PRIME ACADEMY

25^{TH} SESSION MODEL EXAM

FINAL

Total No. of Questions : 6 **Total No. of Printed Pages: 5**
Time Allowed : 3 Hours **Maximum Marks : 100**

AA

Answer all Questions

1. X Ltd. purchases its raw materials from Y Ltd. and sells goods to Z Ltd. in order to ensure regular supply of raw materials and patronage for finished goods. X Ltd. through its wholly owned subsidiary, X Investment Ltd. acquired on 31st December 1996, 51% of equity capital of Y Ltd for Rs. 15 crores and 76% of equity capital of Z Ltd. for Rs.30 crores. X Investments Ltd. was floated by X Ltd. in 1990 from which date, it was wholly owned by X Ltd.

The following are the balance sheets of the four companies as on 31st December, 1996:

(Rs. in Crores)

	X Ltd.		*X Investment Ltd.*		*Y Ltd.*		*Z Ltd.*	
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Share capital :								
Equity (fully paid) Rs. 10 each	25		5		10		15	
Reserves and surplus	75	100	20	25	15	25	20	35
Loan funds :								
Secured	15		-		5		20	
Unsecured	10	25	50	50	10	15	15	35
Total sources		***125***		***75***		***40***		***70***

	X Ltd.		*X Investment Ltd.*		*Y Ltd.*		*Z Ltd.*	
	Rs.	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Fixed assets:								
Cost	60		-		15		30	
Less: Depreciation	35	25	-	-	7	8	17	13
Investments at cost in fully paid								
Equity shares of :								
X investments Ltd.		5		-		-		-
Y Ltd.		-		15		-		-
Z Ltd.		-		30		-		-
Other companies		-		29		-		-
(Market Value Rs. 116 Cr.)								
Net Current assets :								
Current assets	105		1		96		200	
Less : Current liabilities	(10)	95	-	1	64	32	143	57
Total Application		***125***		***75***		***40***		***70***

There are no inter company transactions outstanding between the companies.
You are asked to prepare Consolidated Balance sheet as at 31st December, 1996 in vertical form.

[16 Marks]

2. The following is the balance sheet of Moon and Co. Ltd. as on 31st March, 2004:-

Liabilities	*Rs.*	*Assets*	*Rs.*
Share capital		Fixed assets	
Equity shares of Rs.100 each	10,00,000	Machinery	6,00,000
Less : Calls in arrear		Factory shed	6,50,000
(Rs. 20 for final call)	1,00,000	Vehicles	2,00,000
	9,00,000	Furniture	50,000
Reserve and surplus		Current assets	
General reserve	3,00,000	Stock	3,50,000
Profit and loss account	4,00,000	Debtors	6,70,000
Current liabilities		Bank	50,000
Bank overdraft	3,00,000	Miscellaneous expenditure	
Creditors	7,00,000	to the extent not written off:	
		Preliminary expenses	30,000
	26,00,000		***26,00,000***

The following additional information is furnished.

i. Machinery and factory shed are worth 30% above their book value. Depreciation on appreciated value of machinery and factory shed is not to be considered for valuation of goodwill and share.

ii. For the purpose of valuation of shares, goodwill is to be considered on the basis of 4 years purchase of super profits based on average profit (after tax) of the last 3 years.

	Rs.
For the year ended 31.3.2002	3,60,000
For the year ended 31.3.2003	4,70,000
For the year ended 31.3.2004	3,70,000

In a similar business, return on capital employed is 15% (after tax).

iii. In the year ended 31.3.2002, new addition to factory shed costing Rs. 20,000 charged to profit and loss account. Depreciation charged on factory shed is @ 10% on reducing balance method.

Find out the value of each fully paid and partly paid equity share on net assets basis.

Income tax 50%. Show your workings.

[16 Marks]

3. The following are the summarised balance sheets of three undertakings as on December 31st, 2003.

Particulars	*P Ltd.* *Rs.*	*T Ltd.* *Rs.*	*K and R.* *Rs.*
Freehold premises at cost	5,00,000	1,80,000	1,20,000
Other fixed assets at cost less depreciation	15,80,000	3,70,000	2,00,000
Stock in trade	13,50,000	1,80,000	1,10,000
Sundry debtors	12,30,000	4,30,000	2,10,000
Cash at Bank	2,10,000	1,20,000	55,000
	48,70,000	***12,80,000***	***6,95,000***

Equity Shares of Rs. 10 each	30,00,000	5,00,000	
Capital : K Ltd.			3,05,000
R Ltd.			1,10,000
Reserves	12,20,000	2,60,000	
Creditors	6,50,000	5,20,000	2,80,000
	48,70,000	***12,80,000***	***6,95,000***

It was decided that on Dec. 31,2003 P Ltd. would acquire the whole of the share capital of T Ltd. and the goodwill, fixed assets and stocks of K and R, the purchase consideration in both cases being discharged by the issue of equity shares in P Ltd., valued at Rs. 12.50 per share. The terms agreed upon were the following:

1. The fixed assets were to be taken at the value placed on them by an independent valuer.

2. The stocks of K and R were to be reduced by Rs. 10,000 because of obsolete items. Stocks of T Ltd. were to be taken at their book value.

3. In the case of T Ltd., debtors and creditors to be taken at book value less Rs. 30,000 for debtor and Rs. 15,000 for creditor.

4. Goodwill was to be valued at two years' purchase of the average profits of the last three years subject only to the following adjustments.

In the case of T Ltd.

i. The director's remuneration charged in each year was to be reduced by Rs. 25,000; and

ii. The depreciation charged in each year on other fixed assets was to be substituted with depreciation on those assets calculated at 10% of cost on straight line basis.

In the case of K and R :

i. Notional salaries of Rs. 50,000 p.a. in total, were to be charged for the partners; and

ii. Rs. 20,000 being exceptional items of expense was to be added back to the profits in 2002.

Other Information:

	Particulars	***P Ltd.*** ***Rs.***	***T Ltd.*** ***Rs.***	***K and R*** ***Rs.***
i.	Depreciation on other fixed assets till date	6,20,000	2,50,000	1,00,000
ii.	Independent valuation as on 31st Dec.2003;			
	Freehold premises		6,00,000	2,50,000
	Other Fixed assets		3,30,000	2,10,000
iii.	Profits for the last three years;			
	2001		90,000	90,000
	2002		1,21,000	65,000
	2003		1,31,060	95,000

Depreciation charged on other fixed assets of T Ltd. was Rs. 54,500 in 2001, Rs. 44,580 in 2002 and Rs. 45,360 in 2003.

iv. Particulars of other fixed assets at 31st Dec. 2003 at cost were:

Before 31st December 2001	6,00,000
Purchase on 1st January 2002	1,10,000
Disposed off on 1st January 2003 (acquired on 1 January 1991)	80,000

You are required to prepare:

i. a statement showing the shares to be issued for the acquisition; and

ii. the balance sheet of P Ltd. as on January 1, 2004.

Ignore taxation.

[16 Marks]

4. a. Calculate economic value added (EVA) with the help of the following information of Hypothetical Limited :

Financial leverage	:	1.4 times	
Capital Structure	:	Equity Capital	Rs. 170 lakhs
		Reserves and Surplus	Rs. 130 lakhs
		10% Debentures	Rs. 400 lakhs
Cost of Equity	:	17.5%	
Income Tax Rate	:	30%	

(8 Marks)

4. b. The following is an extract of the Profit and loss account of Better and Best Ltd. for the year ended 31st March, 2004.

Particulars	***Rs. in 000's***
Sales (including excise duty recoveries)	727
Other income	13
	740
Materials	530
Excise duty	62
Salaries, wages and employee benefits	19
Other expenses	47
Interest and finance charges	7
Depreciation	5
Provision for taxation	31
Preliminary expenses written off	5
Transfer to debenture redemption reserve	5
Proposed dividend	5
Transfer to General reserve	24
	740

Notes :

1. Other expenses include fees and commissions to whole-time directors of Rs.9,000 and loss on sale of fixed assets of Rs.3,000.
2. Interest and finance charges include interest on long term loans of Rs.4,000, balance being on short-term borrowings.

You are required to prepare a Value Added Statement for the year ended 31st March 2004.

(12 Marks)

5. a) X. Co. Ltd. supplied the following information. You are required to compute the basic earning per share.

(Accounting year 1.1.2002 - 31.12.2002)

Net Profit	:	Year 2002	:	Rs. 20,00,000
	:	Year 2003	:	Rs. 30,00,000

No. of shares outstanding prior to Right Issue	:	10,00,000 shares.
Right Issue	:	One new share for each four outstanding i.e., 2,50,000 shares. Right Issue Price - Rs. 20 Last date of exercise rights - 31.3.2003.
Fair rate of one Equity share Immediately prior to exercise right on 31.3.03	:	Rs. 25

(4 Marks)

b) While preparing its final accounts for the year ended 31st March 2003, a company made a provision for the bad debts @ 5% of its total Debtors. In the last week of February 2003 a debtor for Rs. 2 Lakhs had suffered heavy loss due to a earthquake; the loss was not covered by any insurance policy. In April 2003, the debtor became bankrupt. Can the company provide for the full loss arising out insolvency of the debtor in the final accounts for the year ended 31st March 2003?

(4 Marks)

c) i) During the year 2001-02, a medium size manufacturing company, wrote down its inventories to net realisable value by Rs.5 lacs. Is a separate disclosing necessary?

(4 Marks)

ii) A limited company has been including interest in the valuation of closing stock. In 2001-2002, the management of the company decided to follow AS 2, and accordingly, interest has been excluded from the valuation of closing stock. This has resulted in a decrease in profit by Rs.3 lacs. Advise. Draft the disclosure statement.

(4 Marks)

iii) A company signed an agreement with employees union on 1-9-2001 for revision of wages with retrospective from 30-9-2000. This would cost the company an additional liability of Rs. 5 lacs per annum. Is a disclosure necessary for the amount paid in 2001-02?

(4 Marks)

6. Write Short note on

a.	Human Resources accounting	(4 Marks)
b.	Jaggi and Lan model on valuation on group basis of Human Resources?	(4 Marks)
c.	Corporate Social reporting	(4 Marks)

PRIME ACADEMY
25^{TH} SESSION MODEL EXAM
SUGGESTED ANSWERS

FINAL

ADVANCED ACCOUNTING

:

Consolidated Balance sheet of 'X' Ltd and its subsidiaries
'X' investment Ltd, 'Y' Ltd and 'Z' Ltd for the year ended as 31.12.96.

(in crores)

	Particulars		Amount Rs.	Amount Rs.
A.	*Sources of funds :*			
	a. Shareholders funds:-			
	i. Share capital		25.00	
	ii. Reserves and Surplus			
	X Ltd	75		
	X investments	20	95.00	1,20.00
	b. Minority interest			
	i. X investments		Nil	
	ii. Y Ltd		12.25	
	iii. Z Ltd		8.40	20.65
	c. Loan funds:-			
	i Secured loans		40.00	
	ii. Unsecured loans		85.00	125.00
	d. Total			***265.65***
B.	*Application of funds*			
	a. Goodwill (WN # 5)			5.65
	On Y Ltd			
	On Z Ltd			
	b. Fixed assets			
	Gross Block		105	
	Less : Depreciation		(59)	46.00
	c. Investments (outside)			29.00
	d. Net current assets :			
	i. Current assets		402.00	
	ii. Less : Current liabilities		(217.00)	185.00
C.	***Total***			***265.65***

WORKING NOTES :

Part I : Preparation of consolidated Balance sheet of "X investment Ltd".

WN # 1 : Date of acquisition -

i. in Y Ltd. - 31st Dec. 1996

ii. in Z Ltd. - 31st Dec. 1996

WN # 2 : ***Shareholding pattern:***

	Particulars	*No. of shares*	*% of holding*
a.	'X' Investments Ltd		
	i. 'X' Ltd	50,00,000	100
	ii. Minority interest	Nil	Nil
b.	'Y' Ltd:-		
	i. 'X' investments Ltd	5,10,000	51
	ii. Minority interest	4,90,000	49
c.	'Z' Ltd:-		
	i. 'X' investments Ltd	11,40,000	76
	ii. Minority interest	3,60,000	24

WN # 3 : Analysis and Apportionment of profits :

A. Y Ltd :

i. Reserves and surplus

Rs. 15 Crores

Rs. 7.65 crores
'X' investments Ltd (51%)
→ CP

Rs. 7.35 crores
Minority (49%)
→ Transfer to minority interest

B. Z Ltd.

i. Reserves :

Closing balance - Rs. 20 Crores

'X' investment Ltd.
(76%)
Rs.15.2 crores

Minority interest
(24%)
Rs. 4.8 crores

CP		Transfer to Minority interest

WN # 4 : Calculation of Minority interest

(in Crores)

	Particulars	*Y Ltd Rs. (49%)*	*Z Ltd Rs. (24%)*
a.	Share capital	4.90	3.60
b.	Capital profit	7.35	4.80
c.	Revenue Profit	-	-
d.	***Total***	***12.25***	***8.40***

WN # 5 : Calculation of Cost of control

(Rs. in Crores)

	Particulars	*'X' Investment Ltd.*	
		in Y Ltd	**in Z Ltd**
a.	Cost of investment		
	i. Amount invested	15.00	30.00
	ii. Less : Pre-acquisition dividend	Nil	Nil
	iii. Adjusted cost of investment	15.00	30.00
b.	Share of net assets as on date of acquisition represented by :		
	i. Paid up share capital	5.10	11.40
	ii. Capital profit (WN # 3)	7.65	15.20
		12.75	***26.60***
c.	Goodwill (a - b)	***2.25***	***3.40***
d.	***Combined goodwill for CBS***	***5.65***	

WN # 6 : Reserves for Consolidated Balance sheet

	Particulars	*Rs. in crores*
a.	Balance in 'X' investment Ltd	20.00
b.	Share of profit from 'Y' Ltd	Nil
c.	Share of profit from 'Z' Ltd	Nil
d.	***Total***	***20.00***

Consolidated balance sheet of 'X' Investments Ltd and its subsidiary 'Y' Ltd and 'Z' Ltd for the year ended on 31.12.1996.

(Rs. in crores)

	Particulars	*Rs.*	*Rs.*
A.	**Sources of Funds :**		
	a. Shareholder's fund		
	i. Capital	5.00	

ii. Reserves and surplus (WN # 6)	20.00	25.00
b. Loan funds		
i. Secured loans	25.00	
ii. Unsecured loans	75.00	100.00
c. Minority interest		
i. 'Y' Ltd (WN # 4)	12.25	
ii. 'Z' Ltd (WN # 4)	8.40	20.65
d. Total		***145.65***

	Particulars	*Rs.*	*Rs.*
B.	**Application of Funds :**		
	a. Fixed assets		
	i Goodwill (WN # 5)		5.65
	ii. Others		
	• Gross block	45.00	
	• Less : Depreciation	(24.00)	21.00
	b. Investments at cost (Market value Rs. 116 Crores)		29.00
	c. Current assets	297.00	
	Less : Current liabilities	(207.00)	
	Net current assets		90.00
	d. Total		***145.65***

Part II :- Consolidation of 'X' Ltd. and its subsidiaries 'X' Investments Ltd. 'Y' Ltd and 'Z Ltd.'

WN # 7 : Analysis of profits

Note : X investment Ltd is itself floated by X Ltd in 1990. The consolidated profits of Rs. 20 crores is after it's acquisition, hence the entire profits are revenue profits.

Since it is a wholly owned subsidiary of 'X' Ltd, there is no Minority interest.

WN 8 : Calculation of Cost of control :

(Rs. in Crores)

	Particulars	*Rs.*	*Rs.*
a.	Cost of investment		
	i. Amount invested	5	
	ii. Less : Pre-acquisition dividend	Nil	5
b.	Share of net assets as on date of acquisition represented by :		
	i. Share capital	5	
	ii. Capital profit	Nil	5
c.	***Goodwill (a-b)***		***Nil***

Problem - 2

Solution :

Valuation of shares

	Particulars	*Rs.*
a.	Net tangible assets (WN # 1)	21,06,664
b.	Add : Goodwill (WN # 3)	3,45,720
c.	Add : Calls in arrears	1,00,000
d.	Net assets available to equity shareholders	25,52,384
e.	Number of equity shares	10,000
f.	Value of fully paid shares	255.24
g.	Value of party paid shares (255.24 - Rs. 20.00)	235.24

WN # 1 : Net trading assets as on 31.12.2004

	Particulars	*Rs.*	*Rs.*
a.	Sundry assets		
	i. Machinery (130%)		7,80,000
	ii. Factory shed	6,50,000	
	Add : Addition	20,000	
	Less : Depreciation(Rs.2,000+1,800+1,620)	(5,420)	
		6,64,580	
	Add : 30% appreciation	1,99,374	8,63,954
	iii. Vehicles		2,00,000
	iv. Furniture		50,000
	v. Stock		3,50,000
	vi. Debtors		6,70,000
	vii. Bank		50,000
	Total		***31,13,954***
b.	Less : Liabilities		
	i) Bank overdraft	3,00,000	
	ii) Creditors	7,00,000	
	iii) Tax Provision*	7,290	10,07,290
c.	***Total net trading assets or net tangible assets (a-b)***		***21,06,664***

* Tax provision

		Rs.
i.	Tax effect / liability on asset wrongly written off (50% of Rs. 20,000)	10,000
ii.	Tax saving on depreciation (50% of {2,000+1,800+1,620})	(2,710)
iii.	Net tax liability	7,290

WN # 2 : Future maintainable profit (FMP)

	Particulars	*31.3.2002*	*31.3.2003*	*31.3.2004*
a.	Profit (as given)	3,60,000	4,70,000	3,70,000

b.	Add : Cost of additional factory shed (net of tax)	10,000		
c.	Less : Depreciation (net of tax) on additional factory shed	(1,000)	(900)	(810)
d.	Adjusted profits	3,69,000	4,69,100	3,69,190
e.	Average profits (12,07,290 ÷ 3)		Rs. 4,02,430	

WN # 3 : Valuation of goodwill (Super profits method)

	Particulars	*Rs.*
a.	Capital employed (WN # 1)	21,06,664
b.	NRR	15%
c.	Normal profits (a x b)	3,16,000
d.	FMP (WN # 2)	4,02,430
e.	Super profit (c-d)	86,430
f.	Number of years of purchase	4 Years
g.	Goodwill	3,45,720

Problem - 3
Solution:

Part - (i) Purchase consideration

WN # 1 : Calculation of goodwill

	Particulars		*T Ltd.* *Rs.*	*K and R Ltd.* *Rs.*
a.	Total Profits for three years			
	2001		90,000	90,000
	2002		1,21,000	65,000
	2003		1,31,060	95,000
			3,42,060	2,50,000
b.	Add: Directors fees		75,000	-
c.	Less: Additional depreciation*		(49,560)	
d.	Add: Exceptional item of expense			20,000
e.	Less: Notional salaries for partners - p.a.	Rs.50,000/-		(1,50,000)
f.	Total		***3,67,500***	***1,20,000***
g.	Number of years		3	3
h.	Average profits		1,22,500	40,000
i.	Goodwill (2 years purchase) [(h) x 2]		2,45,000	80,000

* Calculation of additional depreciation:

(Rs.)

	Year	*2001*	*2002*	*2003*	*Total*
a.	Depreciation to be charged	60,000	71,000	63,000	
b.	Less: Depreciation already charged	(54,500)	(44,580)	(45,360)	
c.	***Additional depreciation to be charged***	***5,500***	***26,420***	***17,640***	***49,560***

Statement showing shares to be issued to T Ltd. and M/s. K and R Ltd.

	Particulars		T Ltd. Rs.	K and R Rs.
a.	Fixed assets :			
	i.	Freehold premises	6,00,000	2,50,000
	ii.	Others	3,30,000	2,10,000
	iii.	Goodwill (WN # 1)	2,45,000	80,000
b.	Current assets:			
	i.	Stock in trade	1,80,000	1,00,000*
	ii.	Sundry debtors (4,30,000 - 30,000)	4,00,000	-
	iii.	Cash at bank	1,20,000	-
			18,75,000	6,40,000
c.	Less: Sundry creditors (5,20,000 - 15,000)		(5,05,000)	-
d.	Net asset value		13,70,000	6,40,000
e.	Share price		12.50	12.50
f.	No. of shares to be issued (d / e)		1,09,600 (13,70,000 / 12.50)	51,200 (6,40,000 / 12.50)

* 1,10,000 - 10,000

ii. Balance Sheet of P Ltd. as at December 31, 2003

Liabilities	*Rs.*	*Assets*	*Rs.*
Share capital :		Fixed assets :	
4,60,800 shares of Rs. 10 each fully paid		Goodwill	80,000
		Freehold premises	7,50,000
(of the above, 1,60,800 shares are being issued for consideration other than cash)	46,08,000	Other fixed assets	17,90,000
		Investments	13,70,000
Reserves and surplus :		(Fully paid shares in Subsidiary Co.)	
General reserves	12,20,000		
Share premium	4,02,000	Current assets :	
Current liabilities and provisions:		Stock in trade	14,50,000
Creditors	6,50,000	Sundry debtors	12,30,000
		Cash at bank	2,10,000
	68,80,000		***68,80,000***

Problem - 4

Solution :

Computation of Economic Value Added (EVA)

	Particulars	*Rs. in lakhs*
a.	Net operating profit after tax (NOPAT) (WN # 1)	70.00

b.	Add : Interest on long term borrowings adjusted for tax [Rs. 400 lakhs x 10% x (1-0.3)]	28.00
c.	Total return to financiers [a+b]	98.00
d.	Less : Cost of capital (WN # 4)	(80.50)
e.	Economic Value Added (c-d)	17.50

WN # 1 : Computation of NOPAT :

	Particulars	***Rs. in lakhs***
a.	Profit before interest and tax (PBIT) [WN # 2]	140
b.	Less : Interest on debentures @ 10%	(40)
c.	Profit before tax	100
d.	Less : Tax @ 30%	(30)
e.	Net operating profit after tax	70

WN # 2 : Profit before interest and tax

$$\text{Financial Leverage} = \frac{\text{Profit before interest and tax (PBIT)}}{\text{Profit before tax (PBT)}}$$

$$1.4 = \frac{\text{PBIT}}{\text{PBIT} - \text{Interest}}$$

$$1.4 = \frac{\text{PBIT}}{\text{PBIT} - 40}$$

(Where Interest = 10% of Rs. 400 lakhs = Rs. 40 lakhs)

$$1.4\ \text{PBIT} - 56 = \text{PBIT}$$
$$0.4\ \text{PBIT} = 56$$
$$\text{PBIT} = \frac{56}{0.4} = \text{Rs. 140 lakhs}$$

WN # 3 : Weighted average cost of capital (WACC)

Sources of funds (1)	***Amount (Rs. in lakhs) (2)***	***Weights (3)***	***Cost of Capital (4)***	***WACC (%) (5) = (3) x (4)***
Equity share capital	170	0.243	17.5%	4.25
Reserves and surplus	130	0.186	17.5%	3.25
10% Debentures	400	0.571	7.0% [10 x (1-03)]	4.00
Total	700	1.00		11.50

WN # 4 : Cost of capital

Cost of Capital = Average capital employed x Weighted average cost of capital

(WN # 3)

= Rs. 700 lakhs x 11.50%

= Rs. 80.50 lakhs

b. The following is an extract of the Profit and loss account of Better and Best Ltd. for the year ended 31st March, 2004.

Particulars	*Rs. in 000's*
Sales (including excise duty recoveries)	727
Other income	13
	740
Materials	530
Excise duty	62
Salaries, wages and employee benefits	19
Other expenses	47
Interest and finance charges	7
Depreciation	5
Provision for taxation	31
Preliminary expenses written off	5
Transfer to debenture redemption reserve	5
Proposed dividend	5
Transfer to General reserve	24
	740

Notes :

1. Other expenses include fees and commissions to whole-time directors of Rs.9,000 and loss on sale of fixed assets of Rs.3,000.
2. Interest and finance charges include interest on long term loans of Rs.4,000, balance being on short-term borrowings.

You are required to prepare a Value Added Statement for the year ended 31st March 2004.

(12 Marks)

Solution :

Value Added Statement for the year ended 31.03.2004 of Better and Best Limited

(Rs. in 000's)

	Particulars	*Amount Rs.*	*Amount Rs.*
A.	**VALUE ADDED**		
	1. Revenue		
	a. Sales	727	
	b. Less : Excise duty	(62)	665
	2. Less : Cost of bought out materials and services		
	a. Materials	530	
	b. Other expenses	35	
	c. Short term interest	3	(568)
	3. Value added from operations		97
	4. Add : Other Income		13
	5. *Gross value added*		*110*

B.	**VALUE APPLIED :-**		
1.	Towards employees		
	a. Salaries, wages and benefits (19+9)		28
2.	Towards Government		
	a. Income tax		31
3.	Towards providers of finance		
	a. Interest on long term loans	4	
	b. Dividend on equity	5	9
4.	Towards replacement and expansion purpose		
	a. Loss on sale of fixed assets	3	
	b. Preliminary expenses written off	5	
	c. Depreciation	5	
	d. Transfer to reserves (5+24)	29	42
5.	*Gross value applied*		*110*

Reconciliation of gross value added and profit before tax

(Rs. in 000's)

		Particulars		*Amount Rs.*
a.	Profit before tax (WN # 1)			65
b.	Add	i. Salaries, wages and other benefits	28	
		ii. Interest on long term loans	4	
		iii. Loss on sale of fixed assets	3	
		iv. Preliminary expenses written off	5	
		v. Depreciation	5	45
c.		**Gross value added**		**110**

WN # 1: Determination of profit before tax

(Rs. in 000's)

	Particulars	*Rs.*	*Rs.*
a.	Amount Transferred to reserves		
	i. Debenture redemption reserve	5	
	ii. General reserve	24	29
b.	Proposed dividend		5
c.	Provision for taxation		31
d.	*Profit before tax*		*65*

Problem – 5 (a)

Solution :

a) Step: 1 Computation of Theoretical Ex-Rights price

	Particulars	No. of Shares	Fair value / Issue price	Product (Rs.)
a.	Opening Number of shares	10,00,000	25	2,50,00,000
b.	Right Shares	2,50,000	20	50,00,000

		12,50,000		3,00,00,000

Theoretical Ex-Rights Price = $\frac{3,00,00,000}{12,50,000}$ = Rs. 24/-

Step: 2 Adjustment Factor :-

a) Fair Value Prior to Rights = Rs. 25
b) Theoretical Ex-Rights Price = Rs. 24
c) Adjustment Factor = $\frac{25}{24}$ = 1.04

Step: 3 Weighted Average Number of Equity Shares (WANES)

	Particulars	No. of Shares	No.of months	Product
a.	Opening Number of shares	*10,40,000	3	31,20,000
b.	Right Shares	12,50,000	9	1,12,50,000
		(10,00,000 + 2,50,000)	12	1,43,70,000

* (10,00,000 x 1.04)

c. WANES = $\frac{1,43,70,000}{12}$
= 11,97,500

Step : 4 Basic EPS: Disclosure

	Annual Report 2003		Annual Report 2002
Particulars / Year	**CY 2003**	**PY 2002**	**CY 2002**
Profit available to Equity Share Holders (PAES)	Rs.30,00,000	Rs.20,00,000	Rs. 20,00,000
WANES	1197500	10,40,000	10,00,000
Basic EPS of Rs. 10/- Share	Rs. 2.51	Rs. 1.92	Rs. 2.00

(5) b)

Solution :

As per the AS – 4, adjustments of assets and liabilities is to be made for events occuring after Balance Sheet date that provide some additional evidence that assist in estimation of amounts relating to conditions existing on Balance Sheet date.

In the given circumstances, the company can make provision for the full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March 2003 in compliance with AS – 4.

(5) c)

Solution :

a. Action is in line with AS 2 requirement. However, the action of writing down the inventories is "during the year", and not specifically in relation to "closing stock". Hence AS 5 applies. Using materiality, and predictive value concepts, disclose separately where warranted.

b. Change in accounting policy in line with ICAI pronouncements, and is in order. Disclosure as per AS 5 is necessary. Draft statement should include (i) change in compliance with ICAI pronouncement, (ii) impact of change lower profit of Rs. 3 lacs

c. Not a prior period item under AS 5. Additional wages Rs.7.5 lacs to be included under current year wages. Notes to accounts will be meaningful.

Problem - 6

6.(a) Human beings are considered central to achievement of productivity, well above equipment, technology and money. Human Resource Accounting **(HRA)** is an attempt to identify, Quantify and report investments made in human resources of an organization that are not presently accounted for under conventional accounting practice. The committee on HRA of the American Accounting Association defined HRA as "the process of identifying and measuring data about human resources and communicating this information to interested parties". However "Human Resources " are not yet recognised as 'assets' in the Balance Sheet. The measures of net income which are provided in the conventional financial statement do not accurately reflect the level of business performance. Expenses relating to the human organization are charged to current revenue instead of being treated as investments to be amortised over the economic service life,with the result that the magnitude of net income is significantly distorted.

The necessity of **HRA** arose primarily as a result of the growing concern for human relations management in industry since the sixties of this century. Behavioural scientists (like R Likert, 1960), concerned with the management of organizations, pointed out that the failure of accountants to value human resources was a serious handicap for effective management.

Many people pointed out that it is very difficult to value human resources. Some others have cautioned that people are sensitive to the value others place on them. A machine never reacts to an over or under –valuation of its capacity, but an employee will certainly react to such distortion. Conventionally human resources are treated just as any other services purchased from outside the business unit. As a result conventional balance sheets fail to reflect the value of human assets and hence distort the value of the business. The treatment of human resources as assets is desirable with a view to ensuring comparability and completeness of financial statements and more efficient allocation of funds as well as providing more useful information to management for decision –making purposes.

6.(b)

Valuation on group basis: Jaggi and Lau Model: Jaggi and Lau realized that proper valuation of human resources is not possible unless the contributions of individuals as a group are taken into consideration. A group refers to homogeneous employees whether working in the same department or division of the organization or not. An individual's expected service tenure in the organization is difficult to predict but on a group basis it is relatively easy to estimate the percentage of people in a group likely to leave the organization in future. This model attempted to calculate the present value of all existing employees in each rank. Such present value is measured with the help of the following steps:

(i) Ascertain the number of employees in each rank.
(ii) Estimate the probability that an employee will be in his rank within the organization or terminated/promoted in the next period. This probability will be estimated for a specified time period.
(iii) Ascertain the economic value of an employee in a specified rank during each time period.
(iv) The present value of existing employees in each rank is obtained by multiplying the above three factors and applying an appropriate discount rate.

Jaggi and Lau tried to simplify the process of measuring the value of human resources by considering a group of employees as valuation base. But in the process they ignored the exceptional qualities of certain skilled employees. The performance of a group may be seriously affected in the event of exit of a single individual.

6 (c) Considering the major socio-economic problems of the country eight major heads have been identified in this study for Social Reporting purpose:

1. Employment Opportunities
2. Foreign Exchange Transactions
3. Energy Conservation
4. Research and Development
5. Contribution to Government Exchequer
6. Social Projects
7. Environmental Control
8. Consumerism.

1. Creation of employment opportunities during the year may be classified into opportunities in India and opportunities abroad. In India employment may be created either by expansion/diversification in backward or other areas. However, employment protection by absorption of sick units may also be treated as employment opportunities. Moreover, the corporate enterprise may create new openings abroad by adopting foreign projects. In all such cases quantitative information needs to be disclosed giving break-up of SC/ST persons. Physically handicapped persons, women and other workers appointed during the year. Tax advantage or subsidy received for establishing industrial units in backward areas or absorption of sick units should be disclosed properly. If the corporate enterprise follows Human Resource Accounting system it may show human assets created during the year and costs incurred for such purpose.

2. In view of the scanty foreign exchange reserve, it is desirable todiscclose foreign exchange transactions in details. Foreign exchange inflows occur by exports or earnings from foreign projects. Also saving in foreign exchange is equivalent to foreign exchange inflows. An enterprise can save foreign exchange by import substitution and replacement of foreign technology / technician. Foreign exchange outflows are caused by purchase of raw material

/ spares, plant and machinery capital repayment,payment of dividend and interest. It is desirable to report inflows and outflows for each currency separately and a summary statement in Indian currency. Any tax advantage/ export subsidy received for foreign exchange should be disclosed as an item of social cost.

3. Energy purchased/generated and energy consumed per unit of standard product are to be reported along with consumption norm of the industry. Energy Audit Reports prepared by BICP may be followed for industry norms wherever applicable. Positive/negative variation in energy should be reported along with reasons therefore.

4. Recurring/non-recurring cost incurred for research and development is to be reported along with results. If possible, effect of Research and Development activities may be quantified in terms of cost saved/profit added. Any tax advantage/subsidy received is to be reported as social cost incurred along with the generation of social benefits from research and development.

5. Contribution to Government exchequer by way of sales tax, income tax, excise, customs and other duties needs to be reported as an item of social benefits.

6. Contribution to cocial projects may be further classified into direct involvement of corporate enterprise and donations to different organisations. Social projects like constructions of road, establishment of school, college, institute, hospital, stadium, etc. may be earmarked alongwith the categories of beneficiaries and cost involved.

In case of donation to any organization, the nature of the organization may be stated along with tax advantage received by way of such donations.

(Contribution of the corporate enterprise for development of sports and games, cultural matters and self-employment programmes may be reported as creation of social benefit.)

7. Negative social effect caused by the Corporate enterprise may be quantified stating use of irreplaceable resources and nature of pollution caused. Action taken and cost involved for pollution control chould be reported as an item of social benefit.

8. Failures in terms of complaints received against improper quality, poor service etc. may be reported under social costs. Action taken and cost involved for undertaking quality control and customers service should be reported under social benefits.

PRIME ACADEMY

25TH SESSION MODEL EXAM

FINAL

Total No. of Questions : 5 **Total No. of Printed Pages: 4**

Time Allowed : 3 Hours **Maximum Marks : 100**

MA

Answer all Questions

1. (a) A project involves an initial capital expenditure of Rs 10 lakhs. The annual CFAT is Rs 2 lakhs for the next 10 years. The opportunity cost of capital is 12% which reflects the project's business risk. Issue costs are 5% of the gross proceeds of the issue. The firm can borrow upto Rs 5 lakhs. The cost of debt is 6% and is payable in 10 equal annual installments of principal.

I. Compute base case NPV

ii. Compute adjusted NPV **(10 Marks)**

1. (b) A firm has an investment proposal requiring an outlay of Rs. 40,000. The investment proposal is expected to have 2 years economic life with no salvage value. In year 1, there is a 0.4 probability that cash inflow after tax will be Rs.25,000 and 0.6 probability that cash inflow after tax will be Rs.30,000. The probabilities assigned to cash inflows after tax for the year II are as under.

The Cash inflow year I	Rs.25,000		Rs.30,000	
The Cash inflow year II		Probability		Probability
	Rs.12,000	0.2	Rs.20,000	0.4
	Rs.16,000	0.3	Rs.25,000	0.5
	Rs.22,000	0.5	Rs.30,000	0.1

The firm uses a 10% discount rate for this type of investment.

Required:

(a) Construct a decision tree for the proposed investment project.

(b) What net present value will be the project yield if worst outcome is realized? What is the probability of occurrence of this NPV?

(c) What will be the best and probability of that occurrence?

(d) Will the project be accepted?

(10% discount factor 1 year 0.909 2 year 0.826)

(10Marks)

2. (a**)** Why do a company declare dividend? **(6 Marks)**

2. (b) Write in brief about "DOW JONES" Theory? **(6 Marks)**

2. (c) You have been given the following information, about Pink and Zinc Ltd.

	Pink and Zinc		Market		
	Average Share Price (Rs) (Rs)	Dividend share	Average Index	Dividend Yield Percentage	Return on Govt. Bonds Percentage
2000	242	20	1812	4	6
2001	279	25	1950	5	5
2002	305	30	2258	6	4
2003	322	35	2220	7	5

(i) Compute the Beta value of the company as at the end of 2003.

(ii) What is your observation? **(8 Marks)**

3. (a) What are the disadvantages of Mutual Funds? **(6Marks)**

3.(b)The following data relate to a newly formed pension fund and the BSE Index

	Pension Fund	Index
Return	12%	8%
Standard deviation	8	5

The correlation between the fund and the index was 0.5. Treasury bills yield is 4%. What was the risk premium on the pension fund? What was the total gain from picking stocks? After allowing for unique risk what was the net gain from picking?

(8Marks)

3.(c). Consider the following data relating to KM stock. KM has a beta of 0.7 with NIFTY. Each Nifty contract is equal to 200 units. KM now quotes at Rs 150 and the Nifty future is 1400 Index points. You expect prices to fall and have gone short on 1200 shares of KM in the spot market.

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

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

(iii)Suppose the price in the spot market jumps up by 5%, what happens? **(6Marks)**

4.(a**)** Silk and Cotton Sholapur, have debts outstanding from Malaysia. Realizations at the end of three months are estimated at Ringitts 49,750/-.The Company is also concerned about future sales to Malaysian party.

Foreign Exchange Rates	**Bid**	**ASK**
Spot	12.68	12.76
Forward	12.40	12.50

Money market rates	**Deposit**	**Loan**
Ringitts	8.5%	12.0%
Rupees	7.5%	10.5%

Required: Demonstrate how money market hedge will operate in the above case.

(10Marks)

4. (b) Assume that you are the Chief Finance Officer of Terraces Plc – a UK based company. Your company has purchased goods from a US supplier , and must pay a sum of US $ 29,50,000. in three months. Following annual interest and exchange rates are available, in London:

$/ £ Spot	1.5865	-- 1.5875
3 months forward	1.80c	-- 1.75 c (Premium)

Money market rates (%)

	Deposit	Borrowing
$	7.00	10.75
£	11.0	14.25

Evaluate the efficacy of alternative hedging methods , and give your reasoned recommendations.

(10Marks)

5.(a) Your company is considering acquiring an additional computer to supplement its time share computer services to its clients. It has two options:

(i) To purchase the computer for Rs. 22 lakhs.

(ii) To lease the computer for three years from a leasing company for Rs.5 lakhs as annual lease plus 10% of gross time – share service revenue. The agreement also requires an additional payment of Rs. 6 lakhs at the end of third year. Lease rents are payable at the year-end, and the computer reverts to the lessor after the contract period. The company estimates that the computer under review will be worth Rs.10 lakhs at the end of third year.

(iii) Forecast revenues are (Amount/Rs.lacs)

Year	1	2	3
Amount/Rs.lacs	22.50	25.00	27.50

(iv) Annual operating costs excluding depreciation / lease rent of computer are estimated at Rs.9 lakhs with an additional Rs. 1 lakh for start up and training costs at the beginning of the first year. These costs are to be borne by the lease. Your company will borrow at 16% interest to finance the acquisition of the computer. Repayments are to made according to the following schedule:

Year-end (Rs.000)	1	2	3
Principal	500	850	850
Interest	352	272	136

(v) Extract from present value table

Year	1	2	3
At 8%	0.926	0.857	0.794
At16%	0.862	0.743	0.641

The company uses straight –line method (SLM) to depreciate its assets and pays 50% tax on its income. The management approaches you to advice. Which alternative would be recommended and why? **(10 Marks)**

5(b). Northern Ltd., is exploring the possibility of bidding for the shares of Southern Ltd., which is in the same line of business, with good profits and track record. CFO of Northern Ltd. has gathered the following information:

Particulars	Northern Ltd	Southern Ltd
Number of shares	300,000	600,000
Current market price	Rs.8	Rs.12
Latest earnings	Rs.400,000	Rs.750,000

Plans of Southern include the following:

1. Southern has two divisions. One division gives earnings of Rs.120,000. This can be readily sold for Rs.800,000.
2. Remaining operations of Southern can be improved by 25%, through managerial and production efficiencies.
3. These two objectives can be achieved without disturbing the existing PE multiple of that company.
4. One of the properties of Northern will itself be rendered surplus. This can be sold for a net realisation of Rs.303,000.
5. Restructuring costs for this M&A deal would be Rs.100,000
6. CFO considers that one share in Northern for four shares in Southern would be an ideal share exchange ratio.

No announcement has been made by Northern. MD is not sure, whether to go to Press and make an announcement, or not to announce now. He has asked you to compute and show him the likely market price, of the combined entity, as also the likely change in price of Southern Ltd.

(10Marks)

1(a).

Step 1: Base case **NPV**

Year	CF (Rs L)	Disc factor	DCF
0	(1,000,000)	1000	(1,000,000)
1-10	200,000	5650	1,130,000
		Total	130,000

Step 2: Issue costs

(a) This is 5% if gross proceeds
(b) Hence if 100 is gross proceeds 95 is net proceeds and Rs 5 is issue costs
(c) Since net proceeds are 10 lacs issue cost is 5/95 x 10 lacs = 52,632

Step 3: PV of tax saved on interest paid (at 6%)

Year	Opening	Interest	Principal	Closing	Tax saved	Disc factor	PV Rs.
1	500,000	30,000	50,000	450,000	15,000	0.943	14,145
2	450,000	27,000	50,000	400,000	13,500	0.890	12,015
3	400,000	24,000	50,000	350,000	12,000	0.840	10,080
4	350,000	21,000	50,000	300,000	10,500	0.792	8,316
5	300,000	18,000	50,000	250,000	9,000	0.747	6,723
6	250,000	15,000	50,000	200,000	7,500	0.705	5,288
7	200,000	12,000	50,000	150,000	6,000	0.665	3,990
8	150,000	9,000	50,000	100,000	4,500	0.627	2,822
9	100,000	6,000	50,000	50,000	3,000	0.592	1,776
10	50,000	3,000	50,000	0	1,500	0.558	837
				Total	65,992		

Step 4: Step 1 NPV 130,000
Less: Step 2 Issue costs (52,632)
Add: Step 3: Tax saved on interest paid 65,992
Total NPV 143,360

The project has an adjusted positive NPV and should be selected.

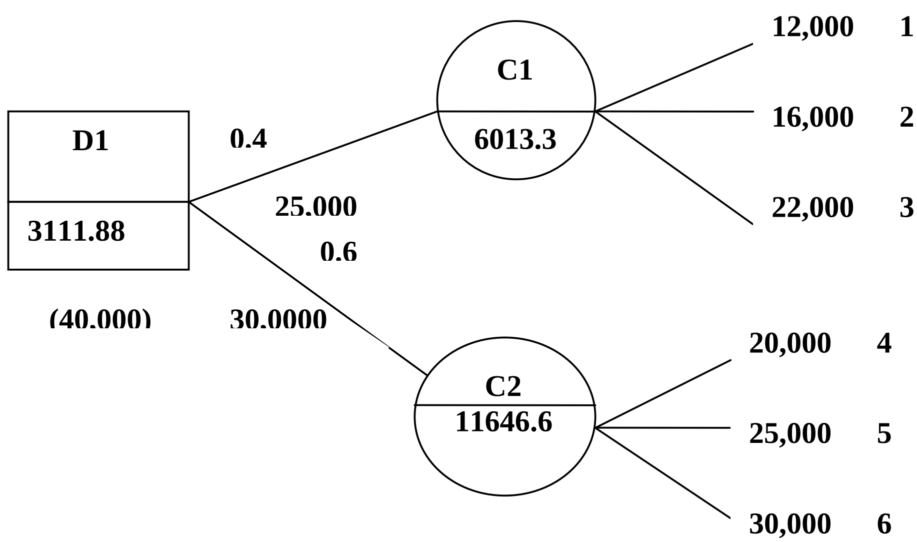
APV and hurdle rates

APV can be used to compute a project's Adjusted IRR. The Adjusted IRR (A-IRR) is the rate at which the ANPV is zero. The A-IRR is useful in decision-making. When project B is in competition with project A, its IRR should be greater than the A-IRR of project.

A for it to get selected! For Project B this A-IRR is the adjusted cost of capital. If Project B's cash flows are discounted at this adjusted cost of capital and if it gives a positive NPV it would mean that Project B should be accepted. This NPV can be called Adjusted NPV. The message: Accept projects with positive NPV at the adjusted cost of capital. While the regular cost of capital is the expected rate of return on similar assets, the adjusting cost of capital takes into account the effects of financing.

1(b)

(a) **Path Ref**



Calculation of Nodes

Node Ref	Calculation	Result
C2	[(0.4x20,000)+(0.5x25,000)+(0.1x30,000)x0.8261]x0.6	11646.60
C1	[(0.2x12,000+(0.3x16,000)+(0.5x22000)x0.8261]x0.4	6013.28
D1	Computation of Joint NPV	**3111.88**

Path Ref	NPV of the path	Probability	Joint NPV
1	7363	0.08	(589.04)
2	(4059)	0.12	(487.08)
3	897	0.20	179.40
4	3790	0.24	909.60
5	7920	0.30	2376.00
6	12050	0.06	723.00
			3111.88

(b) (i) NPV of the project if worst outcome is realized

The worst outcome would be path 1

Year	Cash flow (Rs.)	Discount Factor @ 10%	DCF (Rs)
0	(40,000)	1000	(40,000)
1	25000	0.909	22,725
2	12000	0.826	9,912
			(7363)

Therefore **NPV** of the worst income is Rs. (7363)

(ii) Probability of occurrence of worst outcome.

(a) Computation of standard deviation year 1.

(i) Expected value = 25000 x 0.4 = 10,000.
(ii) Standard deviation

Cash flow	Probability	d	d2	pd2
25000	0.4	15000	2250 lacs	900 lacs

2 = 900 lac = 98486.83

Year 2

(i) Expected value

Cash flow (Rs.)	Probability	Expected value (Rs.)
12000	0.2	2400
16000	0.3	4800
22000	0.5	11000
		18200

(ii) Standard deviation

Cash flow	Probability	d	d^2	pd^2
12000	0.2	(6200)	384.4 lacs	76,88,000
16000	0.3	(2200)	48.4 lacs	14,52,000
22000	0.5	3800	144.4 lacs	72,20,000
				163,60,000

Standard deviation $\sum^{n} pd^2 = \sqrt{163,60,000}$ = 4044.75.

Standard deviation of the options

Year	SD	DF @ 10%	DCF (Rs.)
1	9486.83	0.909	8623.53
2	4044.75	0.826	3340.96
		SD	11964.49

Z Value = $\frac{x-\bar{x}}{SD} = \frac{(7363)-3111.88}{11964.49}$
= -0.875 SD – 0.88.
Table value = 0.3106
Therefore 0.5-0.3106 = 0.1894
= 18.94% = 19%.
Therefore the probability of occurrence of worst outcome is 19%.

(c) (i) NPV of the project if best outcome is realized

The best outcome would be realized if path 6 happens.

Year	Cash flow (Rs.)	DF @ 10%	DCF (Rs.)
0	(40,000)	1.000	(40,000)
1	30,000	0.909	27270
2	30,000	0.826	24780
			12050

(c)(ii) Probability of occurrence of best outcome

(a) Year 1

(i) Expected value

Cash flow	Probability	Expected value
30000	0.6	18000

(ii) Standard deviation

Cash flow	Probability	d	d^2	pd^2
30000	0.6	12000	1440 lacs	864 lacs

Standard deviation $\sum^{n} pd^2 = \sqrt{1864\text{ lacs}}$ = 9295.16.

(b) Year 2

Cash flow	Probability	Expected value
20000	0.4	8000
25000	0.5	12500
30000	0.1	3000
		23500

(ii) Standard deviation

Cash flow	Probability	d	d^2	pd^2
20000	0.4	(3500)	122.5 lacs	49 lacs
25000	0.5	1500	22.5 lacs	11.25 lacs
30000	0.1	6500	422.5 lacs	42.25 lacs
				102.50 lacs

Standard deviation $= \sqrt{102.5\text{ lacs}}$ = 3201.56.

Standard deviation of the option

Year	SD	DF @ 10%	DCF
1	9295.16	0.909	8449.30
2	3201.56	0.826	2644.489
			11093.789

Z value = $\frac{12050 - 3111.88}{11093.789}$ = 0.81 Table value = 0.2910

Since the tail is +ve, 0.5+0.2910 = 0.791.=79.1%

Therefore the probability of occurrence of best outcome is 79%.

(d) Acceptability of the project.

Since the project has a +ve, joint NPV, the project is acceptable.

2(a). **Declaration of dividend by a company.**

1. **Single Effect:** Investors read signals about the future prospects of the company based on the dividends announced. A high dividend payout may suggest that the management is gung-ho about the future. A low dividend payout may suggest that the management is not very confident about the future.
2. **Differential tax rates:** People who sell the story that dividend policy is irrelevant assume that the investors are indifferent between current dividends and capital appreciation. This is fine if the rates of tax are the same for dividends and capital gains. In actual practice, the effective tax on long-term capital gains is lower than that on dividends and on short-term capital gains is higher than that n dividends. The dividend payout decision will, therefore, depend on personal and corporate tax rates. When personal tax rates are higher than corporate tax rates are lower than corporate tax rates, a firm will have an incentive to payout any excess cash as dividends.
3. **Flaw in homemade dividends:** Stock prices tend to fluctuate wildly at the bourses. In a fluctuating market investors looking for current income may be reluctant to sell a part of their shares; instead they would prefer to receive high dividends. Similarly investors looking for low payout ratio. This makes it difficult for an investor to convert current income into equity and vice versa.
4. **Clientele effect:** Different investors have different preferences. Like some have their coffee hot and some have it cold, some investors prefer dividends and others prefer capital gains. Over time, investors line up behind companies that match their preferences. Thus high payout companies will have investors seeking low dividends. Each company hence attracts clients with a certain requirement. This is called clientele effect. The implications are simple: One, firms get the investors they deserve! Two, once set ,. It will be difficult for a firm to change its dividend policy.
5. **Transaction costs:** In the absence of transaction costs , dividends and capital gains are interchangeable. In such a case, if a shareholder desires current income greater than the dividends received, he can sell some shares equal in value to the additional current income sought. Similarly if he desire current income less than the dividends paid, he can buy additional shares equal in value to the difference between dividends received and the current income desired. In actual practice, transaction costs are incurred. For example, a share worth Rs 120 may fetch a net amount of Rs 118 after transaction costs and Rs 122 may be required to buy a share worth Rs 120. Due to transaction costs, shareholders who have a preference for current income would prefer a higher payout ratio and shareholders who have preference for deferred income would prefer a lower payout ratio.
6. **Mental Accounting:** Consider this example. Option 1: You received Rs.5000/- as dividend and spend it. Option 2: The Company does not pay dividend, so you sell a part of your share for Rs 5000/- and spend it. Subsequently the price of the share goes up. In which case do you feel cheated? Most investors feel cheated in the case of option 2 though in both cases the loss is identical! It’s all a frame of the mind.

2(b). <u>Dow Jones Theory</u>

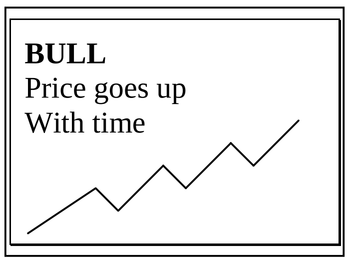
This theory in named after Mr. Charles Dow Jones who propounded this technique of analysis. Well over 100 Years ago, he laid the following rules covering share price movements. (Wall Street Journal, December 19, 1900)

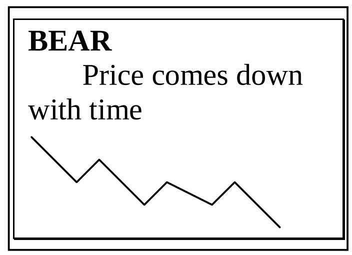
The market is always considered as having three movements, all going at the same time.

- The first is the narrow movement from day-to-day.
- The second is the short swing, running from two weeks to a month or more, and
- The third is the main movement, covering at least four years in its duration.

The narrow movement is also called "daily movements", the short swing as "corrections", and main movements as "primary trend".

The primary trend is considered as **Bullish** when the high point of each rally is lower than the high point of each successive rally, and as **Bearish** when the high point of each rally is lower than the high point of the preceding rally.





A technical analysis based on past data, it should be possible to spot the reversal of a primary trend (say a bullish trend turning bearish, or vice verse). In this technical analysis, Bar charts, Line graphs, Scatter Graph charts, and point and Figure Charts (PFC) are used to identify the corrections as also the primary trends.

2.c

Part (i): Computation of beta value

Step 1. Calculation of returns

$$\text{Returns} = \frac{D_1 + (P_1 - P_0)}{P_0} \times 100$$

Year	Returns $= \frac{D_1 + (P_1 - P_0)}{P_0} \times 100$
2000-01	$\frac{25 + (279 - 242)}{242} \times 100 = 25.62\%$
2001-02	$\frac{30 + (305 - 279)}{279} \times 100 = 20.07\%$
2002-03	$\frac{35 + (322 - 305)}{305} \times 100 = 17.05\%$

Step 2. Calculation of returns from market index

Year	% of Index appreciation	Div Yield %	Total Return %[2+3]
2000-01	$\frac{1950 - 1812}{1812} \times 100 = 7.62\%$	5	12.62

2001-02	$\frac{2258-1950}{1950}\times 100 = 15.79\%$	6	21.79
2002-03	$\frac{2220-2258}{2258}\times 100 = (1.68\%)$	7	5.32

step 3: Compute beta

Observation	X	Y	XY	Y^2
2000-2001	25.62	12.62	323.32	159.26
2001-2002	20.07	21.79	437.33	474.80
2002-2003	17.05	5.32	90.71	28.30
Total	62.74	39.73	851.63	662.36

$$\bar{X} = \frac{62.74}{3} = 20.91 \quad \bar{Y} = \frac{39.73}{3} = 13.24$$

$$\beta = \frac{\sum XY - n\bar{X}\,\bar{Y}}{\sum Y^2 - n\bar{Y}^2} = \frac{851.36 - 3(20.91)*(13.24)}{662.36 - 3(13.24)*(13.24)}$$

$$= \frac{851.36 - 830.55}{662.36 - 525.39} = \frac{20.81}{136.47} = 0.15$$

Part (ii): This is a low beta stock.

3(a) Mutual Nightmares

A mutual fund is not necessarily all sugar and honey. It does have its fair share of disadvantages.

(a) No guarantee of return: There are three related issues:

One, not all mutual funds turn out to be winners. Some may even under-perform the benchmark index. For example, if an amateur investor who knows nothing about the stock market invests in the 30 stocks that constitute the Index his return will be almost the same as that, it means, that it is not even performing as well as the amateur investor.

Two , a mutual fund may perform better than the stock market but there is no guarantee that these would necessarily lead to gain for the investor. Thus, if the market rose by 4% and the mutual fund scheme increased in value by5%, it is not much consolation to an investor because he could have got the same 5% investing in risk free investments.

Three, investors might forgive if the return is not adequate; but they are unlikely to do so if their principal is eroded. Mutual fund investment could depreciate in value.

(b) Diversification: Diversification has its both pluses and minuses. A mutual fund seeks to build a diversified portfolio. Diversification, by its very nature, is about minimizing risk and not about maximizing return. The return that mutual funds will offer should technically be less than what a suave individual investor can achieve.

(c) **Loads of cost:** Mutual funds come with a price tag. Fund managers are amongst the highest paid executives in the country. When you invest you have to pay entry load and when you exit you may have to pay exit load. These go to reduce the return from a mutual fund. Further, the fee to the asset management company is in a way unrelated to performance.

(d) **Selecting the right fund:** The biggest limitation associated with mutual funds is the trouble of picking the right fund. Sometimes, it may be easier to select the right share rather than the right fund. In the case of stocks, you at least have the EIC (Economic, Industry and Company analysis) framework to fall back upon. In the case of mutual funds, the only analysis is of past performance and the past is no prologue to the future.

(e) **Unethical practices:** There are possibilities that the mutual fund may not play the game according to the spirit of the game. According to an unwritten, but formalized principle, each scheme may sell some of its holdings, to its sister schemes, booking fat national gains and posting NAVs.

3(b).

step	Rate	Result	Remarks
1	12%-4%	8%	Risk premium on the pension fund
2	8%-4%	4%	Risk premium of the market
3	0.5 X4	2%	The portfolio manager has a β of 0. 5.anybody would have created a portfolio with β of 0. 5 by investing 50% in the index & 50% in the Rf investments. Hence, total risk premium is merely β x step 2.
4	Step 1 – Step 3 (i.e.)8%-2%	6%	Total gain on account of bill of the fund manager.
5	SDJ/SDM(Rm-Rf)=8/5(8-4)	6.4%	Apt premium for full diversification.
6	Step 1 – Step 5 8% - 6.4%	1. 6%	Net gain on account on skill of portfolio manager.

3(c). Part(i) Since you are short on the spot market, you have to go long in the futures market. Hence you have to buy NIFTY futures.

- Futures to be bought = Hedge ratio x [Units of spot position requiring hedging / No of units underlying one futures contract]
  =0.7 x 1200 / 200 = 4.2

Part(ii) Price falls

- If the price of KM falls by 10% it means it has fallen from Rs 150 to Rs 135 ie by Rs 15. Consequently the index will fall by 15/0.7 ie 21.429.It will fall to 1378.571 index points.
- Since your stock fell by Rs15, on your 1200 shares sold you have gained 1200x15=Rs 18000.
- You have bought 4.2 contracts in index futures. You have lost 21.429 points per contract. You have lost 4.2 x 200 x 21.429 = Rs 18000.
- Your gain is offset by your loss.

Part(iii) Price Increase

- If the price of KM goes up by 5%, it means an increase of Rs 150 x 0.05 = Rs 7. 5. Consequently the index will rise by 7. 5/0.7 ie 10.714 and will touch 1410.714
- Since your stock rose by Rs 5, on your 1200 shares sold you have lost 1200 x 7. 5 = Rs 9000.
- You have bought 4.2 contracts in Index futures. You gained 10.714 points per contract. Since each contract is for 200 units, your total gain on the futures is 4.2 x 200 x 10.714 = Rs 9000
- Your gain is offset by your loss.

4(a) Money market hedge involves the following steps.

(a) Identify and Create: Silk and cotton have a Foreign Currency asset. They should create a matching foreign currency liability.

(b) Borrow: Liability is to be in Foreign Currency. Hence, currency of borrowing will be Malaysian Ringitts.

(c) Amount of borrowing: Borrowing rate is 12%. Period is 3 months. The quarterly rate is 3%. Amount to be borrowed will be 49,750/1.03 = 48300.97 MR.

(d) Convert the amount borrowed into rupees: S & C will sell MR. Hence, relevant rate is Bank's bid rate, i.e. Rs.12.68 per Ringitt. Amount received is Rs1,12,456.30.

(e) Invest: If invested in India for three months the rate is 7.50 % x 3/12 months = 1.875 % p.q. Maturity proceeds will be
Rs. 1,12,456.30 x 101.875 % = Rs. 6,23,939.86.

(f) Settle: Ringitt Liability of 48,300.97 and interest at 12% p.a., would be Ringitt 49,750 (48300.97 X1.03). This liability gets settled, by directing Malaysian party to make remittance to the Bank. Silk and Cotton, will have an immediate rupee inflow of Rs. 6,12,456.30,Which if invested, will grow to be Rs. 6,23,939.86 at the end of three months.

4(b) **WN I.** The transaction involves a liability for Terraces Plc. The company will have to buy dollars using GBP to meet dollar liability. The three alternatives that would be evaluated are (a) forward exchange contract, (b) money market hedge, and (c) lead payments. Decision would be based on cost comparison based on identical terms.

A. Forward contract	**$**
Spot rate ($ per GBP)	1.5865

Swap Bid > Swap Ask (Deduct)	0.0180
Forward rate for three months	1.5685
Dollar amount required at end of 3 months	29,50,000
£ required for buying Dollars	(29,50,000/1.5685)
	£ 18,80,777.81 (A)

This is the cost at the end of three months. The problem does not state whether Terraces Plc is (i) cash rich, and need not borrow, or (ii) is required to borrow the money. At an annual borrowing rate of 14.25%, the present cost of this future value of £s is: £ 18,80,777.81/1.035625 = £ 18,16,079.96.

B. Money market hedge:

Dollar liability to be met on due date; hence asset to be created, by way of investment in US Dollars.

(a) To match a dollar liability, a dollar asset is required.
(b) Annual return on USD investment is 7%, hence, 3-month rate is 1.75%. To accumulate $ 29,50,000 on maturity date, the initial investment will be $ 29,50,000/1.0175 = $ 28,29,262.90.
(c) The bid & ask given is for GBP. CFO wants to buy $. Therefore, he has so sell GBP i.e., bank has to buy GBP. Hence, relevant rate is bid rate viz. 1.5865 $ per GBP.
(d) Arrange for USD by purchase at spot rate at 1.5865.
(e) Cost in terms of GBP would be 28,99,262,90/1.5865 = £ 18,27,458.49 (B).
(f) By this procedure, Terraces will match the maturing liability with the proceeds of investments in USD.

C. Leading the payment (making payment in advance)

(a) Cost of remittance of $ 29,50,000,at current rates.
(b) This will be $ 29,50,000/1.5865 = £ 18,59,439.02 (C).
(c) Evaluating the three alternatives on present value terms:

A. Under a forward exchange contract	GBP 18,16,079.96
B. Under money market hedge	GBP 18,27,458.49
C. Under Lead-the-payment procedure	GBP 18,59,439.02

Decision: lowest cost in PV terms is under a forward contract. This is recommended.

5(a) **WN 1:** The following elements of revenue and expenses are reckoned as irrelevant, since these are common for both lease and borrow/buy options.

1. Revenue for three years
2. Operating costs of Rs.9 lacs for three years
3. Initial start up and training cost of Re.1 lac

WN 2: Lease rentals have been computed as under:

	Year 1	Year 2	Year 3
Basic rental	5,00,000	5,00,000	5,00,000
10% Gross time-share service revenue	2,25,000	2,50,000	2,75,000
Total	7,25,000	7,50,000	7,75,000

WN 3: Computation of tax-shield on depreciation

Original cost	22,00,000	
Residual value	10,00,000	
Depreciable amount	12,00,000	
Useful life	3 years	
Method of depreciation	SLM	
Allocation of annual depreciable amount		4,00,000
Tax rate	50%	
Tax saved on depreciation		2,00,000

(A) Evaluating Lease option

The tax-effect adjusted lease rentals for the period of lease are identified, and discounted at post-tax cost of capital, 16% (1-t) i.e., 8%, as under:

	Year 1	Year 2	Year 3
Lease rentals (WN 2)	7,25,000	7,50,000	7,75,000
Terminal payment	-	-	6,00,000
Sub-total	7,25,000	7,50,000	13,75,000
Tax 50% saved	3,62,500	3,75,000	6,87,500
Net post-tax outflow of lease rentals	3,62,500	3,75,000	6,87,500
Discount factor 8%	0.926	0.857	0.794
PV of outflows	3,35,675	3,21,375	5,45,875
PV of lease outflows	12,02,925		

Evaluating Purchase option

The pre-tax cash flows attributable to purchase option, are identified and discounted at pre-tax cost of debt i.e., 16%* as under:

	Year 1	Year 2	Year 3
Principal repayment	5,00,000	8,50,000	8,50,000
Tax shield on depreciation	2,00,000	2,00,000	2,00,000
Sin-total outflows	7,00,000	10,50,000	10,50,000
Terminal inflow	-	-	(10,00,000)
Net outflows attributable to Purchase option	7,00,000	10,50,000	50,000
Discount factor 16%	0.862	0.743	0.641
PV of outflows	6,03,400	7,80,150	32,050
PV of lease outflows		14,15,600	

Conclusion:

PV of Purchase option Rs. 12,02,925

PV of lease option Rs. 14,15,600

Decision PV of outflows of purchase option is lower than PV of Lease option. Hence select Purchase Option

5(b) The requirement is computation of theoretical market price, after merger based on 4 for 1 share exchange ratio.

Step 1

	Northern	Southern	Combined
	Bidder	Biddee	

Current earnings 400,000 750,000 Number of shares 300,000 600,000

Current Market price 8 12

Market capitalization EPS 24,00,000 72,00,000

PE multiple 6 9.6

Step 2

Current earnings	400,000	750,000
Loss of earnings (sale of division)	-	(120,000)
Balance earnings	400,000	630,000
Efficiency savings 25%	-	157,500
Sub total	400,000	787,500

Step 3 Present PE multiple 6 9.6

Market capitalization	24,00,000	75,60,000	
Sale of property	3,03,000	-	
Sale of division	-	800,000	
Restructuring costs	-	(100,000)	
Expected market capitalization	27,03,000	82,60,000	1,09,63,000

Step 4

Existing shares	300,000	-	-
New shares (4 for 1)		150,000	-
Total shares	300,000	150,000	450,000
Expected market price (on combined Entity) per share			Rs.24.36
Expected market price of Southern (1/4)	Rs.6.09		

- Theoretically, the market price of combined entity would be Rs. 24.366
- The likely fall in the price Southern Ltd. Can be up to Rs 6.09

PRIME ACADEMY
25th SESSION MODEL EXAM
FINAL

Total No of Questions: 8 | **Total No of Printed Pages : 2**

Time Allowed: 3 Hours | **Max. Marks: 100**

AG

Q.1. and Q.2. are compulsory. Answer any 4 from the rest

1. As an auditor, how would you deal with the following –

a. During the course of audit of A Ltd., a listed company, dealing in chemicals, you noticed that their licence to operate in chemical has expired. During discussion with management and experts, it appears that due to change in Government Policy, there are no further prospects of renewal of license. Still the company adopted going concern assumption while preparing them financial statements. **[5 marks]**

b. X Ltd. had a major break down in its plant in the month of February, 2007. In the month of March, 2007, it entered into an agreement with an Engineering Firm for the purpose of repairing its plant for a consideration of Rs.180 lakhs. The Engineering Firm started the repairing work in the month of April, 2007, and completed it in the same month. X Ltd. Made the provisions for the said expenditure on repairs in its books of accounts for the financial year 2006 – 07 on the plea that the event of break down leading to repair expenditure had taken place in the financial year 2006 – 07 and repair work was also completed before the financial statements were approved by the Board of Directors of the Company. **[4 marks]**

c. The Management of C Ltd. Created the provision for bad debts at the rate of five percent. However, as per industrial trend and experts advice it should be 15%. It is evident from past year's financial statement also. However, management refuse to increase the provision. **[4 marks]**

d. During the course of audit of XYZ Ltd., the auditor wants to seek certain external confirmations, whereas, the management requests the auditor not to do so. **[5 marks]**

2. As per provisions of the Chartered Accountants Act, 1949, discuss the following :

a. Mr. A, a chartered accountant in practice, accepted statutory audit of P Ltd. For year 2006 – 07 without communicating with Mr. B, its tax auditor for year 2005 – 06. Is Mr. A guilty. **[5 marks]**

b. Mr. X, a chartered accountant in practice had accepted the appointment as managing director of S Ltd. However, while applying for renewal of his Certificate of Practice to the ICAI, he indicated that he was not engaged in any other business/occupation. **[5 marks]**

c. M, a chartered accountant in practice, provided an unqualified audit report for C Ltd., without checking conducting any examination of financial records and other documents. **[4 marks]**

d. Mr. L, a chartered accountant in service agreed to entrust the legal matters of employer to Mr. M, a lawyer on condition that 1% of fee the lawyer gets, would be paid to him. However, later on Mr. L refuses to take any amount from Mr. M. **[4 marks]**

3. **a.** Explain the duties of auditor with respect to attendance at physical inventory counting. **[8 marks]**

b. Auditor report can be either unqualified or modified. Comment. **[8 marks]**

4. **a.** Explain the concept of CAAT? State whether it is fruitful in fraud detection. **[6+4 marks]**

b. Audit and investigation are two different concepts. Elaborate the statement**.** **[6 marks]**

5. What do you mean by PEER REVIEW? Explain its stages. **[16 marks]**

6. **a.** CARO is applicable for all companies. Comment. **[4 marks]**

b. You have been appointed to conduct Energy Audit for A Ltd. Briefly state its methodology. **[6 marks]**

c. Listed entities are required to have independent directors in their Board. State the concept of independent director. **[6 marks]**

7. **a.** With respect to the Stock Exchange, explain the following terms:

(i) Circuit breakers **[4 marks]**

(ii) Clearing and Settlement mechanism **[4 marks]**

b. You have been appointed as auditor of general insurance company. Explain how you would verify reinsurance. **[8 marks]**

8. Short Note on (any four) **[16 marks]**

(1) Propriety Audit
(2) Exemption from cost audit
(3) Audit program of audit under VAT
(4) Negative Assurance
(5) Audit Risk.

SUGGESTED ANSWERS
FINAL - AUDITING

1(A) As per AAS 16 Going Concern, Auditor should consider whether going concern assumption adopted by the management holds good. There may be financial, operating or other indicator which may raise a question mark on the going concern assumption adopted by the management.

In the present case, there is a major operating indicator i.e. expiry of license to operate without any prospects of renewal. In such cases As per AAS 16 Auditor should discuss with management, analyze their future plans and discuss with experts to judge the reasonableness of going concern assumption.

In present case it is clearly evident that as per management discussion and expert advice, the license would not be renewed, moreover there are no mitigatory factors, thus entity ceases to be going concern and it is clear that going concern assumption adopted by the management does not hold good.

Now the Auditor should advise the management to adjust the financial statements i.e amend their financial statements not incorporating going concern assumption therein. If the management refuses to do so, auditor should render an adverse opinion.

1(B) As per Para 14 of AS-29 a Provision should be recognized if the following conditions are satisfied –

Condition 1 : Present obligation as a result of past event : The agreement with the Engineering Firm was entered into in March 2007. Hence present obligation exists at the Balance Sheet date.

Condition 2 : Outflow resources to settle the obligation is probable : Additional evidence arising after Balance Sheet date lead to the conclusion that the outflow is probable i.e. more likely than not. The repair work was also completed before approval of accounts by the Board of Directors.

Condition 3 : Reliable estimate of the amount : Rs.180 lakhs is the amount of the liability. (Given).

Since all the conditions for recognition of a Provision are satisfied, a Provision should be recognized for the year ending March, 2007. The accounting treatment followed by the Company is correct.

1(C) As per AAS 18, Audit of accounting estimate, Auditor should judge reasonableness of estimates. Now in present case, the provision for bad debts is an estimate, which should be based on past experience and market trends. In this case auditor should discuss with management, consider market positions and compare the provision created in last year's financial statements with actual bad debts. It is given that considering all those points, it should be fifteen percentages and not five percent as shown by the management. The difference between auditors estimated percentage and client estimated percentage appears to be quite material.

As management refuses to adjust the same, in this case auditor should qualify his report regarding provision for bad debts.

1(D) As per AAS 30 "External Confirmation" When the auditor seeks to confirm certain balances or other information, and management requests the auditor not to do so, the auditor should consider whether there are valid grounds for such a request. The auditor should also seek the management to submit its request in a written form, detailing therein the reasons for such request.

If the auditor agrees to managements requests not to seek external confirmation regarding a particular matter, the auditor should –

a. document the reasons for acceding to the management's request; and

b. apply alternative procedures to obtain sufficient appropriate evidence.

If the auditor does not accept the validity of management's request and is prevented from carrying out the confirmations, there has been a limitation on the scope of the auditor's work and the auditor should consider the possible impact on the auditor's report. The auditor should, however, in this case also, document the request made by the management along with the reasons given by the management as well as his own reasons for not accepting the management's request.

2(A) As per the clause (8) of part I of first schedule of the Chartered Accountants Act ,1949 , a chartered accountant in practice is deemed to be guilty of professional misconduct if he accept appointments as auditor, previously held by another Chartered Accountant or restricted state auditor, without first communicating with him in writing.

However as per this clause incoming auditor's duty of communication is with that auditor, who conducted the work previously in same capacity in which incoming auditor is accepting the work, i.e income tax Auditor is required to communicate with outgoing tax auditor only or incoming statutory auditor is required to communicate with previous statutory auditor only. In the present case Mr. A is accepting statutory auditorship (under companies act) for the year 2006-2007. Thus he should communicate with the previous year statutory auditor and not the previous year tax auditor.

So it is not the duty of Mr. A to communicate with Mr. B under this clause and Mr. A will **not** held guilty of professional misconduct.

2(B) As per the clause II of part I of first schedule of the Chartered Accountants Act 1949 , a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he engages himself in any other business occupation other then profession of Chartered Accountant unless permitted by council **so to engage.**

Moreover, as per clause (i) of part I of first schedule, a Chartered Accountant will be held guilty of professional misconduct if he submits any false statement to the council or any of it's committee. Now in present case, it appears that Mr. X did not take permission of council before accepting managing directorship of "S" Ltd. Thus he would be covered under clause 11 of first schedule. Moreover he submits false statements to the ICAI that he is not engaged in any other business/occupation, while he was. Thus he would be covered under clause (i) of third part of first schedule.

Thus Mr. "X" is **guilty** of professional misconduct under first schedule as per clause 11 of part 1 and clause (i) of part III.

2(C) As per clause 8 of part 1 of second schedule of C.A. Act 1949, a C.A. in practice is deemed guilty of professional misconduct if he fails to obtain sufficient information to warrant the expression of opinion as his exceptions are sufficient material to negate the expression of an opinion.

It requires that C.A should express an opinion only after obtaining the required information.
In the present case it is clearly evident that " M " did not conduct any examination i.e. he failed to obtain sufficient information , still he provided an opinion which is prohibited in terms of said clause.

Thus Mr. "M" would be **guilty** of professional misconduct under aforementioned clause.

2(D) As per clause (a) of part II of first schedule, a C.A. in practice will be guilty of Professional misconduct, if he accepts or agrees to accept any part of fee, profits or gain from a lawyer, C.A. or broker engaged by such employer by way of commission or gratification.

In the present case Mr. "L" a C.A. in service, agreed to accept a part of fee of a lawyer because he entrusted the work of his employer to said lawyer. It does not make any difference that later on, Mr. L refused to take anything from the lawyer. The fact that he agrees for such an agreement, tantamount to misconduct because in the clause aforementioned, both acceptance and agreement to accept are prohibited.

Thus Mr. L would be **guilty** of professional misconduct.

3(a) Attendance at Physical Inventory Counting (AAS-34)
Management's Responsibility : Physical verification of inventory is the responsibility of management.

Auditor's Duty :
(1)Sufficient appropriate audit evidence regarding existence and condition of inventory, by attendance at physical inventory counting unless impracticable
(2) If impracticable, he should obtain sufficient & appropriate evidences through alternative procedures
(3) If he can't attend physical inventory count on planned date due to unforeseen circumstances, take some physical counts on alternative date and perform procedures to consider appropriate adjustment of changes in inventory between period end and date of physical count.
(4) He ordinarily observes count procedures adopted by management and perform test counts.

Inventory Under Control of IIIrd Parties: He should obtain confirmation from IIIrd party. He should also consider:
(i) Independence of IIIrd party.
(ii) Observing/arranging another auditor to observe, ph. Count.
(iii) Obtaining another auditors report on IIIrd parties system
(iv) Inspecting documentation regarding inventory held by III parties
(v) Subsequent receipt of goods from IIIrd parties

Management's Representation (physical **Letter) :**
(a) completeness of information provided
(b) assurance with regard to adherence to laid down procedures for inventory count.

Auditor's Conclusion & Reporting
→ If he is unable to obtain sufficient appropriate evidence w.r.t. physical inventory count refer scope limitation in audit report
→ If inventory is not properly disclosed in the financial statements, he should issue qualified report.

3(b). Auditor's Report

The auditor's report can be either the unqualified or modified as per AAS-28.

An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for preparation and presentation of the financial statements.

Under following situations auditor's report may have to be modified
- ➢ Matters that do not affect the auditor's opinion
- ➢ Matters that do affect the auditors opinions including qualified opinion, disclaimer of opinion or adverse opinion.

In respect of matters that do not affect the auditor's opinion, the auditors should modify the report by adding a paragraph to highlight a matter for example some uncertainty the resolution of which is dependent on future events and which may significantly affect the financial statements and the same has already been incorporated by management in financial statement. In such matters, the opinion paragraph would refer to the fact that auditor's opinion is not qualified in this respect. Matters that do affect the auditor's opinion: The AAS specifies that in respect of matters that do affect the auditor's opinion.

a. **A 'qualified opinion'** should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with the management is not so material and pervasive as to require a adverse opinion, or limitation on scope is not material and pervasive as to require a disclaimer or opinion.

b. **A 'disclaimer of opinion'** should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor is in able to obtain sufficient appropriate audit evidence and is hence unable to express an opinion on the financial statements.

c. An '**adverse opinion'** should be expressed when the possible effect of a limitation on scope is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is inadequate to disclose the misleading or incomplete nature of the financial statements.

Opinion other than an unqualified opinion: Whenever the auditor requires an opinion other than unqualified, a description of all the **substantive reasons** should be included in the report and quantification of the possible effect (s), individually and in aggregate, on the financial statements should be mentioned in the report.

4(a) Computer Assisted Audit Techniques (CAAT) (Used in Auditing through the computer)

1. Audit Software: It is a set of computer programs used by the Auditor, as part of his Auditing Procedures, to process data of audit significance from the entity's accounting system. The Auditor should use such programs only after he proves their validity for Audit purposes. Audit Software may consist of:

(a) Package Programs – These are generalised Computer Programs, that perform data processing like reading computer files, selecting information, performing calculations, creating data files and printing reports in a format specified by the Auditor. May be used at many clients site.

(b) Purpose Written Programs – These are Computer Programs, designed by the Auditor / entity / outside programmer, to perform Audit tasks in specific circumstances. The Auditor may sometimes use the programs of the entity in the same or in a modified form. But it may not be used at many clients site thus cost consideration should taken care of.

(c) Utility Programs – These are programs of the entity, designed for non-audit purposes, but for performing common data processing functions like sorting, creating and printing files. These are not designed specifically for audit purpose.

(d) System management software – These are enhanced productivity tool that require specialised knowledge on part of auditor. However these are not specifically meant for audit purposes. Thus used with much skill and care. For example flow chart review systems. It may be used for comparing source code with object code.

2. Test Data: The Auditor enters a set of test data into the entity's computer system and compares the results with predetermined results. Test data are used to test specific controls / specific processing characteristics in computer programs like online password and data access controls. The test data are chosen by the Auditor. They may be of the following types –

(a) Testing a set of data selected from **previously processed transactions,** in the entity's system, ***separately*** from the normal processing procedure.

(b) Establishing a **dummy unit** to which test transactions are posted ***during*** the normal processing cycle of the entity. (Called integrated Test Facility). However, the dummy entries should subsequently be eliminated from the entity's accounting records. These are used mainly on line real time systems.

Use of CAAT / Audit Software Systems in Fraud Detection:

1. Even while auditing in an EDP environment, the Auditor is required to plan his work by exercising reasonable care and skill in such a manner that there is reasonable expectation of detecting material misstatements in the financial information resulting from fraud or error.
2. Use of the above CAAT / audit software systems will help the Auditor to identify errors and frauds in the accounting and internal control system.
3. However, frauds are intentional and generally deep-laid. While auditing through the computer with adequate knowledge of computer systems may highlight some frauds, there is not empirical evidence to prove the assertion that the use of audit software systems has unearthed well-concealed frauds. Thus it cannot be conclusively said that use of audit software systems increases the probability of detection of fraud due to inherent limitation present in any audit.

4(b). Difference between Audit and Investigation :

Audit is independent examination of financial statements of an entity whether profit making or not, irrespective of its size and legal structure, where such an examination is conducted with a view to express an opinion thereon.

Investigation means a critical examination conducted for a specific purpose. The distinction between audit and investigation can be explained in the following points :

1. The objective of audit is to ascertain truthfulness and fairness of financial information, whereas, investigation is conducted to establish a fact for some particular purpose.
2. The scope of audit is determined by law, AAS and terms of engagements. Scope of investigation is limited to specific field of work.

3. Audit is conducted on yearly basis, whereas, for investigation there is no certain period.
4. Auditing requires test checking, whereas, investigation generally requires a detailed study and examination of facts and figures.
5. Audit has more inherent limitations than in investigation.
6. Auditor needs to obtain persuasive evidence whereas investigator requires conclusive evidence.
7. Audit report is submitted to the owner of business, and is generally a general purpose report. Whereas, investigation report is to be submitted to persons on whose behalf it is being conducted and generally more confidential.

5. PEER REVEIW

(a) Peer review is conducted to assure that profession is conscious of its responsibilities and strive its best to ensure that highest standards are observed by all practicing members rendering audit and attestation services to the society.

(b) It involves examination of the systems and procedures of the Practice Unit.

(c) It is conducted to ensure that in professional assignments, the member of ICAI.
   i. Comply with technical standard, and
   ii. Have proper system to maintain quality of work.

(d) Entire Peer Review Process has three stages viz. Planning, Execution, Reporting.

Stage-1 PLANNING

1. ***Empanelment of Reviewers***: The reviewer should be **member** of ICAI having at least **10 years** audit experience (the experience need not be continuous ,it may be on cumulative basis).The reviewer should be **currently in practice.**

2. ***Intimation to practice unit:*** In writing, information is given to the pu by peer reviw board, of its selection for pear review alongwith a panel of 3 reviewers & a copy of the questionnaire.

3. ***Initial communication by PU*** : PU is required to communicate its choice of reviewer to board within **15 days** from receipt of information . Within 1 month of receipt of intimation, PU sends completed questionnaire along with complete list of client to the reviewer.

4. ***Selection of sample Attestation service engagement:*** reviewer selects the sample on Random basis for review.

5. ***Confirmation of visit***: Reviewer in consultation with PU ,fix the dates for on site review to complete the peer review process within the **four months** of receipt of initial intimation to PU.

Stage-II EXECUTION

1. ***Initial meeting***:it is conducted between reviewer & PU to confirm the **accuracy** of responses to the questionnaire.

2. ***Compliance Review***: that is to check the independence, maintenance of professional skills and standard consultation, staff selection & supervision & office administration.This checking is required to understand **working and control** procedures of PU.

3. ***Selection of Attestation services Engagements***: He may **modify** his initial sample selected for review in consultation with the PU at executions stage.

4. ***Review of Records: Compliance & substantive approach:*** he performs compliance procedure to know **worthwhileness of internal controls**. Then he decides whether to rely on internal controls or not. In case of reliance, his substantive procedure will be less extensive & vice-versa. However, Compliance procedures are not necessary if size of firm is small/ medium. In that case, he may adopt only substantive procedure.

Stage-III REPORTING

1. **Preliminary Report of Reviewer:** At end of review, preliminary report is given to PU (before any report to Board) in case its system & procedure found to be **deficient** or where non-compliance has been noticed. Otherwise, No preliminary report is required to be given. Report should be prepared on latter head. It should be dated and should contain reviewers signature, membership no. & reviewers code number.

2. ***Reply to Preliminary Report***: Practice Unit is required to submit the reply to preliminary report to the reviewer in writing **within 21** days from receipt of the preliminary report from reviewers.

3. ***Interim Report of Reviewer:*** If reviewer is **not satisfied** with reply, then he renders interim report to Board. The Board recommends to PU and instruct the reviewer to carry out review again **after 6 months** to verify whether systems and procedures have been modified appropriately.

4. ***Final Report of Reviews***: If reviewer is **satisfied** with reply of PU, he will render final report to the Peer Review Board. Final report should incorporate the findings.

6(a). CARO shall not apply to:

(i) a banking company as defined in clause (c) of section 5 of the Banking regulation Act, 1949.

(ii) An insurance company as defined in clause (21) of section 2 of the Companies Act, 1956.

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

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

(b) Methodology to Energy Auditing: Energy Audit is the activity that serves the purpose of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. As Energy Auditor, we would like to cover it in following two stages :

i. Preliminary Energy Audit :

(1) It typically involves two or three days of plant visit.

(2) It is also referred to as walk-through audit.

(3) One may rely on data supplied by the unit or personally read from meters installed in the industry.

(4) In many instances, the meters installed in the industry do not show accurate reading.

(5) Ideally, the energy auditor must carry proper portable instruments and make recommendations.

ii. Detailed Energy audit :

(1) It goes much beyond the quantitative estimates of cost and savings.

(2) The scope of the audit assignment is discussed in detail with the plant personnel.

(3) The study involves details examination of major energy consuming equipment.

(4) The study proposes specific projects/feasibility study for replacement proposals, providing a cost-benefit analysis of the recommended measures.

(c) Independent director- As per clause 49 of listing agreement, Independent director is a non-ED, who fulfills all the following conditions -

(i) He shouldn't have (apart from receiving managerial remuneration any other material **pecuniary relationship** / transaction with the company, its promoters, management or Subsidiary which (in judgment of Board) may affect independence of judgment of Board.

(ii) Not **related** to promoters or persons occupying management positions at Board level or at one level below the Board.

(iii) Not been **executive of co.** in proceeding 3 Financial Years.

(iv) Not **partner / executive** (this year or Pr. 3 Financial Years.) of (i) Statutory /internal audit firm and (ii) legal / consulting firm have material association with co.

(v) Not a material **supplier, service provider or customer or lesser / lessee** of co.

(vi) He is not a **substantial shareholder** of the company owning 2% or more of block of voting shares.

7(a) I. Circuit Breakers

1. Individual Security-wise 2. Market-wide

1. In Securities :

(a) It is levied to curb excessive **volatility.**

(b) May be 2%, 10%, 20% or 40% based upon categories of shares.

(c) It is calculated w.r.t. closing price of previous trading day.

(d) For example, if on 13:06:2005 the closing rate of AFTEC INFOSYS is Rs.100 the price band in case of 20% circuit breaker is 80 (Lower freeze) and 120 (upper freeze).

2. Market wide C.B.

a. w.e.f. 02:07:2001

b. It has 3 stages of index movement 10%, 15% and 20%.

c. It brings about trading halt in market nationwide (all markets)

d. The percentages are calculated into absolute points of index variations on quarterly basis, based upon closing index of last day of trading in a quarter.

e. So far only twice in Indian history.

f. Depending upon time of index movement and its percentage trading may be halted for specified time period

II. Clearing and Settlement Mechanism

1. The securities pay-in obligations of members are down-loaded by the clearing agency.
2. The members make available the required securities in their pool accounts with Depository Participants (DPs) by the prescribed pay-in time for securities.
3. The depository runs an electronic file to transfer the securities from the pool accounts of members with DPs to the DP account of the clearing agency.
4. The securities are transferred on the pay-out day by the depository from the DP account of the clearing agency to the DP accounts of members.
5. Select banks have been empanelled by clearing agency for electronic transfer of funds.
6. The members are informed electronically of their pay-in obligations of funds.
7. The members make available required funds in their accounts with clearing banks by prescribed pay-in day.
8. Same way, funds are transferred on the pay-out day by the clearing banks from the account of the clearing agency to the accounts of members.

➢ *(b)* Verification of Reinsurance Inwards

- **The Reinsurance inward underwriting should be as per** the norms **and guidelines prescribed in the Insurance Act, 1938 IRDA Regulations as well as the company's approved programme.**
- **The auditor should verify the reinsurance inward transactions are as per the** arrangements **with re-insurers.**
- **The auditor should examine the** accounting policy **of the company in regard to reinsurance business received, premium received and payment of commission and claim costs.**
- **The auditor should satisfy himself about the system of control over the reinsurance inward programme.**
- **The auditor should examine the** foreign currency transactions **and ensure that they comply with Accounting Standards (AS) 11, Accounting for Effects of Changes in Foreign Exchange Rates.**
- **The auditor should examine whether the** outstanding claim figures **have been properly obtained well in time, under proper arrangements and adequate provision has been made for outstanding claims.**
- **The auditor should check whether** provision **has also been made for claims incurred but not reported.**
- **Closing balance of the re-insurer's accounts should be** reconciled **and confirmation should be obtained form them.**

➢Verification of Reinsurance Outward

The auditor should apply the following verification measures for reinsurance outward transactions

- **The auditor should verify that reinsurance outward transactions are as per the** norms **and guidelines prescribed in the Insurance Act, 1938, IRDA Regulations and company's approved reinsurance programme.**
- **The auditor should verify that insurances have been ceded as per** agreements **entered into with various companies.**
- **The auditor should verify the** confirmations **received form re-insurers regarding claims for losses submitted to them.**

- **The auditor should examine the aspects of** reinsurance premium**, commission receivable, paid claims- recovered, outstanding losses-recoverable from re-insurers.**
- **The auditor should examine the** foreign currency transactions **and ensure that they comply with Accounting Standard (AS) – 11.**
- **The auditor should set whether the sub-ledger balance tallies with general ledger control account. He should also** scrutinize **selected accounts of re-insurers.**
- **He should verify** any old outstanding **claims paid or outstanding at the end of the year.**
- **The auditor should look into** events after balance sheet date **which might have significant impact on recovery of claims – paid or outstanding.**

8. (1) Propriety Audit

→ "Propriety Audit stands for verification of transactions on the test of **public interest,** commonly accepted customs & standards of conduct".

→ Propriety is that which meets the tests of public interest, commonly accepted customs and standards of conduct and particularly as applied to professional performance, requirement of law. Government regulations and professional codes" – *E.L. Kohler.*

→ If shifts the emphasis to **substance of transaction**

→ It requires transactions (mainly expenses) to conform to certain general principles :

a) Expense is not prima facie more than the occasion demands and same degree of vigilance is exercised as should be exercised in respect of his own money.

b) **Authority** exercises its **power** of sanctioning expenses to pass an order which will not accrue to its own advantage.

c) Funds **not** utilized for **benefit** of a particular person / group.

d) Apart from agreed **remuneration**, no other avenue is kept open to benefit management personnel, employees and others.

8(2) Exemption from Cost Audit :

The exemption from Cost Audit on year-to-year basis in the following situation :

(i) Temporary Closure of the company / products.

(ii) Negligible production activity.

Fees:

	Company having an authorized Capital	**Amount of fees to be paid**
A	Less than Rs.25 lakh	Rs. 500
B	Rs.25 lakh or more but less than Rs.5 crore	Rs.1,000
C	Rs.5 crore or more	Rs.2,000

Appropriate documents are required to be furnished along with application for exemption:

(i) True copy of complete Annual Report containing balance sheet and profit and loss account for the year for which exemption is being sought along with copies of the same pertaining to preceding two years.

(ii) An affidavit containing full facts of capacity utilization turnover and financial status of the company duly signed by two Directors of the company and authenticated by a Notary Public.

(iii) A brief note/status report on steps taken by the management for revival of the said unit.

8(3) AUDIT PROGRAM for Audit under VAT

i. The turnover of sales/purchases of goods has been properly determined. The sales turnover arrived at by applying the generally accepted accounting policies may not be the same as required under the VAT law.
ii. The turnover of purchases should be tested to enable the auditor to get the purchases eligible for grant of input tax credit segregated from other purchases.
iii. The auditor is expected to list out the due dates of filing of returns and find out the reasons for delay in filing the returns, if any.
iv. The auditor should apply tests as will enable him to ascertain whether the auditee is eligible for composition.
v. The auditor may also be expected to check the consolidation of the returns filed for all the periods covered in the year under audit.
vi. The auditor should check whether all the transactions relating to sale and purchase are entered in the books of account and have been taken into consideration while filing the returns.

8(4) As per AAS-33, "Engagement to review financial statement", the auditor is required to provide the negative assurance which is explained as follows :

Negative Assurance (1) State that –

→ **Nothing** has come to auditor's attention based on review
→ That causes him to **believe**
→ That financial statements do not give a true and fair view (or not presented)
→ In accordance with appropriate framework

(2) If matters come to auditor's attention that impair true and fair view and describe those matters with quantification on financial statement and either

(i) Express qualification of negative assurance, or
(ii) If effect is so material and pervasive that qualification is not adequate give an adverse statement.

(3) If there is material scope limitation, describe the limitation and either–
(i) Express a qualification of negative assurance, or
(ii) When possible effect of limitation is so significant don't provide any assurance.

8(5) a) **As per AAS-6 –** Auditors risk is the risk that the auditor may give **an inappropriate opinion** when the financial statements are materially misstated. Audit risk has three components, *viz*., inherent risk, control risk and detection risk.

1. **Inherent Risk –** Inherent risk is the **susceptibility** of an account balance or class of transaction to a material misstatement, assuming that there were no internal controls. The auditor should study and evaluate the degree of inherent risk in order to determine the audit plan. He should also consider

other factors, which might compensate for an otherwise high degree of inherent risk.

2. **Control Risk –** Control risk is the risk that a material misstatements could occur in an account balance or class of transaction and that will not be **prevented or detected and corrected** on a timely basis by the accounting and internal control system.

3. **Detection Risk –** Detection risk is the risk that an auditor's **substantive procedures** will not detect a material misstatement.

   There is an **inverse relationship** between detection risk and the combined level of inherent and control risks. Thus, when inherent and control risks are high, acceptable detection risk should be low to reduce the audit risk to an acceptably **low level**.

PRIME ACADEMY
25^{th} SESSION MODEL EXAM
FINAL

Total No of Questions: 9 **Total No of Printed Pages : 2**

Time Allowed: 3 Hours **Max. Marks: 100**

CP

Question Nos.1, 2 and 3 are compulsory

Answer any **Four** from the rest of the questions.

1. Answer any **two** of the following: **(2X5=10 Marks)**

a. A, who was a corporate consultant, was appointed as Director of PQ Ltd and was also receiving monthly fees of Rs.10000/- as consultant. The company passed a Board resolution for his appointment under the impression that this was sufficient for approving his appointment.

Advise as to whether the above formality suffices the requirements of the Act or if there is any other procedure to be complied with, explain with reference to the relevant provisions of the Companies Act, 1956 with regard to the said appointment.

b. What is listing of securities and what are the advantages of listing of securities?

c. Explain the provisions of section 210 of the Companies Act, 1956 with regard to the laying of Annual Accounts at the Annual General Meeting of the Company.

2. Answer any **two** of the following: **(2X7= 14 Marks)**

a. Mr.X had resided in India during the Financial Year 1999-2000 for less than 182 days. He again came to India on 1st May 2000 for higher studies and business and stayed upto 15th July 2001. State under the FEMA Act, 1999

i. If Mr. X can be considered ‘ person resident in India’ during the financial year 2000-2001 and
ii. Is citizenship relevant for determining such a status?

b. What should be done by the company after foreign investment in its company is made under the Automatic Route or with Government approval?

c. Explain the provisions of FEMA Act, 1999 with regard to export of Goods and Services.

3. Answer any **two** of the following: **(2X8=16 Marks)**

a. Define the following under the SEBI (Disclosure and Investor Protection) Guidelines 2000.

i. Book Building
ii. Composite Issue

iii. Designated Stock Exchange
iv. Firm Allotment
v. Green Shoe Option
vi. Listed Company
vii. Networth
viii. Preferential Allotment

b. M/s XYZ Ltd an existing unlisted Public Company is planning to issue to the Public five lakhs fully convertible debentures of Rs.100/- each. Explain the eligibility norms to be fulfilled by the company as per SEBI guidelines before making the issue.

c. Define the following as per Competition Act, 2002

i. Consumer
ii. Enterprise
iii. Agreement
iv. Cartel

4. Explain in brief the provisions of section 269 of the Companies Act, 1956 with reference to the appointment of Managing Director as per Schedule XIII to the Act as well as by way of Central Government approval.

(15 Marks)

5. a. List out the points required to be kept in mind while drafting minutes of the board meeting

(8 Marks)

b.What do you understand by Corporate Governance? Prepare a brief note on the same with reference to the Audit Committee.

(7 Marks)

6. a. Explain briefly the provisions of voluntary winding up and also list out the types of voluntary winding up of the company

(8 Marks)

b. What are the provisions of section 257 for appointment of a person other than retiring director?

(7 Marks)

7. Briefly explain the provisions of Section 209 relating to inspection of books of accounts.

(15 Marks)

8. a. Draft a resolution proposed to be passed at the General Meeting of a Public Company giving consent to the Board of Directors for borrowing upto a specified amount in excess of the limits laid down under section 293(1)(d) of the Companies Act.

(8 Marks)

b. Advise the Board of Directors of a public company about their powers in respect of the following proposals explaining the relevant provisions of the Companies Act, 1956.

i. Donation of Rs.5 lakhs to a hospital established exclusively for the benefit of the employees.

(7 Marks)

9. a. Explain under circumstances the company is deemed to be unable to pay its debts.

(8 Marks)

b. State the provisions of the Companies Act with respect to maintenance of Register of contracts, companies and firms in which directors are interested:

(7 Marks)

SUGGESTED ANSWERS
FINAL – CORPORATE LAWS AND SECRETARIAL PRACTICE

1.(a). A Director shall be deemed to hold office or place of profit under the company if he obtains from the company even Re 1/- by way of remuneration over and above the remuneration to which he is entitled to as such director. The provisions of section 314 (1) of the Companies Act, 1956 shall be applicable in case the Director renders the services on regular retainership basis.

As per the Section 314(1)(a), no director shall hold an office or place of profit unless a special resolution has been passed at the general meeting of the company for holding office or place of profit. It shall also be sufficient if the resolution is passed at the general meeting held for the first time after holding such an office or place of profit.

In the present case, Mr. A, corporate consultant who was a retainer, was appointed the Director by passing a board resolution at the Board Meeting. This formality is not sufficient. In the present case, section 314(1) also becomes applicable on his appointment as Director. Therefore, the company also will have to pass a special resolution at a general meeting for the aforesaid appointment as per Section 314(1).

(b) Listing of securities:In order to facilitate the dealing in a security, it is necessary that the security should be listed ina recognized stock exchange. Any person may apply for the listing of securities on a stock exchange. Where securities are listed on the basis of such application, the applicant shall comply with the conditions of the listing agreement with that stock exchangte.

Listing of securities means enlistment of securities of the company on the recognized stock exchange so that the shares, debentures and other securities issued by the company are dealt and quoted on stock exchange and any investor can purchase or sell such securities on the stock exchange.

Advantages of listing of securities to the company

a. The securities when listed receive extensive publicity as the name of the company is carried in daily official list of stock exchange and reported in newspapers
b. Easy marketability of listed shares elicits better response from small investors to subscribe shares and debentures
c. The official quotation of recognized stock exchange is a barometer of the health of the company and it facilitates raising of further finance for modernization, expansion and diversification.
d. Listing encourages institutional and other underwriters to participate in the issue of shares.

(c) (1) At every annual general meeting of a company held in pursuance of section 166, the Board of directors of the company shall lay before the company -

(a) a balance sheet as at the end of the period specified in sub-section (3); and
(b) a profit and loss account for that period.

(2) In the case of a company not carrying on business for profit an income and expenditure account shall be laid before the company at its annual general meeting instead of a profit and loss account, and all references to "profit and loss account", "profit" and "loss" in this section and elsewhere in this Act, shall be construed, in relation to such a company, as references

respectively to the "income and expenditure account", "the excess of income over expenditure", and "the excess of expenditure over income".

(3) The profit and loss account shall relate -

(a) in the case of the first annual general meeting of the company, to the period beginning with the incorporation of the company and ending with a day which shall not precede the day of the meeting by more than nine months; and

(b) in the case of any subsequent annual general meting of the company, to the period beginning with the day immediately after the period for which the account was last submitted and ending with a day which shall not precede the day of the meeting by more than six months, or in cases were an extension of time has been granted for holding the meeting under the second proviso to sub-section (1) of section 166, by more than six months and the extension so granted.

(4) The period to which the account aforesaid relates is referred to in this Act as a "financial year";and it may be less or more than a calendar year, but it shall not exceed fifteen months :

Provided that it may extend to eighteen months where special permission has been granted in that behalf by the Registrar.

(5) If any person, being a director of a company, fails to take all reasonable steps to comply with the provisions of this section, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both :

Provided that in any proceedings against a person in respect of an offence under this section, it shall be a defence to prove that a competent and reliable person was charged with the duty of seeing that the provisions of this section were complied with and was in a position to discharge that duty :

Provided further that no person shall be sentenced to imprisonment for any such offence unless it
was committed willfully.

(6) If any person, not being a director of the company, having been charged by the Board of directors with the duty of seeing that the provisions of this section are complied with, makes default in doing so, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both :

Provided that no person shall be sentenced to imprisonment for any such offence unless it was committed wilfully.

2(a) “Person resident in India” means –

i. A person who resides in India for more than 182 days in the preceding financial year;
Three purposes-
A person may come to India or go out of India
- for or on taking up employment.
- For carrying on any business or profession or
- For any other purpose where the period of his stay would be uncertain.

Therefore a person who comes to India for the above three purposes becomes a resident if his stay exceeds 182 days.

In the present case, Mr. Ram has not resided in India for more than 182 days during financial year 1999-2000. Therefore he is not a person resident in India for financial year 2000-2001. The fact that he came to India during financial year 2000-2001 for higher studies and business is not relevant for determining his residential status for 2000-2001.

ii. Citizenship is no longer relevant for determining residential status under FEMA

2(b). A two-stage reporting procedure has been introduced for approval for foreign investment under the automatic route.-

On receipt of money for investment:

i. Within 30 days of receipt of money from the non-resident investor, the Indian company will report to the Regional Office of the Reserve Bank of India, under whose jurisdiction its Registered Office is located, containing details such as:

- Name and address of the foreign investor/s

-Date of receipt of funds and their rupee equivalent

-Name and address of the authorised dealer through whom the funds have been received, and

-Details of the Government approval, if any.

Upon allotment of shares to non-resident investors:

i. Within 30 days from the date of allotment of shares, a report in Form FC-GPR, PART A together with the following documents should be filed with the concerned Regional Office of the Reserve Bank of India.

-Certificate from the Company Secretary of the company accepting investment from persons resident outside India certifying that;

-The company has complied with the procedure for issue of shares as laid down under the FDI scheme as indicated in the Notification No. FEMA 20/2000-RB dated 3rd May 2000 as amended from time to time

-The proposal is within the sectoral policy / cap permissible under the automatic route of RBI and it fulfills all the conditions laid down for investments under the Automatic approval route namely

a) Non-resident entity/ies (other than individuals) to whom it has issued shares does / do not have any existing joint venture or technology transfer or trade mark agreement in India in the same field.

b) The company is not investing in an SSI unit & the investment limit of 24 % has been observed/ requisite approvals have been obtained.

c) Shares have been issued on rights basis and the shares are issued to non-residents at a price that is not lower than that at which shares are/were issued to residents.

OR

d) Shares issued are bonus shares.

OR

e) Shares have been issued under a scheme of merger and amalgamation of two or more Indian companies or reconstruction by way of demerger or otherwise of an Indian company, duly approved by a court in India.

- Shares have been issued in terms of FIPB approval

- Certificate from Statutory Auditors or Chartered Accountant indicating the manner of arriving at the price of the shares issued to the persons resident outside India.

2(c). Export of goods and services

Export of goods implies transferring goods to any place outside India from India or provision of services from India to any place outside India. Section 7 deals with export of goods and services and payment thereof. To protect and regulate the inflow of foreign currency on exports it is provided that every export shall:

a) Furnish to the Reserve Bank of India or to such other authority a declaration in such form and in such manner as may be specified, containing true and correct material particulars, including the amount representing the full export value or, if the full export value of the goods is not ascertainable at the time of export, the value which the exporter having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India.

b) Furnish to the Reserve Bank of India such other information as may be required by the RBI for the purpose of ensuring the realization of the export proceeds by such exporter.

The exporter may for the purpose of ensuring that the full export value of the goods or such reduced value of the goods as the RBI determines, having regard to the preceding market conditions, is received without delay, direct any exporter to comply with such requirements such as declaration of value as it deems fit.

3(a) **i)"Book Building"** means a process undertaken by which a demand for the securities proposed to be issued by a body corporate is elicited and built up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document;

ii)"Composite Issues" means an issue of securities by a listed company on a public cum rights basis offered through a single offer document wherein the allotment for both public and rights components of the issue is proposed to be made simultaneously;

iii) Designated Stock Exchange" means a stock exchange in which securities of the company are listed or proposed to be listed and which is chosen by the company for purposes of a particular issue under these guidelines.

Provided that where any of such stock exchanges have nationwide trading terminals, the company shall choose one of them as the designated stock exchange.

Provided further that the company may choose a different exchange as a designated stock exchange for any subsequent issue, subject to the above clause.

iv) "Firm Allotment" means allotment on a firm basis in public issues by an issuing company made to Indian and Multilateral Development Financial Institutions, Indian Mutual Funds, Foreign Institutional Investors including nonresident Indians and overseas corporate bodies and permanent/ regular employees of the issuer company.

v) "Green Shoe Option" means an option of allocating shares in excess of the shares included in the public issue and operating a post-listing price stabilizing mechanism in accordance with the provisions of Chapter VIII-A of SEBI Guidelines, which is granted to a company to be exercised through a Stabilising Agent.

vi) "Listed Company" means a company which has any of its securities offered through an offer document listed on a recognised stock exchange and also includes Public Sector Undertakings whose securities are listed on a recognized stock exchange.

vii) "Networth" means aggregate of value of the paid up equity capital and free reserves (excluding reserves created out of revaluation) reduced by the aggregate value of accumulated losses and deferred expenditure not written off (including miscellaneous expenses not written off) as per the audited balance sheet.

viii) "Preferential Allotment" means an issue of capital made by a body corporate in pursuance of a resolution passed under Sub-section (1A) of Section 81 of the Companies Act, 1956.

3(b). Eligibility norms for making public issue of debentures by an unlisted company"

- Conditions for issue of securities

The companies issuing securities offered through an offer document shall satisfy the following at the time of filing the draft offer document with SEBI and also at the time of filing the final offer document with the Registrar of Companies/ Designated Stock Exchange:)

- Filing of offer document

No company shall make any issue of a public issue of securities, unless a draft prospectus has been filed with the Board, through an eligible Merchant Banker, atleast 21 days prior to the filing of Prospectus with the Registrar of Companies (ROCs).

Provided that if, within 21 days from the date of submission of draft Prospectus, the Board specifies changes, if any, in the draft Prospectus (without being under any obligation to do so), the issuer or the Lead Merchant banker shall carry out such changes in the draft prospectus before filing the prospectus with ROCs.

No listed company shall make any issue of security through a rights issue where the aggregate value of securities, including premium, if any, exceeds Rs.50 lacs, unless the letter of offer is filed with the Board, through an eligible Merchant Banker, at least 21 days prior to the filing of the Letter of Offer with Regional Stock Exchange (RSE).

Provided that if, within 21 days from the date of filing of draft letter of offer, the Board specifies changes, if any, in the draft letter of offer, (without being under any obligation to do so), the issuer or the Lead Merchant banker shall carry out such changes before filing the draft letter of offer with RSE.)

- Companies barred not to issue security
No company shall make an issue of securities if the company has been prohibited from accessing the capital market under any order or direction passed by the Board.

- Application for listing
No company shall make any public issue of securities unless it has made an application for listing of those securities in the stock exchange (s).

- Issue of securities in dematerialised form
No company shall make public or rights issue or an offer for sale of securities, unless :

(a) the company enters into an agreement with a depository for dematerialisation of securities already issued or proposed to be issued to the public or existing shareholders; and

(b) the company gives an option to subscribers/ shareholders/ investors to receive the security certificates or hold securities in dematerialised form with a depository.

Explanation:
A "depository" shall mean a depository registered with the Board under the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996.

3 (c) Definitions:

(i) "Consumer" means any person who—

-buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, whether such purchase of goods is for resale or for any commercial purpose or for personal use;

- hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first-mentioned person whether such hiring or availing of services is for any commercial purpose or for personal use;

(ii) "enterprise" means a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

Explanation.-—For the purposes of this clause,—
(a) "activity" includes profession or occupation;
(b) "article" includes a new article and "service" includes a new service;
(c) "unit" or "division", in relation to an enterprise, includes—
- a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods;
-any branch or office established for the provision of any service;

(iii) "agreement" includes any arrangement or understanding or action in concert,—
- whether or not, such arrangement, understanding or action is formal or in writing; or
- whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

(iv) "cartel" includes an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services;

4. The following are the provisions of section 269 of the Companies Act, 1956 relating to the appointment of Managing or Whole-time director or Manager to require government approval only in certain cases.

(1) Every public company, or a private company, which is a subsidiary of a public company, having a paid-up share capital of such sum as may be prescribed (Rs.5 crores as prescribed by the Central Government) shall have a managing or whole-time director or a manager.

(2) No appointment of a person as a managing or whole-time director or a manager in a public company or a private company which is a subsidiary of a public company shall be made

a. except with the approval of the Central Government unless such appointment is made in accordance with the conditions specified in Parts I and II of Schedule XIII and
b. a return in the prescribed form is filed within ninety days from the date of such appointment.

(3) Application seeking approval to the appointment of a managing or whole-time director or a manager shall be made to the Central Government within a period of ninety days from the date of such appointment.

(4) The Central Government shall not accord its approval to an application made under subsection (3), if it is satisfied that -

a) the managing or whole-time director or the manager appointed is in its opinion, not a fit and proper person to be appointed as such or such appointment is not in the public interest; or

(b) the terms and conditions of the appointment of managing or whole-time director or the manager are not fair and reasonable.

(5) It shall be competent for the Central Government while according approval to an appointment under sub-section (3) to accord approval for a period lesser than the period for which the appointment is proposed to be made.

(6) If the appointment is not approved by the Central Government under sub-section (4), the person shall vacate his office on the date on which the decision of the Central Government is communicated to the company, and if he omits or fails to do so, he shall be punishable with fine which may extend to five hundred rupees for every day during which he omits or fails or vacate such office.

(7) Where the Central Government suo motu or on any information received by it is, prima facie, of the opinion that any appointment made under sub-section (2) without the approval of the Central Government has been made in contravention of the requirements of Schedule XIII, it shall be competent for the Central Government to refer the matter to the Company Law Board for decision.

(8) The Company Law Board shall, on receipt of a reference under sub-section (7), issue a notice to the company, the managing or whole-time director or the manager, as the case may be, and the director or other officer responsible for complying with the requirements of Schedule XIII, to show cause as to why such appointment shall not be terminated and the penalties provided under sub-section (10) shall not be imposed.

Explanation : In this section "appointment" includes re-appointment and "whole-time" director in
the whole-time employment of the company.

5(a) The following points must be kept in mind while drafting minutes of the Board Meetings: Minutes must be prepared within 40 days of the conclusion of the meeting. Minutes should include the following particulars

i. Names of the Directors present at the meeting
ii. Names of the directors absent and asking for grant of leave of absence by the Board.
iii. Names of the directors voting for or against the various resolutions under respective items of business
iv. Notice given by the Directors with regard to their directorships to other companies and their shareholdings under the Act.
v. Any unanimous decisions of Directors as contemplated u/s 316, 372A and 386.
vi. Appointment of officials made at the Board meetings.

Board Minutes book must be numbered consecutively.

Every page shall be signed by

- the chairman of the same meeting or
- chairman of the next succeeding meeting

The minutes of the Board meeting are not open for inspection by the members.

The minutes may be inspected by

- Any director
- Auditors of the company
- Registrar of Companies
- Any officer authorized by the Central Government.

Minutes may be maintained in loose leaf form. In such a case, they should be bound at reasonable intervals and must be safeguarded against manipulation.

b) Corporate Governance is about promoting corporate fairness, transparency and accountability. Corporate Governance denotes the process, structure and relationship through which the Board of Directors overseas what the management does. It is also about answerable to different stakeholders.

Listed companies should comply with the provisions contained in clause 49 of the listing agreement.

The concept of audit committee will help in achieving some of the objectives of corporate governance because:

i. It provides a periodic review of internal control system and acts as an early warning system about corporate failure.
ii. It ensures an independence review of the financial position of a company independence is ensured because two thirds of the audit committee shall be non-wholetime directors who would normally be independent.
iii. If implemented in accordance with the spirit of sec. 292A, it would ensure inclusion of seasoned professional and experts on corporate boards thus enhancing the effectiveness of corporate board decision.

6 (a). Circumstances in which company may be wound up voluntarily

1. A company may be wound up voluntarily:

(a) when the period, if any, fixed for the duration of the company by the articles has expired, or the event, if any, has occurred, on the occurrence of which the articles provide that the company is to be dissolved, and the company in general meeting passes a resolution requiring the company to be wound up voluntarily;

(b) if the company passes a special resolution that the company be wound up voluntarily.

(2) In this Act, the expression "a resolution for voluntary winding up" means a resolution passed under clause (a) or (b) of sub-section (1).

Publication of resolution to wind up voluntarily

(1) When a company has passed a resolution for voluntary winding up, it shall, within ten working days of the passing of the resolution, give notice of the resolution by advertisement in a national daily newspaper published in English and in the principal language of the district in which the registered office of the company is situated.

(2) If default is made in complying with sub-section (1), the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues.

For the purposes of this sub-section, a liquidator of the company shall be deemed to be an officer of the company.

Commencement of voluntary winding up

(1) A voluntary winding up shall be deemed to commence from the date when the resolution for voluntary winding up is passed.

(2) In the case of a voluntary winding up, the company shall, from the commencement of the winding up, cease to carry on its business, except so far as may be required for the beneficial winding up of such business.

Provided that the corporate state and corporate powers of the company shall continue until it is dissolved.

6(b) The provisions of Section 257 relating to right of persons other than retiring directors to stand for Directorship are as follows.

(1) A person who is not a retiring director shall, subject to the provisions of this Act, be eligible for appointment to the office of director at any general meeting, if he or some member intending to propose him has, not less than fourteen days before the meeting, left at the office of the company a notice in writing under his hand signifying his candidature for the office of director or the intention of such member to propose him as a candidate for that office, as the case may be, along with a deposit of five hundred rupees which shall be refunded to such person or, as the case may be, to such member, if the person succeeds in getting elected as a director.

(1A) The company shall inform its members of the candidature of a person for the office of director or the intention of a member to propose such person as a candidate for that office, by serving individual notices on the members not less than seven days before the meeting :

Provided that it shall not be necessary for the company to serve individual notices upon the members as aforesaid if the company advertises such candidature or intention not less than seven days before the meeting in at least two newspapers circulating in the place where the registered office of the company is located, of which one is published in the English language and the other in the regional language of that place.

(2) Sub-section (1) shall not apply to a private company, unless it is a subsidiary of a public company.

7) The provisions relating to inspection of books of account, etc., of companies under section 257 of the Companies Act, 1956 are as follows.

(1) The books of account or other books and papers of every company shall be open to inspection during business hours -
(i) by the Registrar, or
(ii) by such officer of Government as may be authorised by the Central Government in this behalf:

Provided that such inspection may be made without giving any previous notice to the company or any officer thereof.

(2) It shall be the duty of every director, other officer or employee of the company to produce to the person making in section under sub-section (1), all such books of account and other books and papers of the company is his custody or control and to furnish him with any statement, information or explanation relating to the affairs of the company as the said person may require of him within such time and at such place as he may specify.

(3) It shall also be the duty of every director, other officer or employee of the company to give to the person making insection under this section all assistance in connection with the inspection which the company may be reasonably expected to give.

(4) The person making the inspection under this section may, during the course of inspection, -
(i) make or cause to be made copies of books of account and other books and papers, or
(ii) place or cause to be placed any marks of identification thereon in token of the inspection having been made.

(5) Notwithstanding anything contained in any other law for the time being in force or any contract to the contrary, any person making an inspection under this section shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit, in respect of the following matters, namely :-
(i) the discovery and production of books of account and other documents, at such place and such time as may be specified by such person;
(ii) summoning and enforcing the attendance of persons and examining them on oath;
(iii) inspection of any books, registers and other documents of the company at any place.

(6) Where an inspection of the books of account and other books and papers of the company has been made under this section, the person making the insection shall make a report to the Central Government.

(7) Any officer authorised to make an inspection under this section shall have all the powers that a Registrar has under this Act in relation to the making of inquires.

8(a) The resolution to be passed under section 293(1)(d) of the Companies Act, 1956 is as follows:

Resolved that in pursuant to the provisions of Section 293(1)(d) and other applicable provisions of the Companies Act, 1956, consent of the Company be and is hereby accorded to the Board of Directors to borrow any sum or sums from time to time, notwithstanding that the moneys to be borrowed together with the moneys already borrowed by the Company (apart from temporary loans obtained from the Company's Bankers in the ordinary course of business) may exceed the aggregate of the paid up capital of the Company and its free reserves, not set apart from any specific purpose, provided however, that the total amount so borrowed shall not exceed Rs.______.

8(b) Contributions to Charitable and other funds directly relating to the welfare of companies employees is not subject to any ceiling limit under Sec.293(1)(e) . Therefore the Board of Directors may donate Rs.5 lakhs to a hospital established exclusively for the benefit of employees.

9(a) A company shall be deemed to be unable to pay its debts

(a) if a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding five hundred rupees then due, has served on the company, by causing it to be delivered at its registered office, by registered post or otherwise, a demand under his hand requiring the company to pay the sum so due and the company has for three weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor ;

(b) if execution or other process issued on a decree or order of any Court in favour of a creditor of the company is returned unsatisfied in whole or in part ; or

(c) if it is proved to the satisfaction of the Court that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the Court shall take into account the contingent and prospective liabilities of the company.

(d) The demand referred to in clause (a) of sub-section (1) shall be deemed to have been duly given under the hand of the creditor if it is signed by any agent or legal adviser duly authorised on his behalf, or in the case of a firm, if it is signed by any such agent or legal adviser or by any member of the firm.

9(b) Register Of Contracts, Companies and firms in which Directors are interested.

(1) Every company shall keep one or more registers in which shall be entered separately particulars of all contracts or arrangements to which section 297 or section 299 applies, including the following particulars to the extent they are applicable in each case, namely :-

(a) the date of the contract or arrangement;
(b) the names of the parties thereto;
(c) the principal terms and conditions thereof;
(d) in the case of a contract to which section 297 applies or in the case of a contract or arrangement to which sub-section(2) of section 299 applies, the date on which it was placed before the Board;
(e) the names of the directors voting for and against the contract or arrangement and the names of those remaining neutral.

(2) Particulars of every such contract or arrangement to which section 297 or, as the case may be, sub-section (2) of section 299 applies, shall be entered in the relevant register aforesaid -

(a) in the case of a contract or arrangement requiring the Board's approval, within seven days (exclusive of public holidays) of the meeting of the Board at which the contract or arrangement is approved.

(b) in the case of any other contract or arrangement, within seven days of the receipt at the registered office of the company of the particulars of such other contract or arrangement or within thirty days of the date of such other contract or arrangement whichever is later, and the register shall be placed before the next meeting of the Board and shall then be signed by all the directors present at the meeting.

(3) The register aforesaid shall also specify, in relation to each director of the company, the names of the firms and bodies corporate of which notice has been given by him under subsection (3) of section 299.