each project.
4) Ensure that required approvals and direction for the project is obtained at each appropriate stage of the project.

Q. 11. (a) What is the role of SEBI in promoting Corporate Governance?

(b) In respect of The Right to Information Act, give the definition of the following :

i. Competent Authority

ii. Appropriate Government

(c) What is Cash Reserve Ratio?

Answer 11. (a)

Good Governance in capital market has always been high on the agenda of SEBI. This is evident from the continuous updation of guidelines, rules and regulations by SEBI for ensuring transparency and accountability. In the process, SEBI had constituted a Committee on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla.

Based on the recommendations of the Committee, the SEBI had specified principles of Corporate Governance and introduced a new clause 49 in the Listing agreement of the Stock Exchanges in the year 2000. These principles of Corporate Governance were made applicable in a phased manner and all the listed companies with the paid up capital of Rs 3 crores and above or net worth of Rs 25 crores or more at any time in the history of the company, were covered as of March 31, 2003.

SEBI, as part of its endeavour to improve the standards of corporate governance in line with the needs of a dynamic market, constituted another Committee on Corporate Governance under the Chairmanship of Shri N. R. Narayana Murthy to review the performance of Corporate Governance and to determine the role of companies in responding to rumour and other price sensitive information circulating in the market in order to enhance the transparency and integrity of the market.

With a view to promote and raise the standards of Corporate Governance, SEBI on the basis of recommendations of the Committee and public comments received on the report and in exercise of powers conferred by Section 11(1) of the Securities and Exchange Board of India Act, 1992 read with section 10 of the Securities Contracts (Regulation) Act 1956, revised the existing clause 49 of the Listing agreement vide its circular SEBI/MRD/SE/31/2003/26/08 dated August 26, 2003. It clarified that some of the sub-clauses of the revised clause 49 shall be suitably modified or new clauses shall be added following the amendments to the Companies Act 1956 by the Companies (Amendment) Bill/Act 2003, so that the relevant provisions of the clauses on Corporate Governance in the Listing Agreement and the Companies Act remain harmonious with one another.

Answer 11. (b)

(i) "Competent Authority" means—

(i) the Speaker in the case of the House of the People or the Legislative Assembly of a State or a Union territory having such Assembly and the Chairman in the case of the Council of States or Legislative Council of a State;

(ii) the Chief Justice of India in the case of the Supreme Court;

(iii) the Chief Justice of the High Court in the case of a High Court;

(iv) the President or the Governor, as the case may be, in the case of other authorities established or constituted by or under the Constitution;

(v) the administrator appointed under article 239 of the Constitution

(ii) "Appropriate Government" means in relation to a public authority which is established, constituted, owned, controlled or substantially financed by funds provided directly or indirectly

(i) by the Central Government or the Union territory administration, the Central Government;

(ii) by the State Government, the State Government.

Answer 11. (c)

Banks are required to keep a fraction of their deposit liabilities in the form of liquid cash with the central bank for ensuring safety and liquidity of deposits. The Cash Reserve Ratio (CRR) refers to this liquid cash that banks have to maintain with the Reserve Bank of India (RBI) as a certain percentage of their demand and time liabilities. For example if the CRR is 10% then a bank with net demand and time deposits of Rs 1,00,000 will have to deposit Rs 10,000 with the RBI as liquid cash.

Q. 12. (a) What is Risk Management? What are the steps of Risk Management?

(b) When a single person can constitute quorum for general meeting?

(c) What are the disclosure requirements in case of related party transactions?

Answer 12. (a)

Risk Management is the name given to a logical and systematic method of identifying, analysing, treating and monitoring the risks involved in any activity or process. Risk Management is a methodology that helps managers make best use of their available resources. Risk Management practices are widely used in public and the private sectors, covering a wide range of activities or operations.

These include :

- Finance and Investment
- Insurance
- Health Care
- Public Institutions
- Governments

Risk Management is now an integral part of business planning.

The steps of Risk Management are :

(i) Establish the context
(ii) Identify the risks
(iii) Analyse the risks
(iv) Evaluate the risks
(v) Treat the risks

Risk' is dynamic and subject to constant change, so the process includes continuing

Monitoring and review and Communication & consultation

Answer 12. (b)

Normally, one person cannot validly constitute a meeting even if he holds proxies for all members. However, in the following circumstances, one person shall form the quorum for a general meeting :

(i) In case a 'class meeting' (i.e. a meeting of a class of shareholders) if all the shares of a particular class are held by one person.
(ii) If there is only one creditor or debenture holder, he shall constitute quorum for the creditors'/ debentureholders' meeting.
(iii) Company Law Board (now Central Government/ Tribunal) may issue directions under section 167 (AGM) or section 186 (EGM) that one member, present in person or by proxy shall constitute quorum.

Answer 12. (c)

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following :

(i) the name of the transacting related party;
(ii) a description of the relationship between the parties;
(iii) a description of the nature of transactions;
(iv) volume of the transactions either as an amount or as an appropriate proportion;
(v) any other elements of the related party transactions necessary for an understanding of the financial statements;
(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and
(vii) amounts written off or written back in the period in respect of debts due from or to related parties.