PAPER – 1 : ADVANCED ACCOUNTING

Answer all questions.

Working notes should form part of the answer.

Question 1

The following information has been extracted from the Books of 'X' Limited group (as at 31st December, 2006):

	X Ltd.	Y Ltd.	Z Ltd.		X Ltd.	Y Ltd.	Z Ltd.
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
Share capital				Fixed Assets Less			
(Fully paid equity shares of Rs.10 each)	8,00,000	6,00,000	4,00,000	Depreciation	4,20,000	3,76,000	5,22,000
				Investment at Cost	6,30,000	4,00,000	---
Profit and Loss Account	2,10,000	1,90,000	1,28,000	Current Assets	1,20,000	60,000	40,000
Dividend received:							
From Y Ltd. in 2005	60,000						
From Y Ltd. in 2006	60,000						
From Z Ltd. in 2006		36,000					
Current Liabilities	40,000	10,000	34,000				
	11,70,000	8,36,000	5,62,000		11,70,000	8,36,000	5,62,000

All the companies pay dividends of 12 percent of paid-up share capital in March following the end of the accounting year. The receiving companies account for the dividends in their books when they are received.

'X' Limited acquired 50,000 equity shares of Y Ltd. on 31st December, 2004.

'Y' Limited acquired 30,000 equity shares of Z Ltd. on 31st December, 2005.

The detailed information of Profit and Loss Accounts is as follows:

	X Ltd.	Y Ltd.	Z Ltd.
	Rs.	Rs.	Rs.
Balance of Profit and Loss Account on 31st December, 2004 after dividends of 12% in respect of			

calendar year 2004, but excluding dividends received	86,000	78,000	60,000
Net profit earned in 2005	1,20,000	84,000	56,000
	2,06,000	1,62,000	1,16,000
Less – Dividends of 12% (paid in 2006)	96,000	72,000	48,000
	1,10,000	90,000	68,000
Net profit earned in 2006 (Before taking into account proposed dividends of 12% in respect of calendar year 2006)	1,00,000	1,00,000	60,000
	2,10,000	1,90,000	1,28,000

Taking into account the transactions from 2004 to 2006 and ignoring taxation, you are required to prepare:

(i) The Consolidated Balance Sheet of X Limited group as at 31st December, 2006.

(ii) The Consolidated Profit and Loss Account for the year ending 31st December, 2006.

(iii) Cost of control.

(iv) Minority shareholders interest. (16 Marks)

Answer

(i) Consolidated Balance Sheet of X Ltd. and its subsidiaries Y Ltd. and Z Ltd. as on 31st December, 2006

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
80,000 Equity shares of Rs.10 each fully paid	8,00,000	Goodwill [Refer (iii)]	18,000
Minority Interest [Refer (iv)]	2,47,167	Other Fixed Assets less depreciation	13,18,000
Reserves and Surplus:			
Profit and Loss Account [Refer (ii)]	3,04,833	Current Assets, Loans and Advances:	
Current Liabilities and Provision:		Current Assets	2,20,000
Current Liabilities	84,000		
Proposed Dividend:			
X Ltd.	96,000		
Minority Interest [Refer (iv)]	24,000		
	15,56,000		15,56,000

(ii) Consolidated Profit and Loss Account

for the year ending 31st December, 2006 (in Rs.)

Particulars	X Ltd.	Y Ltd.	Z Ltd.	Adjust-ments	Total	Particulars	X Ltd.	Y Ltd.	Z Ltd.	Adjust ments	Total
To Dividend (paid for 2005)	96,000	72,000	48,000	96,000	1,20,000	By Balance b/d	2,06,000	1,62,000	1,16,000	-	4,84,000
To Minority Interest	-	39,167	32,000	-	71,167	By Dividend received in 2005 (for 2004)	60,000	-	-	-	60,000
To Capital Reserve (Cost of Control)	-	65,000	51,000	-	1,16,000	By Dividend received in 2006 (for 2005)	60,000	36,000	-	96,000	-
To Investments Accounts						By Profit for the year	1,00,000	1,00,000	60,000	-	2,60,000
(Dividend received out of capital profit)	60,000*	36,000*	-	-	96,000						
To Proposed Dividend	96,000	-	-	-	96,000						
To Balance c/d	1,74,000	85,833	45,000	- -	3,04,833						
	4,26,000	2,98,000	1,76,000	96,000	8,04,000		4,26,000	2,98,000	1,76,000	96,000	8,04,000

Notes:*

(1) X Ltd. receives from Y Ltd., dividend amounting to Rs.60,000 for the year 2004 in the year 2005 for shares acquired in 2004. It is a capital profit, therefore it has been transferred to cost of control to reduce the cost of investment.

(2) Y Ltd. receives a dividend of Rs.36,000 from Z Ltd. for the year 2005 in the year 2006. The shares were acquired by Y Ltd on 31st December, 2005. The entire amount is therefore, a capital profit and hence transferred to cost of control to reduce the cost of investment.

(iii) Cost of Control:

	Rs.	Rs.
Cost of Investment in Y Ltd. on 31st December 2004	6,30,000	
Less: Dividend of the year 2004 received in 2005 out of Pre-acquisition profit	60,000	5,70,000
Cost of Investment in Z Ltd.	4,00,000	
Less: Dividend of the year 2005 received in 2006 out of Pre-acquisition Profit	36,000	3,64,000
		9,34,000

		Rs.	Rs.
Less: Paid up value of shares in Y Ltd.		5,00,000	
Paid up value of shares in Z Ltd.		3,00,000	
Capital Profits in Y Ltd. (Refer W.N. 2)		65,000	
Capital Profits in Z Ltd. (Refer W.N. 2)		51,000	9,16,000
Goodwill			18,000

(iv) Minority shareholders' interest:

	Y Ltd.	Z Ltd.
	Rs.	Rs.
Share Capital (Y Ltd. – 1/6 and Z Ltd. – 1/4)	1,00,000	1,00,000
Capital Profits (Refer W.N. 2)	13,000	17,000
Revenue Profits (Refer W.N. 2)	26,167	15,000
	1,39,167	1,32,000
Total (1,39,167 + 1,32,000)		2,71,167
Less: Minority shareholders' share of proposed dividend (shown separately in the Balance Sheet) $(\frac{1}{6}\text{ of Rs.}72{,}000+\frac{1}{4}\text{ of Rs.}48{,}000)$		24,000
Balance		2,47,167

Working Notes:

1. Shareholding Pattern

	Number of shares	share of holding
In Y Ltd.		
X Ltd.	50,000	5/6
Minority Interest	10,000	1/6
In Z Ltd.		
Y Ltd.	30,000	3/4
Minority Interest	10,000	1/4

2. Analysis of Profits

	Pre - acquisition Capital Profit	Post - acquisition Revenue Profit
Z Ltd.	Rs	Rs.
Balance on 31st December, 2005 after dividend for 2005 (1,16,000 – 48,000)	68,000	-

Profit for the year ending 31st December, 2006 before proposed dividends for 2006	-	60,000
	68,000	60,000
Share of Y Ltd. (3/4)	51,000	45,000
Minority Interest (1/4)	17,000	15,000
Y Ltd.		
Balance on 31st December, 2004	78,000	-
Profit for the year 2005 after payment of dividend for 2005 (84,000 – 72,000)	-	12,000
Profit for the year 2006 (before payment of dividend of the year 2006)	-	1,00,000
Revenue Profit from Z Ltd.	-	45,000
	78,000	1,57,000
Share of X Ltd. (5/6)	65,000	1,30,833
Share of Minority Shareholders' Interest (1/6)	13,000	26,167

Note: This problem has been solved by following 'direct approach'.

Question 2.

The following are the Balance sheets (as at 31.3.2006) of A Ltd. and B Ltd.:

Liabilities	A Ltd.	B. Ltd.	Assets	A Ltd.	B. Ltd.
	Rs.	Rs.		Rs.	Rs.
Share Capital:			Fixed Assets	50,00,000	30,00,000
Equity Shares of Rs.10 each	36,00,000	18,00,000	Investments	5,00,000	5,00,000
			Current Assets		
10% Preference shares of Rs.100 each	12,00,000	-	Stock	18,00,000	12,00,000
			Debtors	15,00,000	12,00,000
			Bills receivable	50,000	10,000
12% Preference shares of Rs.100 each	-	6,00,000	Cash at Bank	1,50,000	90,000
Reserve and Surplus:					
Statutory Reserve	1,00,000	1,00,000			
General Reserve	25,00,000	17,00,000			

Secured Loan					
15% Debentures	5,00,000	-			
12% Debentures	-	5,00,000			
Current Liabilities					
Sundry creditors	10,80,000	12,80,000			
Bills payable	20,000	20,000			
	90,00,000	60,00,000		90,00,000	60,00,000

Contingent liabilities for bills receivable discounted Rs.20,000.

(A) The following additional information is provided to you:

	A Ltd.	B Ltd.
	Rs.	Rs.
Profit before Interest and Tax	14,75,000	7,80,000
Rate of Income-tax	40%	40%
Preference dividend	1,20,000	72,000
Equity dividend	3,60,000	2,70,000

Balance profit transferred to Reserve account.

(B) The equity shares of both the companies are quoted on the Mumbai Stock Exchange. Both the companies are carrying on similar manufacturing operations.

(C) A Ltd proposes to absorb business of B Ltd. as on 31.3.2006. The agreed terms for absorption are:

(i) 12% Preference shareholders of B Ltd. will receive 10% Preference shares of A Ltd. sufficient to increase their present income by 20%.

(ii) The Equity shareholders of B Ltd. will receive equity shares of A Ltd. on the following terms:

(a) The Equity shares of B Ltd. will be valued by applying to the earnings per share of B Ltd. 60 per cent of price earnings ratio of A Ltd. based on the results of 2005-06 of both the Companies.

(b) The market price of Equity shares of A Ltd. is Rs.40 per share.

(c) The number of shares to be issued to Equity shareholders of B Ltd. will be based on the 80% of market price.

(d) In addition to Equity shares, 10% Preference shares of A Ltd. will be issued to the equity shareholders of B Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2005-2006.

(iii) 12% Debentureholders of B Ltd. are to be paid at 8% premium by 15% debentures in A Ltd. issued at a discount of 10%.

(iv) Rs.16,000 is to be paid by A Ltd. to B Ltd. for liquidation expenses. Sundry Creditors of B Ltd. include Rs.20,000 due to A Ltd. Bills receivable discounted by A Ltd. were all accepted by B Ltd.

(v) Fixed assets of both the companies are to be revalued at 20% above book value. Stock in trade is taken over at 10%; less than their book value.

(vi) Statutory reserve has to be maintained for two more years.

(vii) For the next two years no increase in the rate of equity dividend is anticipated.

(viii) Liquidation expense is to be considered as part of purchase consideration.

You are required to:

(i) Find out the purchase consideration.

(ii) Give journal entries in the books of A Ltd.

(iii) Give the Balance Sheet as at 31.3.2006 after absorption. (16 Marks)

Answer

(i) Computation of Purchase Consideration

	Rs.
For Preference Shareholders	
Present Income of Preference Shareholders of B Ltd.	72,000
Add : Required 20% increase	14,400
	86,400

10% Preference Shares to be issued of Rs. 8,64,000 (86,400/10x 100)

For Equity Shareholders

Valuation of Equity Shares of B Ltd. =

Number of shares x Value of one share (i.e. EPS of B Ltd. x P/E ratio of A Ltd. x 60/100)

$= 1,80,000 \times (Rs.2 \times 20 \times \frac{60}{100}) = 1,80,000 \times 24 = Rs.43,20,000$

Issue of Equity Shares

No. of Equity Shares to be issued at 80% of Market Price i.e.

80% of Rs.40 = Rs.32

$\frac{43,20,000}{32} = 1,35,000$ shares

Equity Share Capital = 1,35,000 x Rs.10 = Rs.13,50,000

Securities Premium = 1,35,000 x Rs. 22 =	Rs.29,70,000
	Rs.43,20,000

Issue of Preference Shares	Rs.
Present Equity Dividend	2,70,000
Less: Expected Equity Dividend from A Ltd.	
$(13,50,000 \times \frac{10}{100})$	1,35,000
Loss in income	1,35,000

10% Preference Shares to be issued of Rs. 13,50,000 (1,35,000/10x 100)

Purchase Consideration	
Preference Shares Capital [Rs.8,64,000 + Rs.13,50,000]	22,14,000
Equity Share Capital (1,35,000 shares of Rs.10 each at Rs.32 per share)	43,20,000
Liquidation Expenses (in cash)	16,000
	65,50,000

(ii) Journal Entries in the Books of A Ltd.

	Particulars		Dr.(Rs).	Cr. (Rs.)
1.	Fixed Assets A/c	Dr.	10,00,000	
	To Revaluation Reserve			10,00,000
	(Being Revaluation of Fixed assets at 20% above book value)			
2.	Business Purchase A/c	Dr.	65,50,000	
	To Liquidator of B Ltd.			65,50,000
	(Being purchase consideration payable for the business taken over from B Ltd.			
3.	Fixed Assets A/c	Dr.	36,00,000	
	Investment A/c	Dr.	5,00,000	
	Stock A/c	Dr.	10,80,000	
	Debtors A/c	Dr.	12,00,000	
	Bills Receivable A/c	Dr.	10,000	
	Cash at Bank A/c	Dr.	90,000	
	Goodwill A/c (Balancing figure)	Dr.	19,10,000	

	To 12% Debentures in B Ltd.			5,40,000
	To Creditors			12,80,000
	To Bills Payable			20,000
	To Business Purchase A/c			65,50,000
	(Being incorporation of different assets and liabilities of B Ltd. taken over at agreed values and balance debited to goodwill account)			
4.	Liquidator of B Ltd.	Dr.	65,50,000	
	To Equity Share Capital A/c			13,50,000
	To Securities Premium A/c			29,70,000
	To Preference Share Capital A/c			22,14,000
	To Bank A/c			16,000
	(Being discharge of consideration for B Ltd's business)			
5.	12% Debentures in B Ltd.	Dr.	5,40,000	
	Discount on issue of Debentures	Dr.	60,000	
	To 15% Debentures			6,00,000
	(Being allotment of 15% Debentures to debenture holders at a discount of 10% to discharge liability of B Ltd. debentures)			
6.	Sundry Creditors A/c	Dr.	20,000	
	To Sundry Debtors A/c			20,000
	(Being cancellation of Mutual owing)			
7.	Amalgamation Adjustment A/c	Dr.	1,00,000	
	To Statutory Reserve A/c			1,00,000
	(Being statutory reserve account is maintained under statutory requirements)			
8.	Securities Premium A/c	Dr.	60,000	
	To Discount on issue of Debentures A/c			60,000
	(Being discount on issue of Debentures written off out of securities premium)			

(iii) Balance Sheet of A Ltd (after absorption of B Ltd.)
as on 31.3.2006

Liabilities	Amount Rs.	Assets	Amount Rs.
Share Capital:		Fixed Assets:	
4,95,000 Equity Shares of	49,50,000	Goodwill	19,10,000
Rs. 10 each fully paid (1,35,000 shares have been allotted as fully paid up for consideration other than cash)		Other Fixed Assets (60,00,000+36,00,000)	96,00,000
		Investment	
		(5,00,000+5,00,000)	10,00,000
10% Preference Shares of Rs.100 each fully paid	34,14,000	Current Assets: Stock	
Reserve & Surplus:		(18,00,000+10,80,000)	28,80,000
Statutory Reserve	2,00,000	Debtors	26,80,000
Revaluation Reserve	10,00,000	(15,00,000+12,00,000-	
General Reserve	25,00,000	20,000)	
Securities Premium	29,10,000	Bills Receivable	60,000
Secured Loan:		(50,000+10,000)	
15% Debentures	11,00,000	Cash at Bank	2,24,000
(5,00,000 + 6,00,000)		(1,50,000 + 90,000-	
Current Liabilities and		16,000)	
Provisions:		Amalgamation	1,00,000
Creditors		Adjustment A/c	
(10,80,000+12,80,000-20,000)	23,40,000		
Bills Payable (20,000 + 20,000)	40,000		
	1,84,54,000		1,84,54,000

Note: No footnote will appear for contingent liability as it has been converted into actual liability after absorption of B Ltd.

Working Notes:

1. Calculation of EPS & P/E ratio

	A Ltd. Rs.	B Ltd. Rs.
Profit before Interest and Tax	14,75,000	7,80,000
Less: Interest on debentures	75,000	60,000
Profit before tax	14,00,000	7,20,000
Less: Tax @ 40%	5,60,000	2,88,000

	8,40,000	4,32,000
Less: Preference Dividend	1,20,000	72,000
Earnings available for equity shareholders	7,20,000	3,60,000
Number of shares	3,60,000 shares	1,80,000 shares
EPS (Earnings/ No. of shares)	2	2
Market Price	Rs.40	Not given
P/E ratio	40/2 = 20	N.A.

2. Computation of Goodwill/Capital Reserve on absorption:

			Rs.
Purchase Consideration			65,50,000
Fixed Assets taken over	30,00,000		
Add: Increase by 20%	6,00,000	36,00,000	
Investments		5,00,000	
Current Assets:			
Stock	12,00,000		
Less: Reduction in value by 10%	1,20,000		
	10,80,000		
Debtors	12,00,000		
B/R	10,000		
Cash at Bank	90,000	23,80,000	
		64,80,000	
Less: Outside Liabilities:			
12% Debentures at premium	5,40,000		
Sundry Creditors	12,80,000		
Bills Payable	20,000	18,40,000	46,40,000
Goodwill			19,10,000

Question 3

The following is the Balance Sheet (as at 31st December, 2006) of Sun Ltd.:

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
80,000 Equity shares of Rs.10 each fully paid up	8,00,000	Goodwill	1,00,000
50,000 Equity shares of Rs.10 each Rs.8 paid up	4,00,000	Plant and Machinery	8,00,000

36,000 Equity shares of Rs.5 each fully paid up	1,80,000	Land and Building	10,00,000
30,000 Equity shares of Rs.5 each Rs.4 paid-up	1,20,000	Furniture and Fixtures	1,00,000
3,000 10% Preference shares of Rs.100 each fully paid	3,00,000	Vehicles	2,00,000
Reserve and Surplus:		Investments	3,00,000
General reserve	1,40,000	Current Assets:	
Profit and Loss account	2,10,000	Stock	2,10,000
Secured Loan: 12% Debenture	2,00,000	Debtors	1,95,000
Unsecured Loan: 15% Term loan	1,50,000	Prepaid Expenses	40,000
Deposits	1,00,000	Advances	45,000
Current Liabilities:		Cash and Bank balance	2,00,000
Bank Loan	50,000	Preliminary Expenses	10,000
Creditors	1,50,000		
Outstanding expenses	20,000		
Provision for tax	2,00,000		
Proposed Dividend:			
Equity	1,50,000		
Preference	30,000		
	32,00,000		32,00,000

Additional Information:

(1) In 2004 a new machinery costing Rs.50,000 was purchased, but wrongly charged to revenue (no rectification has yet been made for the same).

(2) Stock is overvalued by Rs.10,000 in 2005. Debtors are to be reduced by Rs.5,000 in 2006, some old furniture (Book value Rs.10,000) was disposed of for Rs.6,000.

(3) Fixed assets are worth 5 per cent more than their actual book value. Depreciation on appreciated value of Fixed assets except machinery is not to be considered for valuation of goodwill.

(4) Of the investment 20 per cent is trading and the balance is non-trading. All trade investments are to be valued at 20 per cent below cost. Trade investment were purchased on 1st January, 2006. 50 percent of the non-trade investments were acquired on 1st January, 2005 and the rest on 1st January, 2004. A uniform rate of dividend of 10 percent is earned on all investments.

(5) Expected increase in expenditure without commensurate increase in selling price is Rs.20,000.

(6) Research and Development expenses anticipated in future Rs.30,000 per annum.

(7) In a similar business a normal return on capital employed is 10%.

(8) Profit (after tax) are as follows:

In 2004 – Rs.2,10,000, in 2005 – Rs.1,90,000 and in 2006 – Rs.2,00,000.

(9) Current income tax rate is 50%, expected income tax rate will be 40%.

From the above, ascertain the ex-dividend and cum-dividend intrinsic value for different categories of Equity shares. For this purpose goodwill may be taken as 3 years purchase of super profits. Depreciation is charged on machinery @ 10% on reducing system.

(16 Marks)

Answer

Computation of Value of Shares:

		Rs.
Value of Net Assets (As computed for Goodwill)		21,02,073
Value of Goodwill [Refer W.N.3]		11,406
Non-trade investments		2,40,000
	.	23,53,479
Less: Preference Share Capital	3,00,000	
Proposed Dividend of Preference shares	30,000	
Proposed Dividend of Equity shares	1,50,000	4,80,000
Net Assets available for Equity Shareholders		18,73,479

Computation of Number of Equivalent Equity Shares:

Equity shares		No. of Equivalent Shares
80,000 shares+ 50,000 shares = 1,30,000 shares of Rs.10 each	$1,30,000 \times \frac{10}{10}$	1,30,000
36,000 shares+ 30,000 shares = 66,000 shares of Rs.5 each	$66,000 \times \frac{5}{10}$	33,000
Total Equivalent Equity Shares of Rs.10 each		1,63,000

Calculation of Ex-Dividend intrinsic value of different categories of Equity Shares of Sun Ltd.

Net Assets available to deemed fully paid-up Equity Shareholders

= Net Assets as computed above + Notional Cash from partly paid-up shares

=Rs.18,73,479 + (50,000 x 2 + 30,000x1)

= Rs.18,73,479 + 1,00,000 + 30,000 = Rs.20,03,479

Computation of Ex-Dividend value per Equity Share

(i) Value of Rs.10 fully paid Equity Share = $\frac{20,03,479}{1,63,000}$ = Rs.12.29 per share (approx.)

(ii) Value of Rs.8 paid-up Equity Share = 12.29 - 2 = Rs.10.29 per share (approx.)

(iii) Value of Rs.5 fully paid-up Equity Share = 12.29 x $\frac{5}{10}$ = Rs.6.15 per share (approx.)

(iv) Value of Rs.4 paid-up Equity Share = 6.15 – 1 = Rs.5.15 per share (approx.)

Calculation of Cum-Dividend intrinsic value of different categories of Equity Shares of Sun Ltd.

Value of Net Assets (including proposed dividend on equity shares) =Rs.18,73,479 + 1,50,000

= Rs.20,23,479

Net assets (including dividend) available to deemed fully paid-up Equity Shareholders

= Net Assets as computed above + Notional Cash from partly paid-up shares

=Rs.20,23,479 + (50,000 x 2 + 30,000x1)

= Rs.20,23,479 + 1,00,000 + 30,000 = Rs.21,53,479

Computation of Cum-Dividend value per share*

(i) Value of Rs.10 fully paid Equity Share = $\frac{21,53,479}{1,63,000}$ = Rs.13.21 per share (approx.)

(ii) Value of Rs.8 paid-up Equity Share = 13.21 – 2 = Rs.11.21 per share (approx.)

(iii) Value of Rs.5 fully paid-up Equity Share = 13.21 x $\frac{5}{10}$ = Rs.6.605 per share (approx.)

(iv) Value of Rs.4 paid-up Equity Share = 6.605 – 1 = Rs.5.605 per share (approx.)

Working Notes:

1. Calculation of Average Capital Employed

	Rs.
Fixed Assets:	
Plant and Machinery (including Rs.36,450 for a Machine charged in 2004)	8,36,450
Land and Building	10,00,000
Furniture & Fixtures (1,00,000-4,000)	96,000

* **Note:** Candidates can also arrive at the cum-dividend value of shares by calculating the percentage of proposed dividend of equity shares to paid-up capital and adding that percentage of paid-up value of each share to ex-dividend value of equity shares.

Vehicles		2,00,000
		21,32,450
Add: Appreciation @ 5%		1,06,623
		22,39,073
Trade Investment (3,00,000 x $\frac{20}{100}$) x $\frac{80}{100}$		48,000
Current Assets:		
Stock		2,10,000
Debtors (1,95,000-5,000)		1,90,000
Prepaid Expenses		40,000
Advances		45,000
Cash & Bank Balance		2,00,000
		29,72,073
Less: Outside Liabilities:		
12% Debentures	2,00,000	
15% Term Loan	1,50,000	
Deposits	1,00,000	
Bank Loan	50,000	
Creditors	1,50,000	
Outstanding Expenses	20,000	
Provision for Tax	2,00,000	8,70,000
Capital employed at the end of the year i.e. Net Assets		21,02,073
Less: $\frac{1}{2}$ of the current year's Accounting Profit after Tax:		
Profit before Tax	3,80,950	
Less: Tax 40%* of Rs.3,80,950	1,52,380	
	2,28,570	
50% of Rs.2,28,570		1,14,285
Average capital employed		19,87,788

* Future tax rate has been considered.

2. Future Maintainable Profits

Statement of Average Profit

Particulars		2004 Rs.	2005 Rs.	2006 Rs.
Profit after Tax		2,10,000	1,90,000	2,00,000
Profit before Tax (PAT x $\frac{1}{0.50}$)		4,20,000	3,80,000	4,00,000
Add:	Capital expenditure charged to revenue	50,000	-	-
Less:	Depreciation of the Machinery	(5,000)	(4,500)	(4,050)
	Dividend on Non-Trade Investments	(12,000)	(24,000)	(24,000)
	Over-valuation of closing stock	-	(10,000)	-
Add:	Overvaluation of opening stock	-	-	10,000
Add:	Loss on sale of furniture	-	-	-
	(Presumed to be extra ordinary items)	-	-	4,000
Less:	Provision for debtors			(5,000)
		4,53,000	3,41,500	3,80,950
Total profit for the three years				11,75,450
Average Profit = $\frac{\text{Rs.}11,75,450}{3}$				3,91,817
Less:	Depreciation @ 10% on increase in the value of machinery			
	8,36,450 x $\frac{5}{100}\times\frac{10}{100}=\text{Rs.}41,823\times\frac{10}{100}$ i.e.,		4,182	
	Expected increase in expenditure		20,000	
	Annual R & D Expenses anticipated in future		30,000	54,182
Future Maintainable profit before tax				3,37,635
Less:	Tax @ 40% of Rs.3,37,635			1,35,054
Future Maintainable Profit After Tax				2,02,581

3. Computation of Goodwill

	Rs.
Future Maintainable Profit After Tax	2,02,581
Less: Normal Profit (10% of Rs.19,87,788)	1,98,779
Super Profit	3,802
Value of Goodwill = Super Profit x No. of years' purchase	
= Rs.3,802 x 3	11,406

Question 4

(a) A buyer buys a stock option of New Light Company Limited on 30th August, 2006 with a strike price of Rs.150 per unit to be expired on September 30, 2006. The premium is Rs.10 per unit and the market lot is of 100. The margin to be paid is Rs.60 per unit.

Show, how the transactions will appear in the books of the seller, when:

(i) The option is settled by delivery of the Asset, and

(ii) The option is settled in cash and the Index price is Rs.160 per unit.

(b) When the general price index, was 100, Expert Ltd. purchased fixed assets of Rs.2 crore and it had also permanent working capital of Rs.80 lakhs. The entire amount required for purchase of the fixed assets and permanent working capital was raised by way of 12% redeemable preference share capital. Expert Ltd. wants to maintain its physical capital.

On 31st March, 2006, the company had reserves of Rs.3.50 crores. The general price index on that day was 200. The written down value of fixed assets was Rs.20 lakhs and they were sold for Rs.3.00 crores. The proceeds were utilized for redemption of the Preference Shares.

On the same day (31st March, 2006), the Company purchased a new factory for Rs.20 crores. The ratio of permanent working capital to cost of assets is to be maintained at 0.4:1.

The company raised the additional funds required for the purpose by issue of equity shares:

(1) Calculate the amount of equity capital raised, and

(2) Show the balance Sheet as at 1.4.2006. (8+8 = 16 Marks)

Answer

(a) In the Books of Seller

			Dr. Amount Rs.	Cr. Amount Rs.
At the time of inception:				
30th August	Equity Stock Option Margin A/c (100 x Rs.60)	Dr.	6,000	
	To Bank A/c			6,000
	(Being the initial Margin paid on option)			
	Bank A/c (100 x Rs.10)	Dr.	1,000	
	To Equity Stock Option Premium A/c			1,000
	(Being the premium on option collected)			

At the time of final settlement:

	Bank A/c	Dr.	6,000	
	To Equity Stock Option Margin A/c			6,000
	(Being margin on equity stock option received back on exercise/expiry of option).			

(i) Option is settled by delivery of asset

30th September	Bank A/c	Dr.	15,000	
	To Equity Shares of New Light Ltd A/c			15,000
	(Being shares delivered on exercise of option)			
	Equity Stock Option Premium A/c	Dr.	1,000	
	To Profit & Loss A/c			1,000
	(Being premium on option recognized as income)			

(ii) Option is settled in cash

30th September	Profit & Loss A/c [(160 – 150) x 100]	Dr.	1,000	
	To Bank A/c			1,000
	(Being difference in index price and strike price i.e. loss on exercise of option paid in cash)			
	Equity Stock Option Premium A/c	Dr.	1,000	
	To Profit & Loss A/c			1,000
	(Being premium on option recognized as income)			

(b) (1) Computation of amount of equity share capital raised

	Rs. in crores
Requirement for purchase of new factory	20.00
Requirement for permanent working capital (20x .4)	8.00
	28.00
Less: Existing working capital(Refer Working Note 3)	6.30
Amount raised through equity capital	21.70

(2) Balance Sheet of Expert Ltd. as on 1st April, 2006

Liabilities	(Rs. in crores) Rs.	Assets	(Rs. in crores) Rs.
Equity Share Capital	21.70	Fixed Assets	20
Reserves and Surplus (Working Note 3)	6.30	Working Capital	8.00
	28.00		28.00

Working Notes:

1. Physical capital as on 31st March, 2006

	Rs. in crores
Fixed Assets	2.00
Working Capital	0.80
Financed by 12% Redeemable Preference Share Capital	2.80

On the basis of general price index on 31st March, 2006, physical capital has been worked out as follows:

$$2.80 \times \frac{200}{100} =$$ 5.6 crores

2. Working Capital as on 31st March, 2006

	Rs. in crores
Preference Share Capital	2.80
Reserves	3.50
	6.30
Less: Written Down Value of Fixed Assets	0.20
	6.10

The computation shows that the actual working capital which is available with the company was more than the minimum physical capital required to be maintained.

3. Position as on 31st March, 2006

(after sale of fixed assets and redemption of preference shares)

	Rs. in crores
Assets	
Fixed Assets	-
Working Capital [6.10 + 3.0 – 2.80]	6.30
	6.30

Liabilities	
Preference Share Capital	-
Reserves	3.50
Profit on sale of Fixed Assets (3.00 – 0.20)	2.80
	6.30

Question 5

(a) During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company Accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write back to the Profit and Loss account as a prior period item.

Is the Company's proposed accounting treatment correct? Discuss.

(b) Mr. 'X' as a contractor has just entered into a contract with a local municipal body for building a flyover. As per the contract terms, 'X' will receive an additional Rs.2 crore if the construction of the flyover were to be finished within a period of two years of the commencement of the contract. Mr. X wants to recognize this revenue since in the past he has been able to meet similar targets very easily.

Is X correct in his proposal? Discuss.

(c) A Company is in the process of setting up a production line for manufacturing a new product. Based on trial runs conducted by the company, it was noticed that the production lines output was not of the desired quality. However, company has taken a decision to manufacture and sell the sub-standard product over the next one year due to the huge investment involved.

In the background of the relevant accounting standard, advise the company on the cut-off date for capitalization of the project cost.

(d) A Company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct? (4+4+4+4 = 16 Marks)

Answer

(a) The balance amount of maintenance provision written back to profit and loss account, no longer required due to crash of the helicopters, is not a prior period item because there was no error in the preparation of previous periods' financial statements. The term 'prior period items', as defined in AS 5 (revised) "Net Profit or Loss for the Period, Prior Period Items and Changes In Accounting Policies", refer only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. As per paragraph 8 of AS 5, extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit

or loss can be perceived. The amount so written-back (If material) should be disclosed as an extraordinary item as per AS 5.

(b) According to para 14 of AS 7 (Revised) 'Construction Contracts', incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when: (i) the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and (ii) the amount of the incentive payment can be measured reliably. In the given problem, the contract has not even begun and hence the contractor (Mr. X) should not recognize any revenue of this contract.

(c) As per provisions of AS 10 'Accounting for Fixed Assets', expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalized as an indirect element of the construction cost. However, the expenditure incurred after the plant has begun commercial production i.e., production intended for sale or captive consumption, is not capitalized and is treated as revenue expenditure even though the contract may stipulate that the plant will not be finally taken over until after the satisfactory completion of the guarantee period. In the present case, the company did stop production even if the output was not of the desired quality, and continued the sub-standard production due to huge investment involved in the project. Capitalization should cease at the end of the trial run, since the cut-off date would be the date when the trial run was completed.

(d) AS 17 'Segment Reporting' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

Question 6

Write short notes on any five of the following:

(a) Capital adequacy requirements of merchant bankers.

(b) Interest rate swaps.

(c) Major issues in environmental accounting.

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

(e) Treatment of borrowing costs.

(f) Accounting for investment by a holding company in subsidiaries. (4x5= 20 Marks)

Answer

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

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

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

	Minimum requirement
Category I: Merchant bankers who carry on activity of the issue management, which will inter alia, consist of preparation of prospectus and other information relating to the issue, determining the financial structure, tie-up of financiers and final allotment and refund of subscriptions and act as advisor, consultant, manager, underwriter, portfolio manager etc.	Rs. 5 crores
Category II – Merchant bankers who act as advisor, consultant, co-manager, underwriter, portfolio manager	Rs.50 lakhs
Category III – Merchant bankers who act as underwriter, adviser, consultant to the issue.	Rs.20 lakhs
Category IV – Merchant bankers who act only as an advisor or consultant to the issue.	Nil

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

(b) Interest rate swap can be defined as a financial contract between two parties (called counter parties) to exchange on a particular date in the future, one series of cash flows (fixed interest) for another series of cash flows (variable or floating interest) in the same currency on the same principal (an agreed amount called notional principal) for an agreed period of time. The contract will specify the interest rates, the benchmark rate to be followed, the notional principal amount for the transaction, etc. Interest rates are of two types, fixed interest rates and floating rates which vary according to changes in a standard benchmark interest rate. An investor holding a security which pays a floating interest rate is exposed to interest rate risk. The investor can manage this risk by entering into an interest rate swap.

(c) Major accounting issues involved in environmental accounting can be explained as follows:

(i) Distinction between environmental expenditure and normal business expenditure: Many new machines may incorporate state-of-the-art environmental technology and accordingly, a portion of such capital costs and also the running and maintenance

expenditure may be treated as environment related expenditure. It is necessary to frame guidelines indicating whether the reporting entity should properly allocate the capital and revenue expenditures between environmental expenditure and normal business expenditure.

(ii) Capitalization of environmental expenditures vis-a-vis expensing them during the current accounting period: Environmental protection costs relating to prior periods and current period are generally very high and if expensed in one year as and when a reporting entity is persuaded to follow environmental accounting, the adverse impact in EPS is a major concern. Accordingly many Western Corporations prefer to capitalize environment costs instead of immediate expensing and adopt an amortization policy extending up to 10 years. Although this accounting practice has no theoretical support and rather contradicts the well established accounting concept of "prudence", it is considered as a practical solution to off-load burden of accumulated environmental costs without abruptly disturbing the cash flows attributable to the lenders, Government and finally to the shareholders. However, recognition of environmental costs should not necessarily be restricted to the expenses accrued in view of the applicable environmental laws. It should be guided by ethical consideration.

(iii) Recognition of environment related contingent liabilities: Environmental contingent liabilities are a matter of increasing concern throughout the world. Recognizing a liability of hazardous waste remediation frequently depends on the ability to estimate remediation costs reasonably.

In fact, identification and measurement of contingent liabilities are highly debatable accounting aspects. The United Nations Conference on Environment and Development (UNCEAD) papers raise the basic question why environmental contingencies should not be merged with other business contingencies. There is an urgent need for tightening the reporting rules on contingencies incorporating specific requirements for disclosure of environmental contingencies along with other contingencies.

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

these assets already contain specific requirements for recognizing and measuring the impairment related to these assets.

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

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

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

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

PAPER – 2 : MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS

Question No. 1 is compulsory. Answer any four from the rest.
Figures in the margin indicate marks allotted to each question.
Working notes should form part of the answer.

Question 1

(a) XYZ Ltd. is considering a project for which the following estimates are available:

	Rs.
Initial Cost of the project	10,00,000
Sales price/unit	60
Cost/unit	40
Sales volumes	
Year 1	20000 units
Year 2	30000 units
Year 3	30000 units

Discount rate 10% p.a.

You are required to measure the sensitivity of the project in relation to each of the following parameters:

(a) Sales Price/unit

(b) Unit cost

(c) Sales volume

(d) Initial outlay and

(e) Project lifetime

Taxation may be ignored. (16 Marks)

(b) Write short notes on the role of Financial Advisor in a Public Sector undertaking. (4 Marks)

Answer

(a) Calculation of NPV:-

$$\text{NPV} = -10,00,000 + \frac{20,000 \times 20}{1.1} + \frac{30,000 \times 20}{1.21} + \frac{30,000 \text{ x } 20}{1.331}$$

= - 10,00,000 + 3,63,636 + 4,95,868 + 4,50,789

= 13,10,293 – 10,00,000

= Rs.3,10,293/-.

Measurement of sensitivity is as follows:

(a) Sales Price:-

Let the sale price/Unit be S so that the project would break even with 0 NPV.

$$\therefore 10{,}00{,}000 = \frac{20{,}000 \times (S-40)}{1.1} + \frac{30{,}000 \times (S-40)}{1.21} + \frac{30{,}000(S-40)}{1.331}$$

= S – 40 = 10,00,000/65,512

= Rs.15.26

= S = Rs.55.26 which represents a fall of (60-55.26)/60

Or 0.079 or 7.9%

Alternative Method

$$\frac{10{,}00{,}000 \text{ x } 20}{13{,}10{,}293} = \text{Rs.}15.26$$

S= Rs.40 + Rs.15.26

= Rs.55.26

(b) Unit Cost:-

If sales price = Rs. 60 the cost price required to give a margin of Rs.15.26 is (Rs.60 – Rs.15.26) or Rs.44.74 which would represent a rise of 11.85% i.e., $\left(\frac{44.74-40}{40} \times 100\right)$

(c) Sales volume:-

The requisite percentage fall is:-

3,10,293/13,10,293 $\times$ 100 = 23.68%

(d) Since PV of inflows remains at Rs.13,10,293 the initial outlay must also be the same.

$\therefore$ Percentage rise = 3,10,293/10,00,000 $\times$ 100 = 31.03%.

(e) Present value for 1st two years.

= - 10,00,000 + 4,00,000 x 909 + 6,00,000 x 0.826

= - 10,00,000 + 3,63,600 + 4,95,600

= - 10,00,000 + 8,59,200

= - 1,40,800

$\therefore$ The project needs to run for some part of the third year so that the present value of return is Rs.1,40,800. Let us consider that fraction of the year be x.

$\therefore$ $6,00,000\ x/(1.1)^{2+x} = 1,40,800$

Putting x = 0.2 in above equation the present value of the return is Rs.97,301.

Putting x = 0.3 the present value becomes Rs.1,44,578.

By interpolating we get X = 0.292

Thus if the project run for 2.292 years then break even would be achieved.

Note: The above calculation may also be made as follows:

(i) = 30,000 units x Rs.20 x .751 = Rs.4,50,600

(ii) Per day Production in (Rs.) assuming a year of 360 days = $\frac{\text{Rs.4,50,600}}{360} = \text{Rs.1,252}$

(iii) Days needed to recover Rs.1,40,800 = $\frac{\text{Rs.1,40,800}}{\text{Rs.1,252}} = 112$

Thus, if the project runs for 2 years and 112 days then break even would be achieved.

(b) Role of Financial Advisor in PSUs: The Financial Advisor occupies an important position in all public sector undertakings. He functions as the principal advisor to the chief executive of the enterprise on all financial matters. The committee on public sector undertakings has specified the following functions and responsibilities of a financial adviser:

(i) Determination of financial needs of the firm and the ways these needs are to be met.

(ii) Formulation of a programme to provide most effective cost-profit volume relationship.

(iii) Analysis of financial results of all operations and recommendations concerning future operations.

(iv) Examination of feasibility studies and detailed project reports from the point of view of overall economic viability of the project.

(v) Conduct of special studies with a view to reduce costs and improve efficiency and profitability.

Question 2

(a) XYZ Ltd. a US firm will need £ 3,00,000 in 180 days. In this connection, the following information is available:

Spot rate 1 £ = $ 2.00

180 days forward rate of £ as of today = $1.96

Interest rates are as follows:

	U.K.	US
180 days deposit rate	4.5%	5%
180 days borrowing rate	5%	5.5%

A call option on £ that expires in 180 days has an exercise price of $ 1.97 and a premium of $ 0.04.

XYZ Ltd. has forecasted the spot rates 180 days hence as below:

Future rate	Probability
$ 1.91	25%
$ 1.95	60%
$ 2.05	15%

Which of the following strategies would be most preferable to XYZ Ltd.?

(a) a forward contract

(b) a money market hedge

(c) an option contract

(d) no hedging

Show calculations in each case.

(b) Expected returns on two stocks for particular market returns are given in the following table:

Market Return	Aggressive	Defensive
7%	4%	9%
25%	40%	18%

You are required to calculate:

(a) The Betas of the two stocks.

(b) Expected return of each stock, if the market return is equally likely to be 7% or 25%.

(c) The Security Market Line (SML), if the risk free rate is 7.5% and market return is equally likely to be 7% or 25%.

(d) The Alphas of the two stocks.

(c) Explain briefly the advantages of investing in mutual funds. (8+8+4= 20 Marks)

Answer

(a) (a) Forward contract: Dollar needed in 180 days = £3,00,000 x $ 1.96 = $5,88,000/-

(b) Money market hedge: - Borrow $, convert to £, invest £, repay $ loan in 180 days

Amount in £ to be invested = 3,00,000/1.045 = £ 287081

Amount of $ needed to convert into £ = 2,87,081 x 2 = $ 5,74,162

Interest and principal on $ loan after 180 days = $5,74,162 x 1.055

= $ 6,05,741

(c) Call option:

Expected Spot rate in 180 days	Prem./ unit	Exercise Option	Total price per unit	Total price for £3,00,000 xi	Prob. Pi	pixi
1.91	0.04	No	1.95	5,85,000	0.25	1,46,250
1.95	0.04	No	1.99	5,97,000	0.60	3,58,200
2.05	0.04	Yes	2.01	6,03,000	0.15	90,450
						5,94,900

(d) No hedge option:

Expected Future spot rate	Dollar needed Xi	Prob. Pi	Pi xi
1.91	5,73,000	0.25	1,43,250
1.95	5,85,000	0.60	3,51,000
2.05	6,15,000	0.15	92,250
			5,86,500

The probability distribution of outcomes for no hedge strategy appears to be most preferable because least number of $ are needed under this option to arrange £3,00,000.

(b) (a) The Betas of two stocks:

Aggressive stock - 40% - 4%/25% - 7% = 2

Defensive stock - 18% - 9%/25% - 7% = 0.50

(b) Expected returns of the two stocks:-

Aggressive stock - 0.5 x 4% + 0.5 x 40% = 22%

Defensive stock - 0.5 x 9% + 0.5 x 18% = 13.5%

(c) Expected return of market portfolio = 0.5 x 7% + 0.5% x 25% = 16%

∴ Market risk prem. = 16% - 7.5% = 8.5%

∴ SML is, required return = 7.5% + i 8.5%

(d) Alpha for stock A = 0.22 – (0.075 + 2 x 0.085) = -2.5%

Alpha for stock B = 0.135 – (0.075 + 0.5 x 0.085) = 1.75%

(c) The advantages of investing in a Mutual Fund are:

1. Professional Management: Investors avail the services of experienced and skilled professionals who are backed by a dedicated investment research team which analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.
2. Diversification: Mutual Funds invest in a number of companies across a broad cross-section of industries and sectors. Investors achieve this diversification through a Mutual Fund with far less money and risk than one can do on his own.
3. Convenient Administration: Investing in a Mutual Fund reduces paper work and helps investors to avoid many problems such as bad deliveries, delayed payments and unnecessary follow up with brokers and companies.
4. Return Potential: Over a medium to long term, Mutual Fund has the potential to provide a higher return as they invest in a diversified basket of selected securities.
5. Low Costs: Mutual Funds are a relatively less expensive way to invest compared to directly investing in the capital markets because the benefits of scale in brokerage, custodial and other fees translate into lower costs for investors.
6. Liquidity:In open ended schemes investors can get their money back promptly at net asset value related prices from the Mutual Fund itself. With close-ended schemes, investors can sell their units on a stock exchange at the prevailing market price or avail of the facility of direct repurchase at NAV related prices which some close ended and interval schemes offer periodically.
7. Transparency:Investors get regular information on the value of their investment in addition to disclosure on the specific investments made by scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

Question 3

(a) AFC Ltd. wishes to acquire BCD Ltd. The shares issued by the two companies are 10,00,000 and 5,00,000 respectively:

(i) Calculate the increase in the total value of BCD Ltd. resulting from the acquisition on the basis of the following conditions:

Current expected growth rate of BCD Ltd.		7%
Expected growth rate under control of AFC Ltd., (without any additional capital investment and without any change in risk of operations)		8%
Current Market price per share of AFC Ltd.	Rs.	100

Current Market price per share of BCD Ltd.	Rs.	20
Current Dividend per share of BCD Ltd.	Re.	0.60

(ii) On the basis of aforesaid conditions calculate the gain or loss to shareholders of both the companies, if AFC Ltd. were to offer one of its share for every four shares of BCD Ltd.

(iii) Calculate the gain to the shareholders of both the Companies, if AFC Ltd. pays Rs.22 for each share of BCD Ltd., assuming the P/E Ratio of AFC Ltd. does not change after the merger. EPS of AFC Ltd. is Rs.8 and that of BCD is Rs.2.50. It is assumed that AFC Ltd. invests its cash to earn 10%.

(b) AMK Ltd. an Indian based company has subsidiaries in U.S. and U.K.

Forecasts of surplus funds for the next 30 days from two subsidiaries are as below:

U.S.	$12.5 million
U.K.	£ 6 million

Following exchange rate informations are obtained:

	$/Rs.	£/Rs.
Spot	0.0215	0.0149
30 days forward	0.0217	0.0150

Annual borrowing/deposit rates (Simple) are available.

Rs.	6.4%/6.2%
$	1.6%/1.5%
£	3.9%/3.7%

The Indian operation is forecasting a cash deficit of Rs.500 million.

It is assumed that interest rates are based on a year of 360 days.

(i) Calculate the cash balance at the end of 30 days period in Rs. for each company under each of the following scenarios ignoring transaction costs and taxes:

(a) Each company invests/finances its own cash balances/deficits in local currency independently.

(b) Cash balances are pooled immediately in India and the net balances are invested/borrowed for the 30 days period.

(ii) Which method do you think is preferable from the parent company's point of view?

(c) A money market instrument with face value of Rs.100 and discount yield of 6% will mature in 45 days. You are required to calculate:

(i) Current price of the instrument.

(ii) Bond equivalent yield

(iii) Effective annual return. (8+8+4= 20 Marks)

Answer

(a) (i) For BCD Ltd., before acquisition

The cost of capital of BCD Ltd. may be calculated by using the following formula:

$$\frac{\text{Dividend}}{\text{Price}} + \text{Growth\%}$$

Cost of Capital i.e., Ke = (0.60/20) + 0.07 = 0.10

After acquisition g (i.e. growth) becomes 0.08

Therefore, price per share after acquisition = 0.60/(0.10-0.08) = Rs.30

The increase in value therefore is = Rs.(30-20) x 5,00,000 = Rs.50,00,000/-

(ii) To share holders of BCD Ltd. the immediate gain is Rs.100 – Rs.20x4 = Rs.20 per share

The gain can be higher if price of shares of AFC Ltd. rise following merger which they should undertake.

To AFC Ltd. shareholders	(Rs. (In lakhs)
Value of Company now	1,000
Value of BCD Ltd.	150
	1,150
No. of shares	11.25
∴ Value per share	1150/11.25= Rs.102.22

Gain to shareholders of BCD Ltd. = Rs.102.22 – Rs.(4 x 20) = Rs.22.22

Gain to shareholders of AFC Ltd. = Rs.102.22 – Rs.100.00 = Rs.2.22

(iii) Gain to shareholders of AFC Ltd:-

Earnings of BCD Ltd. (5,00,000 x 2.50) =	Rs.12,50,000/-
Less: Loss of earning in cash (5,00,000/- x 22 x 0.10)	Rs.11,00,000/-
Net Earning	Rs.1,50,000/-
Number of shares	10,00,000
Net increase in earning per share	0.15

P/E ratio of AFC Ltd. = 100/8 = 12.50

Therefore, Gain per share of shareholders of AFC Ltd.

= 0.15x12.50 = Rs.1.88

Gain to the shareholders of BCD Ltd. Rs. (22-20) = Rs.2/- per share

(b) Figures in 000's

(a) Cash Balances:

Acting independently

	Capital	Interest	Rs. in 30 days
India	-5,00,000	-2,666.67	-5,02,667
U.S.	12,500	15.63	5,76,757
U.K.	6,000	18.50	4,01,233
			4,75,323

(b) Cash Balances:-

Immediate Cash pooling

	Rs.
India	– 5,00,000
U.S. $\frac{12{,}500}{0.0215}$ =	5,81,395
U.K. $\frac{6{,}000}{0.0149}$ =	4,02,685
	4,84,080

Immediate cash pooling is preferable as it maximizes interest earnings

Note: If the company decides to invest pooled amount of Rs.4,84,080/- @ 6.2% p.a. for 30 days an interest of Rs.2,501/- will accrue.

(c) (i) Current price of the Bond = 100 x [1-{45/360} x 0.06]

= Rs.99.25

Alternatively, the current price of bond may also be calculated as follows:

$$\frac{D}{100-D}\times\frac{360}{45}=0.06$$

$$\frac{D}{100-D}=0.06\times\frac{45}{360}$$

$$\frac{D}{100-D}=0.06\times\frac{1}{8}$$

8D = 6 – 0.06D

8.06D = 6

$$D = \frac{6}{8.06}=0.7444$$

Current price of the bond = Face value – D

= Rs.100 – 0.7444 = Rs.99.2556

(ii) Bond equivalent yield = $\frac{100-99.25}{99.25}\times\frac{360}{45}=6.045\%$ P.A.

(iii) Effective annual return = $\left[1+(0.06045/8)^{8})\right]-1$

= 6.045% P.A..

Note:If a year of 365 days is considered the Bond equivalent yield and Effective annual return works out to 6.129% P.A.

Question 4

(a) ABC Co. is considering a new sales strategy that will be valid for the next 4 years. They want to know the value of the new strategy. Following information relating to the year which has just ended, is available:

Income Statement	Rs.
Sales	20,000
Gross margin (20%)	4,000
Administration, Selling & distribution expense (10%)	2,000
PBT	2,000
Tax (30%)	600
PAT	1,400
Balance Sheet Information	
Fixed Assets	8,000
Current Assets	4,000
Equity	12,000

If it adopts the new strategy, sales will grow at the rate of 20% per year for three years. The gross margin ratio, Assets turnover ratio, the Capital structure and the income tax rate will remain unchanged.

Depreciation would be at 10% of net fixed assets at the beginning of the year.

The Company's target rate of return is 15%.

Determine the incremental value due to adoption of the strategy.

(b) Discuss the major sources available to an Indian Corporate for raising foreign currency finances.

(c) (i) What are Stock futures?

(ii) What are the opportunities offered by Stock futures?

(iii) How are Stock futures settled? (8+8+4= 20 Marks)

Answer

(a)

Projected Balance Sheet

	Year 1	Year 2	Year 3	Year 4
Fixed Assets (40%) of Sales	9,600	11,520	13,824	13,824
Current Assets (20%) of Sales	4,800	5,760	6,912	6,912
Total Assets	14,400	17,280	20,736	20,736
Equity	14,400	17,280	20,736	20,736

Projected Cash Flows:-

	Year 1	Year 2	Year 3	Year 4
Sales	24,000	28,800	34,560	34,560
PBT (10%) of sale	2,400	2,880	3,456	3,456
PAT (70%)	1,680	2,016	2,419.20	2,419.20
Depreciation	800	960	1,152	1,382
Addition to Fixed Assets	2,400	2,880	3,456	1,382
Increase in Current Assets	800	960	1,152	-
Operating cash flow	(720)	(864)	(1,036.80)	2,419.20

Present value of Projected Cash Flows:-

Cash Flows	PV at 15%	PV
-720	0.870	-626.40
-864	0.756	-653.18
-1,036.80	0.658	-682.21
		-1,961.79

Residual Value - 2419.20/0.15 = 16,128

Present value of Residual value = $16128/(1.15)^3$

= 16128/1.521 = 10603.55

Total shareholders value = 10,603.55 – 1,961.79 = 8,641.76

Pre strategy value = 1,400 / 0.15 = 9,333.33

∴ Value of strategy = 8,641.76 – 9,333.33 = 691.57

Conclusion: The strategy is not financially viable

(b) The major sources are:-

Foreign currency term loan from Financial Institutions.

Export credit schemes.

External commercial borrowings.

Euro issues

Issues in foreign domestic markets.

They are discussed here below:-

1. Foreign currency term loan from Financial Institutions:- Financial Institutions provide foreign currency term loan for meeting the foreign currency expenditures towards import of plant, machinery, and equipment and also towards payment of foreign technical know how fees.

2. Export Credit Schemes:- Export credit agencies have been established by the government of major industrialized countries for financing exports of capital goods and related technical services. These agencies follow certain consensus guidelines for supporting exports under a convention known as the Berne Union. As per these guidelines, the interest rate applicable for export credits to Indian companies for various maturities are regulated. Two kinds of export credit are provided i.e., buyer's and supplier's credit.

   Buyer's Credit:- Under this arrangement, credit is provided directly to the Indian buyer for purchase of capital goods and/or technical service from the overseas exporter.

   Supplier's Credit:- This is a credit provided to the overseas exporters so that they can make available medium-term finance to Indian importers.

3. External commercial borrowings:Subject to certain terms and conditions, the Government of India permits Indian firms to resort to external commercial borrowings for the import of plant and machinery. Corporates are allowed to raise up to a stipulated amount from the global markets through the automatic route. Companies wanting to raise more than the stipulated amount have to get an approval of the MOF. ECBs include bank loans, supplier's and buyer's credit, fixed and floating rate bonds and borrowing from private sector windows of Multilateral Financial Institution such as International Finance Corporation.

4. Euro Issues: The two principal mechanisms used by Indian companies are Depository Receipts mechanism and Euro convertible Issues. The former represents indirectly equity investment while the latter is debt with an option to convert it into equity.

5. Issues in foreign domestic markets: Indian firms can also issue bonds and Equities in the domestic capital market of a foreign country. In recent year, Indian companies like Infosys Technologies and ICICI have successfully tapped the US equity market by issuing American Depository Receipts(ADRs). Like GDRs, ADRs

represent claim on a specific number of shares. The principal difference between the two is that the GDRs are issued in the euro market whereas ADRs are issued in the U.S. domestic capital market.

(c) (i) Stock future is a financial derivative product where the underlying asset is an individual stock. It is also called equity future. This derivative product enables one to buy or sell the underlying Stock on a future date at a price decided by the market forces today.

(ii) Stock futures offer a variety of usage to the investors. Some of the key usages are mentioned below:

Investors can take long-term view on the underlying stock using stock futures.

(a) Stock futures offer high leverage. This means that one can take large position with less capital. For example, paying 20% initial margin one can take position for 100%, i.e., 5 times the cash outflow.

(b) Futures may look over-priced or under-priced compared to the spot price and can offer opportunities to arbitrage and earn riskless profit.

(c) When used efficiently, single-stock futures can be effective risk management tool. For instance, an investor with position in cash segment can minimize either market risk or price risk of the underlying stock by taking reverse position in an appropriate futures contract.

(iii) Up to March 31, 2002, stock futures were settled in cash. The final settlement price is the closing price of the underlying stock. From April 2002, stock futures are settled by delivery, i.e., by merging derivatives position into cash segment.

Question 5

(a) A Company is planning to acquire a machine costing Rs.5,00,000. Effective life of the machine is 5 years. The Company is considering two options. One is to purchase the machine by lease and the other is to borrow Rs.5,00,000 from its bankers at 10% interest p.a. The Principal amount of loan will be paid in 5 equal instalments to be paid annually. The machine will be sold at Rs.50,000 at the end of 5th year. Following further informations are given:

(a) Principal, interest, lease rentals are payable on the last day of each year.

(b) The machine will be fully depreciated over its effective life.

(c) Tax rate is 30% and after tax.. Cost of Capital is 8%.

Compute the lease rentals payable which will make the firm indifferent to the loan option.

(b) The following information are supplied to you:

	Rs.
Total Earnings	2,00,000
No. of equity shares (of Rs.100 each)	20,000
Dividend paid	1,50,000
Price/Earning ratio	12.5

(i) Ascertain whether the company is the following an optimal dividend policy.

(ii) Find out what should be the P/E ratio at which the dividend policy will have no effect on the value of the share.

(iii) Will your decision change, if the P/E ratio is 8 instead of 12.5? (12+8 = 20 Marks)

Answer

(a) Borrowing option:

Annual Instalment = Rs.50,00,000/- / 5 = Rs.1,00,000/-

Annual depreciation = Rs.50,00,000/- / 5 = Rs.1,00,000/-

Computation of net cash outflow:

Year	Principal	Interest	Total	Tax Saving Depn. & Interest	Net cash Outflow	PV @ 8%	Total PV
1	1,00,000	50,000	1,50,000	45,000	1,05,000	0.926	97,230
2	1,00,000	40,000	1,40,000	42,000	98,000	0.857	93,986
3	1,00,000	30,000	1,30,000	39,000	91,000	0.794	72,254
4	1,00,000	20,000	1,20,000	36,000	84,000	0.735	61,740
5	1,00,000	10,000	1,10,000	33,000	77,000	0.681	52,437
							3,67,647

Less: Present value of Inflows at the end of 5th year (Rs.50,000/- x 0.7) or Rs.35,000 x 0.681 =	23,835
PV of Net Cash outflows	Rs.3,43,812

Calculation of lease rentals:

Therefore, Required Annual after tax outflow = 3,43,812/3.993 = Rs.86,104/-.

Therefore, Annual lease rental = 86,104/0.70 = Rs.1,23,006/-

(b) (i) The EPS of the firm is Rs.10 (i.e., Rs.2,00,000/20,000). The P/E Ratio is given at 12.5 and the cost of capital, k_e, may be taken at the inverse of P/E ratio. Therefore, k_e is 8 (i.e., 1/12.5). The firm is distributing total dividends of Rs.1,50,000 among 20,000 shares, giving a dividend per share of Rs.7.50. the value of the share as per Walter's model may be found as follows:

$$P = \frac{D}{K_e} + \frac{(r/K_e)(E-D)}{K_e}$$

$$= \frac{7.50}{.08} + \frac{(.10/.08)(10-7.5)}{.08}$$

= Rs.132.81

The firm has a dividend payout of 75% (i.e., Rs.1,50,000) out of total earnings of Rs.2,00,000. since, the rate of return of the firm, r, is 10% and it is more than the k_e of 8%, therefore, by distributing 75% of earnings, the firm is not following an optimal dividend policy. The optimal dividend policy for the firm would be to pay zero dividend and in such a situation, the market price would be

$$P = \frac{D}{k_e} + \frac{(r/K_e)(E-D)}{K_e}$$

$$= \frac{0}{.08} + \frac{(.10/.80)(10-0)}{.08}$$

= Rs.156.25

So, theoretically the market price of the share can be increased by adopting a zero payout.

(ii) The P/E ratio at which the dividend policy will have no effect on the value of the share is such at which the k_e would be equal to the rate of return, r, of the firm. The K_e would be 10% (=r) at the P/E ratio of 10. Therefore, at the P/E ratio of 10, the dividend policy would have no effect on the value of the share.

(iii) If the P/E is 8 instead of 12.5, then the ke which is the inverse of P/E ratio, would be 12.5 and in such a situation k_e > r and the market price, as per Walter's model would be

$$P = \frac{D}{K_e} + \frac{(r/K_e)(E-D)}{K_e}$$

$$= \frac{7.50}{.125} + \frac{(.1/.125)(10-7.5)}{.125}$$

= Rs.76

Question 6

(a) The historical rates of return of two securities over the past ten years are given. Calculate the Covariance and the Correlation coefficient of the two securities:

Years:	1	2	3	4	5	6	7	8	9	10
Security 1: (Return per cent)	12	8	7	14	16	15	18	20	16	22
Security 2: (Return per cent)	20	22	24	18	15	20	24	25	22	20

(b) Write brief notes on Leveraged Buyouts (LBOs).

(c) Find the current market price of a bond having face value Rs.1,00,000 redeemable after 6 year maturity with YTM at 16% payable annually and duration 4.3202 years. Given $1.16^6 = 2.4364$. (10+4+6= 20 Marks)

Answer

(a) Calculation of Covariance

Year	R_1	Deviation $(R_1 - \overline{R_1})$	R_2 $(R_2 - \overline{R_2}$	Deviation	Product of deviations
1	12	-2.8	20	-1	2.8
2	8	-6.8	22	1	-6.8
3	7	-7.8	24	3	-23.4
4	14	-0.8	18	-3	2.4
5	16	1.2	15	-6	-7.2
6	15	0.2	20	-1	-0.2
7	18	3.2	24	3	9.6
8	20	5.2	25	4	20.8
9	16	1.2	22	1	1.2
10	22	7.2	20	-1	-7.2
					-8.00

$$\overline{R_1 = \frac{148}{10} = 14.8} \qquad R_2 = \frac{210}{10} = 21$$

$$\text{Covariance} = \frac{\sum_{i=1}^{N} [R_1 - \overline{R_1}][R_2 - \overline{R_2}]}{N}$$

$= -8/10 = -0.8$

For calculation of correlation, the standard deviation of the two securities are also required.

Calculation of Standard Deviation

Year	R_1	R_1^2	R_2	R_2^2
1	12	144	20	400
2	8	64	22	484
3	7	49	24	576
4	14	196	18	324
5	16	256	15	225
6	15	225	20	400
7	18	324	24	576
8	20	400	25	625
9	16	256	22	484
10	22	484	20	400
	148	2398	210	4494

Standard deviation of security 1:

$$\sigma_1 \sqrt{\frac{N\sum R_1^2 - (\sum R_1)^2}{N^2}}$$

$$= \sqrt{\frac{(10\times 2398) - (148)^2}{10\times 10}} = \sqrt{\frac{23980 - 21904}{100}}$$

$$= \sqrt{20.76} = 4.56$$

Standard deviation of security 2:

$$\sigma_2 = \sqrt{\frac{N\sum R_2^2 - (\sum R_2)^2}{N^2}}$$

$$= \sqrt{\frac{(10\times 4494) - (210)^2}{10\times 10}} = \sqrt{\frac{44940 - 44100}{100}}$$

$$= \sqrt{\frac{840}{100}} = \sqrt{8.4} = 2.90$$

Correlation Coefficient

$$r_{12} = \frac{Cov}{\sigma_1 \sigma_2}$$

$$= \frac{-0.8}{4.56 \times 2.90} = \frac{-0.8}{13.22}$$

= -0.0605

(b) Leveraged Buyouts (LBOs)

(1) A popular technique that was widely used during the 1980s to make acquisition is the leveraged buyouts, which involves the use of a large amount of debt to purchase a firm.

(2) While some leveraged buyouts involve a company in its entirety, most involve a business unit of a company. After the buyout, the company invariably becomes a Private Company.

(3) A large part of the borrowing is secured by the firms assets, and the lenders, because of a high risk, take a portion of the firms equity. Junk bonds have been routinely used to raise amounts of debt needed to finance the LBO transaction.

(4) The success of the entire operation depends on their ability to improve the performance of the unit, contain its business risk, exercise cost controls and liquidate disposable assets. If they fail to do so, the high fixed financial costs can jeopardize the venture.

(5) An attractive candidate for acquisition through leveraged buyout should possess three basic attributes:

(a) It must have a good position in its industry with a solid profit history and reasonable expectations of growth.

(b) The firm should have a relatively low level of debt and a high level of bankable assets that can be used as loan collateral.

(c) It must have a stable and predictable cash flows that are adequate to meet interest and principal payment on the debt and provide adequate working capital.

Of course, a willingness on the part of existing ownership and management to sell the company on a leveraged basis is also needed.

(c) Duration 4.3202 = (1.16/0.16) – [1.16 + 6 (c-0.16)]/ (c [(1.16)^6 – 1] + 0.16)

$$4.3202 = \frac{1.16}{0.16} - \frac{1.16 + 6(c - 0.16)}{c\left[(c\,1.16)^6 - 1\right] + 0.16}$$

$$\frac{1.16 + 6c - 0.96}{1.4364\,c + 0.16} = 2.9298$$

$0.2 + 6c = 4.20836472\ c + 0.468768$

$1.79163528c = 0.268768$

$C = 0.150012679$

$\therefore\ c = 0.15$

Where c = Coupon rate

Therefore, current price = Rs.(1,00,000/- x 0.15 x 3.685 + 1,00,000/- x 0.410)

= Rs.96,275/-.

PAPER – 3 : ADVANCED AUDITING

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

Question 1

As an auditor, how would you deal with the following?

(a) L Private Ltd., which has outstanding loan of Rs. 50 lakhs from Financial Institution defaulted in repayment thereof to the extent of 50%. The company holds that it being a private limited company, the Companies Auditors Report Order (CARO) is not applicable.

(5 Marks)

(b) In the audit of ABC Private Limited, auditor came across cases of payments to Directors, whereby, expenses of a personal nature were re-imbursed. (5 Marks)

(c) The management of a limited company states that proposed dividend does not represent a liability and hence no provision need to be made-Comment. (4 Marks)

(d) ABC Limited to whom CARO is applicable made a public issue of 7% debentures of Rs. 3 crores, redeemable after 5 years and used the proceeds of issue for payment of Sundry creditors and other Current liabilities to the tune of 3 crores. (4 Marks)

Answer

(a) Applicability of CARO to a Private Ltd. Co.: A Private Ltd. Co., in order to be exempt from the applicability of CARO must satisfy all the following conditions cumulatively :

(i) its paid-up capital and reserves are Rs. 50 lacs or less;

(ii) it has no outstanding loan exceeding Rs. 25 lacs from any bank or financial institutions; and

(iii) its turnover does not exceed Rs. 5 crores during the financial year.

Since condition (ii), above, is violated, the Order is applicable to L Pvt. Ltd.

The period and amount of default be reported by the auditor as per para 4(xi) of the CARO.

(b) Reimbursement of personal expense of Director: All payments to Directors as remuneration or perquisites whether in the case of a public or private company are required to be authorised both in accordance with the Companies Act and Articles of Association of the company. Articles may provide that such remuneration require sanction of the shareholders either by ordinary or special resolution while in some cases it may require only approval of Directors. If the terms of appointment of a Director include payment of expenses of a personal nature, then such expenses can be incurred by the company; otherwise, no such expense can be incurred or reimbursed by the company. In the instant case the auditor has to ensure that the above is complied with, without which, if such expenses are paid, he has to disclose the fact in his report, as also in the accounts. In this regard attention is invited to section 227 (1A) (e) of the Companies Act

wherein auditor has to inquire into whether personal expenses have been charged to revenue.

(c) Provision for proposed dividend: As per the ICAI's Guidance Note, proposed dividend does not represent a liability, nor does it amount to a provision, pending the approval of the share holders in the general meeting.

Though the format given in schedule VI requires proposed dividend to be shown under 'Current Liabilities and Provisions', it does not mean in fact that the proposed dividend becomes a liability or is necessarily a provision. Part 1 of Schedule VI that prescribes the form of balance sheet requires " proposed dividend' to be shown under 'Provisions' and paragraph 3(xiv) of Part II of the same Schedule requires specific disclosure of the proposed dividend.

It is recommended, that if no appropriation is made, shareholders' attention should be drawn to such fact and the amount should be quantified. The fact that provision for proposed dividend has not been made should be disclosed by means of a note in the accounts. The auditor should refer to the note in his report and make his report subject thereto.

(d) End use of issue proceeds of a public issue: Para 4(xx) of CARO deals with end use of issue proceeds of a public issue. Public issue may relate to equity shares, preference shares, debentures and other securities. The auditor is expected to verify and report whether the end use of moneys raised by way of public issue have been properly disclosed in the financial statements.

The auditor must see whether the terms of issue of debentures contain any specific purpose/project for which the funds raised will be utilized.

It the terms of issue of debentures is for liquidating sundry creditors and other current liabilities, it would be in order for the company to do so. Auditor should verify that the amount of end use of money disclosed in the financial statements by the management is adequate and is not significantly different from the proposed and actual use. If either end use is not for the purpose for which a public issue is made or the disclosure is not adequate, the auditor should state the fact in his report.

Question 2

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

(a) A chartered accountant in practice created his own website in attractive format and colours and circulated the information contained in the website through E-mail. (5 Marks)

(b) A chartered accountant in practice takes up the appointment as managing director of a public limited company. (4 Marks)

(c) S. a practicing chartered accountant gives power of attorney to an employee chartered accountant to sign reports and financial statements, on his behalf. (5 Marks)

(d) A is the auditor of Z Ltd., which has a turnover of Rs. 200 crore. The audit fee for the year is fixed at Rs. 50 lakhs. During the year, the company offers A an assignment of management consultancy within the meaning of Section 2(2)(iv) of the CA Act, 1949 for a remuneration of Rs. 1 crore. A seeks your advice on accepting the assignment. (4 Marks)

Answer

(a) Creation of own website by a chartered accountant/firm of chartered accountants : The guidelines approved by the Council of the Institute of Chartered Accountants of India permits creation of own website by a chartered accountant in his or his firm name and no standard format or restriction on colours is there. The chartered accountant or firm, as per the guidelines, should ensure that none of the information contained in the website be circulated on their own or through E-mail or by any other mode except on a specific "Pull" request.

Since in the given case, the chartered accountant circulated the information contained in the website through E-mail, he is guilty of misconduct under clause 6 of Part I of the First Schedule to the Chartered Accountants Act, ie., a chartered accountant in practice is deemed to be guilty of professional misconduct if he solicits client or professional work either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means.

(b) Appointment of a CA in practice as MD of a Public Limited Company: Under clause 11 of Part I of First Schedule to the Chartered Accountants Act, a chartered accountant in practice is deemed to be guilty of professional misconduct, if he engages in any business or occupation other than the profession of chartered accountants, unless permitted by the council so to engage.

However, nothing contained in clause 11 shall disentitle a chartered accountant from being a director of a company, unless he or any of his partners is interested in such company as an auditor.

Regulation 190A, states a member in practice cannot engage himself in any business or occupation other than that of a chartered accountant except when permitted by the council. As per Appendix 10 of CA Regulations, 1988, a CA in practice may hold the office of a Managing Director a Whole Time Director of a body corporate, provided that the member and/or his relatives do not hold substantial interest in such concern, after obtaining the specific and prior approval of the Council.

He should seek prior approval of the council otherwise he would be held guilty of misconduct.

(c) Power of signing reports and financial statements: Under clause 13 of Part I of First Schedule to the Chartered Accountants Act a CA in practice is deemed to be guilty of professional misconduct if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.

This clause read in conjunction with Section 26 of the CA Act 1949 stipulates that no person other than the member of the institute shall sign any document on behalf of a CA in practice or a firm of CA' s in his or its professional capacity.

The term 'Financial Statement' for this purpose would cover an examination of the accounts or financial statements given under a statutory enactment or otherwise. Accordingly S is guilty of professional misconduct under clause 13 of part I of First Schedule and also under clause (1) of Part II of Second Schedule for contravening Section 26.

(d) Appointment as a statutory auditor of a PSUs'/Govt company(ies)/listed company(ies) and other public company(ies) : In exercise of the powers conferred by clause (ii) of part II of the Second Schedule to the CA Act, 1949, the Council of ICAI specifies that a member of the Institute in practice shall be deemed to be guilty of professional misconduct if he accepts the appointment as a statutory auditor of a PSUs'/Govt company(ies)/listed company(ies) and other public company(ies) having a turnover of Rs. 50 crores or more in a year and accepts any other work(s) or assignment(s) or service(s) in regard to same undertaking(s) on a remuneration which in total exceeds the fee payable for carrying out the statutory audit of the same undertaking. In view of the above position it would be a misconduct on A's part if he accepts the management consultancy assignment for a fee of Rs. 1 crore.

Question 3

(a) State the items contained in the SEBI's check list for auditors in respect of contractnotes issued by a Stock Broker. (8 Marks)

(b) What are the advantages that accrue to the stockholders of a company because of a Cost audit? (8 Marks)

Answer

(a) SEBI's check list for auditors in respect of contract notes issued by a Stock Broker:

(1) Members should issue Contract Notes to his clients for all trades executed by him on their behalf.

(2) The member should stamp his order sheets/records and the order time should be reflected in the Contract Note along with the time of execution of order.

(3) The Contract Notes should bear SEBI Registration number of the member. If should be pre printed and issued within 24 hours of trade execution. Appropriate stamps should be affixed on the contract Note. Duplicate copies of the contract note should be maintained.

(4) The Contract Note should be signed by the member or his constituted attorney.

(5) Contract note issued to the clients should show the brokerage separately .

(6) In case the broker acts as a principal, the Contract Note should be in Form B.

(7) Consent of the client should be taken for any trade done by the broker while acting as a principal.

(8) Brokerage should be within the limits prescribed by the exchange.

(b) Advantages of Cost Audit : Cost Audit will be advantageous to the stockholders in the following manner :

(1) To Management:

(i) Reliability of data for price fixing, control and decision making.

(ii) Waste control and consequently cost reduction.

(iii) Through the system of budgetary control and standard costing, cost control is established.

(iv) Proper valuation of closing stock, work in progress.

(2) To Society:

(i) Cost Audit is often introduced for the purpose of price fixation. Customers are saved from exploitation through proper costing of products and services.

(ii) Since price increase by some industries is not allowed without proper justification as to increase in cost of production, inflation through price hikes can be controlled and consumers can maintain their standard of living.

(3) To Shareholders: Cost Audit ensures that proper records are kept as to purchases and utilization of materials and expenses incurred on wages etc. It also makes sure that the valuation of closing stock and work-in-progress is on a fair basis. The shareholders are assured about the calculation of the profitability and thus return on their investments.

(4) To Government:

(i) In a cost plus contract, price fixation is properly calculated.

(ii) Price ceiling for essential commodities and thus undue profiteering is checked.

(iii) Able to monitor inefficient units

(iv) Decision support on Government protection to certain industries.

(v) Settlement of trade disputes.

Cost audit and consequent management action can create a healthy competition among the various units in an Industry. This imposes an automatic check on inflation.

Question 4

(a) State the procedure to determine the value of listed and unlisted equity securities and derivative instruments of an insurance company. (10 Marks)

(b) How would you verify "Acceptances, Endorsements and other obligations" appearing in the Balance Sheet of a bank ? (6 Marks)

Answer

(a) Procedure to determine the value of listed and unlisted equity securities and derivative instruments of an insurance company : Equity securities and derivative instruments that are traded in active markets, shall be measured at fair value as at the Balance Sheet date. Fair value will be the lowest of the last quoted closing price of the stock exchanges where the securities are listed. The insurance company shall assess on each Balance Sheet date whether any impairment of listed security/derivative instruments has occurred.

An active market shall mean a market, where the securities traded are homogeneous, availability of willing buyers and sellers is normal and the prices are publicly available.

Unrealized gains/losses arising due to changes in fair value of listed equity shares and derivative instruments shall be taken to equity under the head 'Fair Value Change Account'. The 'profit' on sale of investments' or 'loss on sale of investments', as the case may be, shall include accumulated changes in the fair value previously recognized in equity under the heading Fair Value Change Account in respect of particular security and being recycled to profit and loss account on actual sale of that listed security.

Any credit balance in Fair Value Change Account will not be available for distribution as dividends. Also any debit balance in such an account shall be reduced from profits/free reserves while declaring dividends.

At every Balance Sheet date, impairment loss should be recognized as an expense to the extent of the difference between the re-measured fair value of the security and its acquisition cost as reduced by any previous impairment loss already recognized. Any reversal of impairment loss earlier recognized as an expense, should be recognized in the Revenue/Profit & Loss Account.

Unlisted and other than actively traded equity securities and derivative instruments will be measured at historical costs. Provision shall be made for diminution in value of such investments. The provision so made shall be reversed in subsequent periods if estimates based on external evidence show an increase in the value of investments over its carrying amount. The increased carrying amount of the investments due to reversal of the provision shall not exceed the historical cost.

(b) Acceptances, Endorsements and Other Obligations: This item includes the following balances:

(a) letters of credit opened by the bank on behalf of its customers and

(b) bills drawn by the bank's customers and accepted/endorsed by the bank.

Letters of credit: Evaluate the adequacy of the internal controls over LC Forms e.g. custody, maintenance of records, periodical verification, reconciliation etc.

Verify the balance of LC from the Register maintained by the bank to ascertain the amount of LC and payments made under them.

Examine the guarantees of the customers, copies of the LC issued & security obtained for issuing LC.

In respect of other acceptances and endorsements the following procedure may be adopted.

(i) Examine the arrangements made by the bank with its customers.

(ii) Test check the amounts of bills with the register maintained by the bank.

(iii) Verify whether such bills are marked off in the register on payment at maturity.

Letters of comfort: Where letters of comfort has been issued,, verify whether the bank has incurred a potential financial obligation under such a letter. If an obligation has been cast under letters of comfort, ensure that the amount has also been shown as contingent liability in the Balance Sheet.

Question 5

(a) Outline the contents of a due diligence report. (8 Marks)

(b) Enumerate some of the key functions of the Energy Auditor. (8 Marks)

Answer

(a) Contents of a Due Diligence Report : The Contents of a due diligence report vary with individual cases but the following can be illustrative headings:

(i) Executive summary.

(ii) Introduction.

(iii) Background of target.

(iv) Objective of due diligence.

(v) Terms of reference and scope of verification.

(vi) Brief history of the company.

(vii) Summary on capital structure and group structure of company.

(viii) Shareholding pattern.

(ix) Observations on the review.

(x) Assessment of Management structure.

(xi) Assessment of financial liabilities.

(xii) Assessment of valuation of assets.

(xiii) Comments on properties, terms of leases, lien and encumbrances.

(xiv) Assessment of operating results.

(xv) Assessment of taxation and statutory liabilities.

(xvi) Assessment of possible liabilities on account of litigation.

(xvii) Assessment of net worth.

(xviii) Any liabilities not provided for in the books.

(xix) SWOT analysis comments on future projections.

(xx) Status on charges, liens, mortgages and assets of the company.

(xxi) Ways and means to cover unforeseen contingent liabilities.

(xxii) Aspects to be taken care of before/after merger.

(xxiii) Interlocking investments and financial obligations with group/associate companies amounts receivable subject to litigation.

(b) Key functions of the Energy Auditor: Following are some of the key functions of the Energy Auditor:

(i) Quantify energy costs and quantities.

(ii) Correlate trends of production or activity to energy costs.

(iii) Devise energy database formats to ensure they depict the correct picture –by department, consumer, product, etc.

(iv) Advise and check the compliance of the organization for policy and regulation aspects.

(v) Highlight areas that need attention for detailed investigation.

(vi) Conduct preliminary and detailed energy audits which should include the following:

(a) Data collection and analysis

(b) Measurements, mass and energy balances.

(c) Reviewing energy procurement practices.

(d) Identification of energy efficiency projects and techno-economic evaluation.

(e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.

(f) Recommendation on goal setting for energy saving, record keeping, reporting and energy accounting, organization requirements, communications and public relations.

Question 6

As a chartered accountants firm draft an engagement letter to the Board of Directors for the compilation of financial statements of XYZ Ltd. as at 31.3.2007. (16 Marks)

Answer

Engagement letter to the Board of Directors for the compilation of financial statements of XYZ Ltd. as at 31.3.2007:

To

The Board of Directors

XYZ Ltd.

…………

You have vide your letter dated ………requested that we compile the Balance Sheet of XYZ. Ltd. as at 31.3.2007 and the related Profit and Loss account for the year ended on that date.

We are pleased to confirm our acceptance and understanding of the engagement by means of this letter. As no audit or review engagement procedures would be carried out, no opinion on the financial statements will be expressed. Further, our engagement cannot be relied upon to disclose whether frauds or defalcations, or illegal acts exist. However, we will inform you of any such matters which might come to our attention in the course of the engagement.

As Management, you are responsible for :

(a) The accuracy and completeness of the information supplied to us, including maintenanceof adequate accounting records and internal controls and selection and application of appropriate accounting policies.

(b) Preparation and presentation of the financial statements of the entity, in accordance with the applicable laws and regulations, if any.

(c) Safeguarding the assets of the entity and also establishing appropriate controls designed to prevent and detect fraud and other irregularities.

(d) Ensuring that the activities of the entity are carried on in accordance with applicable laws and regulations and that it institutes appropriate controls to prevent and detect any non-compliance.

You will confirm that events and transactions are recorded in accordance with the applicable accounting standard(s), issued by the Institute of Chartered Accountants of India and other recognized accounting principles and practices and inform us of any departures therefrom.

As part of our normal procedures, we may request you to provide written confirmations of any information or explanations given to us orally during the course of our work.

We understand that the intended use and distribution of the information we have compiled is ………(specify purpose)

We look forward to full co-operation with your staff and we trust that they will make available to us whatever records, documents and other information requested in connection with our engagement.

Our fees will be billed as the work progresses.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our compilation of your financial statements.

XYZ & Co.
Chartered Accountants
S/d

Question 7

(a) A company wants to amend its accounts after the completion of the audit and adoption of the Accounts by the Board, but before circulation to the shareholders. It requires its statutory auditor to report on the amended accounts. State the steps the statutory audit should adopt in such a situation. (8 Marks)

(b) K Ltd., requires you to organize a Management audit program. Briefly state a plan of action. (8 Marks)

Answer

(a) Amendment of accounts after the completion of the audit and adoption of the Accounts by the Board before circulation to the shareholders: This pertains to the manner in which the statutory auditor should report upon amended accounts. The Companies Act does not contemplate the revision of accounts and a further report by the statutory auditor on the amended accounts. At the same time, it is entirely within the competence of the Board of Directors to amend the accounts and resubmit the same to statutory auditors for report before the accounts are placed before the annual General Meeting. The report issued by the statutory auditor on such amended accounts will be in substitution of the report issued before the amendment. Unless all copies of the original accounts and reports are returned to the auditor, such substitution is not possible.

The guidance on Auditor's report on revised accounts of companies before circulation to shareholders recommends that members, when called upon to issue a report on amended accounts for the same period due to amendments to the accounts, should ensure all copies of the original accounts and reports are returned to him, adequate disclosure about the revision of accounts already reported, appears as a specific note on the amended accounts. If the Statutory auditor is satisfied about the adequacy of disclosure, there may not be any need for him to refer to the revision of balance sheet and/or the profit and loss account in his report otherwise he has to refer to the revision in his report.

(b) Organizing a Management Audit for K Ltd.: The key requirement for a successful Management audit program would be the approval and support of the top management to initiate. Accordingly the following shall be the matters that should be considered while organizing the Management Audit of K. Ltd.

(i) Devising a statement of policy : In consultation with the top Management, a policy statement on Management should be issued. The policy should ideally cover the scope, objective, the authority of the management audit function. In short the policy should be drafted to become a charter of Management Audit .

(ii) Location of audit function within the organization: The hierarchical status of the Management auditor and his team should be clearly defined.

(iii) Allocation of personnel : The Management audit team should comprise of personnel who have adequate experience on all the facets of the organization, Ideally it should comprise of technical audit team.

(iv) Staff Training : In order to maintain qualitative standards, adequate and continuous training should be offered to the Management audit team.

(v) Time and other aspects : While planning management audit adequate consideration should be given to time & cost involved in conducting the audit.

(vi) Frequency of audit : Depending on the pace of change that happens in that industry, the frequency of the Management audit should be determined. This can be fixed in consultation with the top Management.

Question 8

Write short notes on any four of the following:

(a) Analytical procedures in planning an audit

(b) Public Accounts Committee

(c) Method of accounting in Form No. 3CD of Tax Audit

(d) Contents of Audit report of Mutual Fund

(e) Eight situations of external confirmations

(f) Factors to consider in determining the use of Computer Assisted Audit Techniques (CAATs). (4 x 4 = 16 Marks)

Answer

(a) Analytical procedures in planning an audit: In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures.

Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, the square feet of selling space, volume of goods produced and similar information.

(b) Public Accounts Committee: The parliament as well as each state legislative sets up a public accounts committee to scrutinize the appropriation accounts and the report of the auditors thereon. The committee also examines financial statements (together with the auditors' report thereon) of the State Corporation and other autonomous and semi-autonomous bodies (except Government companies and those public undertakings which assigned to the committee on public undertakings).

(c) Method of accounting in Form No. 3CD of Tax Audit: Clause 11 of Form No. 3CD of the tax audit requires to state method of accounting employed in the previous year. It also requires to state change in method of accounting vis-à-vis the preceding year. If so, details of change and the effect on the profit or loss are to be stated. Also details of deviation thereof if any, from accounting standards prescribed under section 145 and the effect thereof on the profit or loss are stated.

Section 145 provide that method of accounting be either cash or mercantile. Hybrid system is not permitted.

(d) Audit report of mutual fund: It comprises the following:

(i) The auditor has obtained all information and explanations which, to the best of his knowledge and belief, were necessary for the purpose of the audit.

(ii) The balance sheet and the revenue account give a fair and true view of the scheme, state of affairs and surplus or deficit in the fund for accounting period to which the balance sheet or, as the case may be, the revenue account relates.

(iii) The statement of account has been prepared in accordance with accounting policies and standards as specified in the ninth schedule.

(e) Eight situations of external confirmations:

(i) Bank balances from bankers.

(ii) Accounts receivable balances.

(iii) Accounts payable balances.

(iv) Stocks held by third parties.

(v) Property title deeds held by third parties.

(vi) Investments purchased but delivery not taken.

(vii) Loans from lenders.

(viii) Long outstanding share application money.

(f) Factors to consider in determining the use of Computer Assisted Audit Techniques:

(i) The IT knowledge, expertise and experience of the audit team.

(ii) The availability of CAATs and suitable computer facilities and data.

(iii) The impracticability of manual tests due to complex processing needed.

(iv) Effectiveness and efficiency in evaluating evidence involving large population.

(v) Time constraints.

The above is in consonance with the guidance note on Computer Assisted Audit Techniques.

PAPER – 4 : CORPORATE LAWS AND SECRETARIAL PRACTICE

Question Nos. 1,2, and 3 are compulsory. Answer any four from the rest of the questions

Question 1

Answer any two of the following:

(a) A Company wants to include the following clause in its Articles of Association:

"Each director shall be entitled to be paid out of the funds of the company for attending meetings of the Board or a committee thereof including adjourned meetings such sum as sitting fees as shall be determined from time to time by the Directors, but not exceeding a sum of Rs. 30,000 for each such meeting to be attended by the Director."

You are required to advise the Company as to the validity of such a clause and the correct legal position. (5 Marks)

(b) Describe the provisions of the Securities Contracts (Regulation) Act, 1956 regarding the powers of the Central Government to supersede the Governing Body of a recognized Stock Exchange and the consequences of such supersession. (5 Marks)

(c) SEBI is of the opinion that in the interest of investors, it is desirable to amend the rules of RSP Stock Exchange prohibiting the appointment of the broker-member as President of the Stock Exchange. Explain briefly with reference to the provisions of Securities Contracts (Regulation) Act, 1956, whether it is possible for SEBI to amend the rules of the Stock Exchange, if the Stock Exchange does not change the rules. (5 Marks)

Answer

(a) The payment of sitting fee to a Director is governed by the provisions of Section 310 of the Companies Act, 1956 read with Rule 10B of the Companies (Central Government's) general Rules and Forms 1956. According to t he said provisions, a Company with a paid up share capital and free reserves of Rs. 10 crores and above or a turnover of Rs. 50 crores and above can pay to its director by way of sitting fee for each meeting of the board of directors or a committee thereof an amount not exceeding Rs. 20,000/- and in case of other company the limit has been set at Rs. 10,000/-.

In view of the above legal provisions, the company cannot have a clause in its Articles of Association which exceeds the limit prescribed by law. The Company is advised to check whether the aggregate of its paid up capital and free reserves exceeds Rs. 10 crores or whether its turnover exceeds Rs. 50 crores and accordingly it can have a clause in its Articles of Association. In case the company keeps the clause as given in the question, it shall be ultra vires the Companies Act, 1956, as section 9 states that any provision contained in Memorandum of Association, Articles of Association, Agreements or Resolutions to the extent it is repugnant to the provisions of the Companies Act, 1956, shall be void.

(b) In accordance with the provisions of Section 11 of the Securities Contracts (Regulation) Act, 1956, where the Central Government is of opinion that the governing body of any recognized stock exchange should be superseded, then notwithstanding anything contained in any other law for the time being in force, the Central Government may serve on the governing body a written notice that the Central Government is considering the supersession of the governing body for the reasons specified in the notice. After giving an opportunity to the governing body of such Stock Exchange to be heard in the matter, the Central Government may, by notification in the Official Gazette, declared the governing body of such Stock Exchange to be superseded.

The Central Government may appoint any person or persons to exercise and perform all the powers and duties of the governing body. If more than one person is so appointed, one of them may be the Chairman and another as the Vice-chairman. Such person shall hold office for such period as may be specified in the Notification and the Central Government may vary such period by way of another Notification.

On the publication of the notification in the Official Gazette, following are the consequences:

(i) the members of the governing body of such Stock Exchange ceases to hold office as such members on and from the date of notification.

(ii) The person or persons appointed by the Central Government may exercise and perform all the powers and duties of the governing body which has been so superseded.

(iii) The property of the Stock Exchange as deemed necessary and so specified in writing by such person or persons to carry on the business of Stock Exchange shall vest in such person or persons.

(c) In accordance with the provisions of section 8 of Securities Contracts (Regulation) Act, 1956, The Central Government is empowered to issue written order directing all or any of the recognized stock exchange to make any rules or to amend any rules already made within two months from the date of the order in respect of matters specified in section 3(2) of the said Act. One of the matters specified in the said section 3(2) is the governing body of stock exchange, its constitution and powers of management and the manner in which its business is to be transacted. Hence, the Central Government is empowered to direct the stock exchange in respect of prohibition on broker-member being appointed as President of the stock exchange. According to notification issued by Central Government under section 29A of the said Act, this power is also exercisable by SEBI.

If any recognized stock exchange fails or neglects to comply with any order made by SEBI with in two months, SEBI may itself make the rules or amend the rules made by stock exchange either in the form proposed in the order or with such modification thereof as may be agreed to between SEBI and the stock exchange. The amended rules are required to be notified in the Gazette of India and in the Gazette of the State where the principal office of the stock exchange is situated. After such publication, the rules shall be valid as if the same were made or amended by the recognized stock exchange itself.

Accordingly of the above provisions of Securities Contracts (Regulation) Act, 1956, SEBI can issue directions to RSP Stock Exchange to amend the rules and if the said stock exchange does not comply with the above, SEBI can amend the rules on its own.

Question 2

Answer any two of the following:

(a) (i) Tomco Ltd. A vehicles manufacturing company situate at Pune, Maharastra has received an order from a transport company in Italy for supply of 100 Trucks on lease. You are required to state, how the said Tomco Ltd. can accept such an order.

(3 Marks)

(ii) Forex Dealers Ltd. Is an Authorised Person within the meaning of Foreign Exchange Management Act, 1999. Reserve Bank of India issued certain directions to the said Authorised person to file certain returns which it failed to file. You are required to state the penal provisions to which the said Authorised Person has exposed itself.

(4 Marks)

(b) (i) Mr. Sekhar resided in India for a period of 150 days in India during the financial year 2006-07 and thereafter went abroad. He came back to India on 1st April, 2007 as an employee of a business organization. What would be his residential status during the financial year 2007-2008? (3 Marks)

(ii) Mr. Atul, an Indian National desires to obtain foreign exchange for the following purposes:

(a) Remittance of US Dollar 10,000 for payment for goods purchased from a party situated in Nepal.

(b) US Dollar 10,000 for remitting as commission to his agent in USA for sale of commercial plot situated near Bangalore, consideration in respect of which was received by Mr. Atul by way of foreign currency inward remittance amounting to US Dollar 1,00,000.

Advise him, if he can get the Foreign Exchange and under what conditions.

(4 Marks)

(c) (i) Hon'ble Justice Mr. HCJ, a retired High Court Judge, attained the Age 61 years on 31st December, 2004. The Central Government appointed him as the Chairperson of the Competition Commission of India with effect from 1st January, 2005. You are required to state, with reference to the provisions of the Competition Act, 2002, the term for which he may be appointed as Chairperson of the Competition Commission of India. Whether he can be reappointed as such and till when he can remain as Chairperson of the Competition Commission of India ? (3 Marks)

(ii) After ceasing to be a member of the Competition Commission of India with effect from 31st March, 2007, Mr. MKP was offered the post of Executive Director with

appropriate remuneration and perquisites in the following organizations with effect from 1st April, 2007:

(a) HLL Ltd. a private sector public limited company, whose case was disposed off by the Competition Commission under the provisions of the Competition Act, 2002 in the month of February, 2007.

(b) Life Insurance Corporation of India.

You are required to state with relevant provisions of the Competition Act, 2002, the option available to Mr. MKP in respect of accepting the offers. (4 Marks)

Answer

(a) (i) Under provisions of section 7 of the Foreign Exchange Management Act, 199 certain rules have been made governing export of goods and services. Regulation 14-A of the Foreign Exchange Management (Export of Goods and Services) Regulations, 2000 prescribes that no person shall, except with prior permission of the Reserve Bank of India, take or send out by land, sea or air any goods from India to any place outside India on lease or hire or under any arrangement or in any other manner other than sale or disposal of such goods.

Accordingly if Tomco Ltd. wants to accept the order for dispatching 100 trucks to Italy on lease, it has to take prior permission of the Reserve Bank of India.

(ii) In accordance with the provisions of the Foreign Exchange Management Act, 1999 as contained in section 11(3), stated that where any authorized person contravenes any direction given by the Reserve Bank of India under the said Act or fails to file any return as directed by the Reserve Bank of India, the Reserve Bank of India may, after giving reasonable opportunity of being heard, impose on Authorised Person a penalty which may extend to ten thousand rupees and in the case of continuing contraventions with an additional penalty which may extend to two thousand rupees for every day during which such contravention continues.

Since as per the facts given in the question, the Authroised person, namely, Forex Dealers Ltd., has failed to file the return as directed by the Reserve Bank of India, according to the above provisions if has exposed itself to a penalty which may extend to Rs. 10,000 and in the case of continuing contraventions in the nature of failure to file the return, with an additional penalty which may extend to Rs. 2,000 for every day during which such contravention continues.

(b) (i) In accordance with the provisions of Section 2(v) of the Foreign Exchange Management Act, 1999, as contained in section 2(v) a person in order to qualify for the purpose of being treated as a "Person Resident in India" in any financial year, must reside in India for a period of ore than 182 days during the preceding financial year. In the given case, Mr. Sekhar has resided in India for a period of only 150 days, i.e., less than 182 days, during the financial year 2006-2007. Hence he cannot be considered as a "Person Resident in India" during the financial year 2007-2008 irrespective of the purpose or duration of his stay.

(ii) In accordance with the provisions the Foreign Exchange Management Act, 1999 as contained in Section 5, certain Rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, drawal Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account transactions, Foreign Exchange can be drawn with prior permission of the Central Government while in case of some Current Account transactions, prior permission of Reserve Bank of India is required.

(a) In respect of item (a), i.e., remittance to Nepal, such remittance is prohibited and the same is included in First Schedule to be Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence, Mr. Atul cannot withdraw Foreign Exchange for this purpose.

(b) The type of payment as envisaged in item (b) is covered under Third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules 2000 and for withdrawing foreign Exchange exceeding 5% (five percent) of the inward remittance as commission to agent abroad for sale of commercial plot in India, Mr. Atul will require the prior permission of the Reserve Bank of India.

(c) (i) According to Section 10(1) of the Competition Act, 2002, the Chairperson and every other Member shall hold office as such for a term of five years from the date on which he enters upon his office and shall be eligible for re-appointment.

Provided that no Chairperson or other Member shall hold office as such after he has attained, -

(a) in the case of the Chairperson, the age of sixty-seven years;

(b) in the case of any other Member, the age of sixty-five years.

Based on the above provisions of the Competition Act, 2002, it can be concluded that Hon'ble retired Justice Mr. HCJ can be appointed as the Chairperson of the Competition Commission of India by the Central Government initially for a period of five years and he can also be re-appointed after his initial term of five years is over. But since he shall be attaining the age of 67 years as on 31st December, 2010, he will have to step down from the post on his attaining the age of 67 years.

(ii) In accordance with the provisions of the Competition Act, 2002 as contained in Section 12, the Chairperson and other Members shall not, for a period of one year from the date on which they ceased to hold office, accept any employment in, or connected with the management or administration of, any enterprise which has been a party to a proceeding before the Commission under this Act:

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

Based on the above provisions of the Competition Act, 2002, Mr. MKP will not be able to accept the offer of HLL Ltd. for one year from the date of his cessation as a member of the Competition Commission since in a case of the said company, it was a party to the proceedings before the Commission.

However, since Life Insurance Corporation of India is a Corporation established under the Central Act, the above restriction does not apply and Mr. MKP can accept the offer to join as the Executive Director of the said corporation with effect from 1st April, 2007.

Question 3

Answer any two of the following:

(a) As on 31st December, 206, following information and figures are noticed from the Annual Accounts for the year ended 31st March, 2006 of CAS Ltd., a Company listed with the Stock Exchange, Mumbai:

(i) Authorised Share Capital Rs. 20.22 Crores comprising of 2 Crore Equity Shares of Rs. 10 each.

(ii) Paid up Share Capital Rs. 9.00 Crores comprising of 80 lac Equity Shares of Rs. 10 each fully paid up and 20 lac Equity Shares of Rs. 10 each called and paid upto Rs. 5 each. The total paid up capital is paid up in cash.

(iii) Securities Premium Account Rs. 20.00 Crores.

(iv) 5 lac Full Convertible Debentures of Rs. 100 each. These debentures are due for conversion on 31st March, 2007 in full into fully paid Equity Shares of Rs. 10 each in the ratio of one Debenture : two Equity Shares.

(v) General Reserve Rs. 30.00 crores.

(vi) Fixed Assets Revaluation Reserve Rs. 10.00 crores.

(vii) Outstanding Liabilities in respect of Bonus to Employees & workers Rs. 25.00 lacs.

(viii) Outstanding Liabilities in respect of Interest payable on Public Deposits comprising of Fixed Deposits from general public Rs. 15.00 lacs.

Following other information is gathered from the books of account and other records of the said Company for the period upto 31st December, 2006:

(a) The partly paid shares were made fully paid prior to 30th June, 2006.

(b) Bonus to employees and workers was paid on 15th September, 2006.

(c) Interest on Public Deposits was outstanding on 31st December, 2006.

The Directors of CAS Ltd. Wants to issue Bonus Shares on or after 1st April, 2007 in ratio of 1:1. Advise the Directors on the matter with reference to the guidelines issued by Securities and Exchange Board of India on Bonus Issue. (8 Marks)

(b) Securities and Exchange Board of India (SEBI) has issued certain guidelines in respect of fixation of exit price through "Book Building" process for the shares to be bought back

by the listed companies, who want to voluntarily delist their shares from the stock exchanges. You are required to state the salient features of the said "Book Building" process. (8 Marks)

(c) (i) What is the effect of proviso ? Does it qualify the main provisions of an Enactment?

(ii) Does an explanation added to a section widen the ambit of a section ? Support your answer with an example from the Companies Act, 1956.

(iii) What do you understand by the term 'Preamble" and how does it help in interpretation of a statute ? (8 Marks)

Answer

(a) According to Guidelines issued by Securities & Exchange Board of India on Bonus Issue, a listed Company proposing to issue bonus shares has to comply with the following:

(i) Pending the conversion of Fully Convertible Debentures (FCDs) / Partly Convertible Debentures (PCDs), the Company cannot issue shares by way or bonus unless similar benefit is extended to the holders of FCDs / PCDs through reservation of shares and the shares so reserved may be issued at the time of conversion of FCDs / PCDs on the same terms on which the bonus issues were made.

(ii) The bonus issue is made out of free reserve built out of genuine profits or securities premium collected in cash only.

(iii) Fixed Assets Revaluation Reserves are not capitalized for the purpose of bonus issue.

(iv) The bonus issue is not made in lieu of dividend.

(v) The bonus issue can be made only after any partly paid shares are made fully paid.

(vi) The Company should not have defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption.

(vii) The Company should have sufficient reasons to believe that it has not defaulted in respect of the payment of statutory dues like contribution to P.F., Gratuity and bonus to employees etc.

(viii) The Board of Directors' proposal to make bonus issue is implemented within six months from the date of approval by the Board of Directors and the same can not be revoked.

(ix) The bonus issue must be permitted by the Articles of Association and if the Articles of Association does not contain such a clause, then first the same should be suitably amended.

(x) If Authorised Capital is not sufficient to accommodate the post bonus issue paid up capital, the capital clause of the Memorandum of Association should be suitably amended.

(xi) A compliance certificate by the Company duly countersigned by the statutory auditor or company secretary in practice is to be submitted to SEBI.

Based on the abovementioned guidelines of SEBI, the Board of Directors is advised as follows:

(a) Check the Articles of Association whether it allows the issue of bonus shares. If not, the Articles of Association should be amended to include the relevant clause.

(b) The Paid up Share Capital of the Company as on 31st March, 2006 was Rs. 9.00 Crores and after the partly paid shares were made fully paid, the paid up share capital became Rs. 10.00 Crores. Moreover, after the conversion of 5 lac FCDs, the paid up capital will increase by 10 lac shares of Rs. 10/- each, that means the paid up capital shall become 11.00 Cores as on 31st March, 2007. The Directors want to make bonus issue in the ratio of 1:1. Therefore, the post bonus issue paid up capital shall become Rs. 22.00 crores. But the Authorised Share Capital is only Rs. 20.00 Crores, hence, the Directors are required to take steps to increase the authorized capital to at least Rs. 22.00 crores.

(c) The Company is having sufficient amount in General Reserve and Securities Premium Account and the Directors can use from Any/both of thse accounts for bonus issue. But they should not utilize any amount from the Fixed Assets Revaluation reserve.

(d) Since the Bonus to employees and workers have been paid within the time allowed by the Payment of Bonus Act, the requirement of the SEBI Guidelines have been fulfilled.

(e) The default in paying the interest on fixed deposits should be rectified by paying the necessary amount as provided in the Companies (Acceptance of Deposit Rules) 1975.

(f) The Directors should pass necessary resolution in the meeting of Board of Directors and take further steps to issue the bonus shares within six months from the passing of such resolution.

(g) After the issue of bonus shares, the company should forward a compliance certificate duly counter signed by its statutory auditor or a company secretary in practice to SEBI.

(b) Any promoter of a company which desires to delist from the stock exchange shall determine an exit price for delisting of securities in accordance with book building process. The Book Building process starts after a floor price is fixed by the management. The Book Building process for this purpose is as follows:

1. The book building process shall be made through an electronically linked transparent facility.

2. The number of bidding centres shall not be less than thirty, including all stock exchange centres and there shall be at least one electronically linked computer terminal at all bidding centres.
3. The promoter shall deposit in an escrow account, 100% of the estimated amount of consideration calculated on the basis of the floor price indicated and the number of securities required to be acquired. The provisions of clause 10 of the Securities and Exchange Board of India (Buyback of Securities) Regulations, 1998 shall be applicable mutatis mutandis to such escrow accounts.
4. The offer of buy shall remain open to the security holders to a minimum period of three days. The security holders shall have a right to revise their bids before the closing of the bidding.
5. The promoter or acquirer shall appoint 'trading members' for placing bids on the on-line electronic system.
6. Investors may approach trading members for placing offers on the on-line electronic system.
7. The security holders desirous of availing the exit opportunity shall deposit the shares offered with the trading members prior to placement of orders. Alternatively they may mark a pledge for the same to the trading member. The trading members in turn may place these securities as margin with the exchanges/clearing corporations.
8. The offers placed in the system shall have an audit trail in the form of confirmations which gives broker ID details with time stamp and unique order number.
9. The final offer price shall be determined as the price at which the maximum number of shares has been offered. The acquirer shall have the choice to accept the price. If the price is accepted then the acquirer shall be required to accept all offers up to and including the final price but may not have to accept higher priced offers. An illustration is given below:

Offer quantity (No. of shares)`	Offer price (Rs. Per share)	Remarks
5000	120	Floor price
8200	125	---------------
15000	130	Final price as quantity offered is maximum
27000	135	-----------------
500	140	------------------

10. If final price is accepted the acquirer shall have to accept offers up to and including the final price i.e. 28200 shares at the final price of Rs. 130/-.

11. At the end of the book build period the merchant banker to the book building exercise shall announce in the press and to the concerned exchanges at the final price and the acceptance (or not) of the price by the acquirer.
12. The acquirer shall make the requisite funds available with the exchange/clearing corporation on the final settlement day (which shall be three days from the end of the book build period). The trading members shall correspondingly make the shares available. On the settlement day the funds and securities shall be paid out in a process akin to secondary market settlement.
13. The entire exercise shall only be available for demat shares. For holders of physical certificates the acquirer shall keep the offer open for a period of 15 days from the final settlement day for the shareholders to lodge the certificate(s) specified by the merchant banker.

(c) (i) Normally a Proviso is added to a section of an Act to except something or qualify something stated in that particular section to which it is added. A proviso should not be, ordinarily, interpreted as a general rule. A proviso to a particular section carves out an exception to the main provision to which it has been enacted as a Proviso and to no other provision. [Ram Narian Sons Ltd. Vs. Commissioner of Sales Tax AIR (1955) S.C. 765]

(ii) Sometimes an explanation is added to a section of an Act for the purpose of explaining the main provisions contained in that section. If there is some ambiguity in the provisions of the main section, the explanation is inserted to harmonise and clear up and ambiguity in the main section. Something may added to or something may be excluded from the main provision by insertion of an explanation. But the explanation should not be construed to widen the ambit of the section.

For example, Section 294AA of the Companies Act, 1956 gives power to the Central Government to prohibit the appointment of Sole Selling Agents of a company in certain cases. An explanation has been added to that section which states that an "appointment" includes "re-appointment". By inclusion of this explanation, the legislature has only clarified the main provisions of that section and has not widened the ambit of the powers of the Central Government.

(iii) The "Preamble" expresses the scope, object and purpose of the Act. It may recite the ground and the cause making a statue and the evil, which is sought to be remedied by it. It is a part of the statute and can legitimately be used for construing it. However, it does not over-ride the plain provisions of the Act, but if the wording of the statute gives rise to the doubts as to its proper construction, e.g., where the words or phrase have more than one meaning and a doubt arises as to which of the two meanings is intended in the Act, then the Preamble can and ought to be referred to in order to arrive at the proper construction.

Question 4

(a) (i) Mr. MTP was appointed as a director at the Annual General Meeting of a limited company held on 30th September, 2005 and he carried on his duties and functions

as a director. In the month of August, 2006, it was found out that there were certain irregularities in his appointment and on 31st August, 2006, his appointment was declared invalid. But Mr. MTP continued to act as director even after 31st August, 2006. You are required to state, with reference to the provisions of the Companies Act, 1956, whether the acts done by Mr. MTP are valid and binding upon the company ?

(ii) In course of administration of the affairs of a limited company, Chairman of its Board of Directors came across a matter, which required the approval by say of a board resolution. In the prevailing circumstances, it is not possible to convent and hold a Board Meeting. The Chairman approaches you to advise him of the way and the relevant procedure to obtain such approval without holding the Board Meeting. You are required to advise him on the matter as per the provisions of the Companies Act, 1956. (8 Marks)

(b) The management of ATP Ltd., a company listed with The Stock Exchange, Mumbai wants to appoint Mr. BDF as a Director of a Company at the Annual General Meeting of the Company to be held on 24th May, 2007. It maybe noted that Mr. BDF is not a retiring Director. The Management seeks you guidance regarding the procedure to be adopted for the purpose. You are required to state the procedure to be followed for giving effect to such proposal and formalities to be observed after appointment of Mr. BDF as Director, by the management of ATP Ltd., as per the provisions of the companies Act, 1956. (8 Marks)

Answer

(a) (i) In accordance with the provision of the Companies Act, 1956 as contained in section 290, acts done by a person as a director shall be valid, notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles:

The Proviso to section 290 further provide that nothing in this section shall be deemed to give validity to acts done by a director after his appointment has been shown to the company to be invalid or to have terminated.

In view of the provision of section 290 of the Companies Act, 1956, the acts done by Mr. MTP prior to 31st August, 2006 are to be treated as valid and binding on the Company.

However in view of the Proviso to the said section 290, the acts done by Mr. MTP after 31st August, 2006 shall be deemed to be invalid and not binding upon the Company.

(ii) As per the provisions of the Companies Act, 1956, several Board Resolutions are required in course of carrying on the affairs of a limited company. But it may sometimes so happen that a Board Meeting can not be held. To meet such eventualities, the Companies Act, 1956 contains the solution in section 289. According to this section, the board resolution can be passed by way of circulation.

It may however be noted that the matter listed in the provisions of section 292 and other sections requiring passing of resolution at the board meetings only can not passed by way of circulation and can be passed only at the Board Meeting. The Chairman of the company is advised that the approval in the form of a Board Resolution may be obtained by way passing the relevant resolution by circulation if the matter is not covered by the barring sections of the said Act.

The procedure to be adopted for the purpose shall be as follows:'

(i) Send the draft of the resolution in duplicate together with the necessary papers, if any, to all the directors then in India. It is to be ensured that the number of such directors is not less than the directors required to form the quorum for a Board meeting.

(ii) Send the draft of the resolution in duplicate together with the necessary papers, if any, to all other directors at their usual address in India.

(iii) Obtain one copy of the draft resolution duly signed by the directors, whether approving the resolution or disapproving the same. It may be noted that the resolution shall be deemed to be passed by the Board if all the directors then in India or majority of all directors as are entitled to vote on the matter approve the resolution by singing one copy and returning the same to the company.

(iv) The resolution passed by circulation shall be placed before the next Board Meeting for confirmation.

(v) The resolution shall be recorded in the minutes of the next Board Meeting.

(b) The directors of a company are appointed by the shareholders at the general meeting. Though the retiring directors are normally re-appointed, it may sometimes become necessary to appoint a person other than the retiring director as director. The shareholders also have a right to propose the appointment of a person as a director. This power may be exercised in order to increase the strength of the Board or to permit the shareholders to exercise this important right available to them.

In the case of private company which is not a subsidiary of a public company, the producers given below are not applicable and the appointment shall be in accordance with the Articles of Association.

Procedure to be adopted:

1. A person, other than the retiring director, shall be eligible for appointment to the office of director only if he or some other member intending to propose him has, at least 14 days before the meeting, left at the office of the company a special notice in writing under his hand signifying his candidature for the office of director along with a deposit of Rs. 500 as required under section 257 of the Companies Act, 1956.

2. On receipt of the special notice, information should be sent to all the members of the company not less than 7 days before the meeting. Alternatively, an advertisement may be issued regarding the candidature or intention not less than 7

days before the meeting in at least in two newspapers circulating in the place where the registered office of the company is situated both in English and in the local language.

3. The resolution for the appointment should be move before the annual general meeting and an ordinary resolution should be passed for this purpose. If the resolution is not passed, no further action needs to be taken in this regard.
4. In case the resolution is passed, the deposit money is Rs. 500 should be refunded to the person who made the payment.
5. In the case of a listed company, copy of the minutes of the meeting and intimation regarding the appointment should be sent to each of the stock exchanges in which the securities are listed.
6. Within 30 days of the appointment, a return in Form No. 32 should be filed electronically, with the Registrar of Companies together with the prescribed filing fee.
7. The Company and the director has to complete the formalities as prescribed under Companies (Director Identification Number) Rules, 2006.
8. A genial notice of disclosure of interest in Form No. 24AA indicated the names of bodies corporate of which he is a director or member (holding more than 2% of paid-up capital) or firms in which eh is a partner should be obtained. The said disclosures should be placed before the Board and a resolution taking the notice on record should be passed. The notice shall expire at the end of the financial year but may be renewed by giving a fresh Form No. 24AA in the last month of the financial year in which it would otherwise expire.
9. Articles of Association should be check and in case it provides for acquiring of qualification shares, the same should be acquired within two months of appointment, if the new appointee does not hold the same.
10. Particulars regarding directors should be entered in the Register of Directors and the Register of Directors' Shareholdings.

Question 5

(a) A majority of the Board of Directors of M/s Bulk Drugs Ltd. have reasons to believe that some of the business activities carried on in the name of the company and prima facie against the interest of the company and its members. They want the matter to be referred to Central Government in the form of an application for appointment of an Inspector to reach to the bottom of the matter and unveil and truth. In this connection you are required to:

(i) State the steps required to be taken with reference to the provisions of the Companies Act, 1956.

(ii) Draft an application to be made to the Central Government. (8 Marks)

(b) (i) Mr. SDR, a shareholder in M/s JKP Ltd. Holding ten equity shares of Rs. 10 each fully paid up wants to give a special notice to the company for removal of a Mr. EDM, a director of M/s JKP Ltd. without stating any reasons in the notice. You are required to state as per the provisions of the Companies Act, 1956 and / or any decided case law whether Mr. SDR is entitled to do so ?

(ii) Would your answer be different, if Mr. EDM was a director appointed by the Central Government under Section 408 of the Companies Act, 1956 ?

(iii) State the relevant provisions of the Companies Act, 1956 in case of an appropriate special notice is received by the company for removal of any director. (7 Marks)

Answer

(a) The case stated in the question relates to the provisions of Section 237 of the Companies Act, 1956 dealing with appointment of Inspectors to investigate the affairs of a company and to report thereon.

Clause (a) of the section 237 provides that Central Government shall appoint one or more person as Inspectors to investigate the affairs of a company if the company by way of a special resolution or the court by an order declares that the affairs of the company should be investigated.

Clause (b) of the said section further states that the Central Government may appoint an Inspector if in the opinion of the Company Law Board (Now Tribunal), there are circumstances suggesting that:

(i) the business of the company is being conducted with intent to defraud the creditors, members or any other person.

(ii) the person concerned in the formation of the company or the management of its affairs have been guilty of fraud, misfeasance or misconduct towards the company or its members.

(iii) the members have not been given all the information with respect to its affairs.

In view of the above stated legal provisions, M/s Bulk Drugs Ltd. have following options to get the company's affairs investigated by an inspector appointed by Central Government under the said Section 237:

(i) To get a special resolution passed in a general meeting and apply to the Central Government.

(ii) To approach the court with a petition requesting it to direct the Central Government for the desired purpose.

(iii) To approach the Company Law Board (now Tribunal) with a petition requesting it to express its opinion on the affairs of the company and then bringing to the notice of the Central Government.

It may, however, be noted that while in first two options, the Central Government is bound to act as per provisions of the said section 237 but it has discretionary powers in the case of the third option.

DRAFT APPLICATION

BULK DRUGS LTD.

(Address)

Dated ________________

To,

The Secretary,
Department of Company Affairs,
(Address)
New Delhi

Sir,

At an Extra-ordinary General Meeting of the shareholders of the company held on _______date___________ at the registered office of the company, the members have unanimously passed the following Special Resolution:

"RESOLVED that the Central Government be approached to appoint an Inspector pursuant to the provisions of section 237 of the Companies Act, 1956 to carry out an investigation whether the following activities carried out in the name of the company are or are not in the interest of the company or its members:

1. Granting of interest-free loans to certain parties.
2. Purchase of Raw Materials without complying with the procedure laid down by the Drug Controller."

"Resolved further that Mr. ___________, the Secretary of the Company be and is hereby authorized to do needful in the matter."

It is, therefore, prayed that the Central Government be please to appoint, pursuant to section 237 of the Companies Act, 1956, an inspector to investigate the affairs of the Company regarding the matters mentioned in the Special Resolution quoted above and communicate its decision to the company.

The Challan evidencing the payment of prescribed fee as per Companies (Fees on Application) Rules, 1999 and other papers & documents as required by rules are enclosed.

Yours faithfully,

For BULK DRUGS LTD.
Secretary

(b) (i) The problems as stated in the question is governed by the provisions of section 284 of the Companies Act, 1956. Sub-Section (2) of the said section stated that a special notice is required of any resolution to remove a director. The section states that a special notice is required of any resolution to remove a director. The section does not put any condition in respect of the number of members or their shareholding and furnishing any reason therefore. Accordingly the Karnataka High Court in the case of Karnataka Bank Ltd. Vs. A.B. Datar & Other reported at [1994] 79 Comp. Cases 417 held that here is no requirement with regard to the number of members of their shareholding and even one member is entitled to give special notice for removal of director, The Court also held that there is no need to give any reason for removal of a director in the resolution proposed to be moved. Hence Mr. SDR holding only ten equity shares can alone give a special notice for removal of Mr. EDM from the office of director of M/s. JK Ltd.

(ii) According to section 284 (1) of the Companies Act, 1956, the provisions relating to removal of directors are not applicable to the directors appointed by the Central Government under section 408 of the said Act. Hence, in case Mr. EDM was a director appointed by the Central Government under the said section 408, Mr. SDR would not be entitled to give any special notice under section 284 for removal of director.

(iii) On receipt of notice of a resolution to remove a director, the relevant provisions of the Companies Act, 1956 in this regard are as follows:

(a) The Company has to forward a copy of the notice to the concerned director, [Sec 284(3)].

(b) The concerned director, whether he is a member of the company or not, shall be entitled to be heard on the resolution at the meeting. [Sec 284(3)].

(c) In case the concerned director makes any representation in writing of reasonable length and requests the company to notify the same to the members of the company, the fact of receiving the representation should be stated in the notice of the meeting and a copy should be circulated to all the members of the company. [Sec. 284 (4)]

(d) In case the representation received by the company is too late for inclusion in the notice or if there is an omission of the part of the company, the same should be read out at the meeting. [Sec 284 (4)]

(e) The company or the person who claims to be aggrieved may make an application to the Central Government seeking exemption from circulation or reading out the representation if the rights are sought to be abused to secure needless publicity for defamatory matter and the Central Government may pass an order granting such exemption. [Proviso to Sec 284 (4)].

(f) The Central Government may also order the company's costs on the application to be paid in whole or in part by the director concerned not withstanding that he is not a party to it. [Proviso to Sec 284 (4)].

(g) The Board of Directors is not entitled to appoint a person as a Director if he has been removed from his office under the provision of section 284 of the Companies Act, 1956. [proviso to Sec 284 (6)]

Question 6

(a) (i) Define the expression "Accounting Standards" within the meaning of Companies Act, 1956.

(ii) XYZ Limited did not prepare its Balance Sheet as at 31st March, 2007 and the Profit and Loss Account for the year ended on that date in conformity with some of the mandatory Accounting Standards issued by the Institute of Chartered Accountants of India. You are required to stat with reference to the provisions of the companies Act, 1956, the responsibilities of directors and statutory auditor of the company in this regard. (8 Marks)

(b) (i) A two year old Producer Company registered under Section 581C of the Companies Act, 1956 wants to donate some amount. The Chief Executive of the producer Company hs approached you to advise him as to how and for what purposes the donation can be made by such company. Also state the monetary restrictions, if any, laid down in the Companies Act, 1956 on making donations by a Producer Company. You are informed that as per the profit and loss account of the Producer Company for its last account year the profit was Rs. 20.00 lacs.

(ii) State the powers and functions of the Board of Directors of a Producer Company as enumerated in the Companies Act, 1956. (7 marks)

Answer

(a) (i) As per sub-section (3c) of Section 211 of the Companies Act, 1956, the expression "accounting standards" means the standards of accounting recommended by the Institute of Chartered Accounts of India Constitution under the Chartered Accountants Act, 1949 as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards established under sub-section (1) of section 210 of the said Act.

Proviso to the above sub-section further the states that the standards of accounting specified by the Institute of Chartered Accountants of India shall be deemed to be the accounting standards until the according standards are prescribed by the Central Government under this sub-section.

(ii) Sub-Section (3A) of the said section states that every profit and loss account and balance sheet of the company shall comply with the accounting stardards.

(a) the deviation from the accounting standards;

(b) the reasons for such deviation; and

(c) the financial effect, if any, arising due to such deviation.

Accordingly to sections 211 (7) and (8) read with section 209 (6) of the Companies Act, 1956 following persons are responsible for complying with the above requirements:

(a) the managing director or manager of the company, if any,

(b) all officers and employees of the company, and

(c) if the company does not have a managing director or manager, then every director of the company.

In view of the above provisions of the Companies Act, 1956, the managing director/directors have a responsibility to ensure that in case of non-compliance of any mandatory Accounting Standard, proper disclosure is made in the profit & loss account and the balance sheet.

Moreover, the board of directors is also required under section 217 of the companies Act, 1956 to include a Directors Responsibility Statement indicating therein that in the preparation of the annual accounts the applicable accounting standards have been followed along with proper explanation relating to material departures.

Responsibilities of auditors:

As per section 227(3) (d) of the Companies Act, 1956, the statutory auditor's responsibility is to state in his report, whether, in his opinion, the profit and loss account and balance sheet comply with the accounting standards referred to in sub-section 211 of the Companies Act, 1956.

(i) As per provisions of section 581-ZH of the Companies, Act, 1956, a Producer Company may, by special resolution, make donation or subscription to any institution or individual for the following purposes-

   (a) For promoting the social and economic welfare of Producer Members of producers of general public; or

   (b) For promoting the mutual assistance principles

   Thus as per the above stated provisions of the Companies Act, 1956, a Producer Company may make a donation by passing a special resolution and for the above mentioned purposed.

   The 1st proviso to the said section 581-ZH lays down the monetary limit for making the donation by Producer Company. According to the said proviso the aggregate amount of all such donation and subscription in any financial year shall not exceed three per cent of the net profit of the Producer Company in the financial year immediately proceeding the financial year in which the donation or subscription was made.

   Since the net profit of the Producer Company as per its last profit & loss account was Rs. 20.00 lacs, it can make a total donation of Rs. 60,000/- in this year being three percent thereof.

(ii) Sub-section (3) of section 581-R of the Companies Act, 1956 states that all the powers specified in sub-section (1) and (2) shall be exercised by the Board, by means of resolution passed at its meeting on behalf of the Producer Company.

Sub-section (1) of the said section states that subject to the provisions of this Act and articles, the Board of directors of a Producer Company shall exercise all such powers and to do all such acts and things, as that company is authorized so to do.

Sub-section (2) of the said section states that such powers of the Board of Directors of a Producer Company May include all or any of the following matters, Namely:-

(a) determination of the dividends payable;

(b) determination of the quantum of withheld price and recommend patronage to be approved at general meeting;

(c) admission of new Members;

(d) pursue and formulate the organizational policy, objectives, establish specific long-term and annual objectives, and approve corporate strategies and financial plans;

(e) appointment of a Chief Executive and such other officers of the Producer Company, as may be specified in the articles;

(f) exercise superintendence, direction and control over Chief Executive and other officers appointed by it;

(g) cause proper books of account to be maintained; prepare annual accounts to be placed before the annual general meeting with the auditor's report and the replies on qualifications, if any, made by the auditors.

(h) acquisition or disposal of property of the Producer Company in its ordinary course of business;

(i) investment of the funds of the Producer Company in its ordinary course of its business;

(j) sanction any loan or advance, in connection with the business activities of the Producer Company to any Member, not being a director or his relative;

(k) take such other measures or do such other acts as may be required in the discharge of its functions or exercise of its powers

Question 7

(a) 60% shares of Indo-French Ltd. are held by French Group and balance by an Indian Group. As per articles of association of the company both groups had equal managerial powers. The relationship between the two groups soured and the operations of the

company reached a deadlock. The Indian Group approached the Company Law Tribunal (Company Law Board till Company Law Tribunal becomes functional, referred to as CLB hereinafter) for action against the French Group for oppression. Based on these facts, you are required to decide, with reference to the provisions of the Companies Act, 1956 and/or the decided case laws, the following issues:

(i) Whether the contention of oppression against the French Group by the Indian Group is tenable ?

(ii) What are the powers of the CLB in this regard ? (8 Marks)

(b) State the provisions of the Companies Act, 1956 in respect of appointment of Auditor in the following cases:

(i) A Government Company within the meaning of Section 617 of the Companies Act, 1956.

(ii) A public limited company at whose annual general meeting hold on 30th November, 2006 in respect its accounting year ended on 30th June, 2006, the auditor was appointed to hold office as such till the conclusion of its next annual general meeting, but whose auditor has resigned on 15th March, 2007.

(iii) A company whose shareholders include the following:

(a) Bank of Baroda (a nationalized bank) holding 12% of the Subscribed capital in the Company.

(b) National Insurance Co. Ltd. (carrying on general insurance business) holding 10% of the Subscribed capital in the Company.

(c) Maharashtra State Financial Corporation (a public financial institution) holding 8% of the Subscribed capital in the Company. (7 Marks)

Answer

(a) (i) Section 397 of the Companies Act, 1956 deals with the remedy in a situation when the affairs of the company are being conducted in a manner oppressive to a shareholder or shareholders. This means that some of the shareholders must be in such a position that they can be oppressed by other shareholders or the management. In the present case a s given in the question, both the Indian Group and the French Group are equally strong and none is able to oppress the other. The situation stated in the question is a deadlock but it can not be termed as oppression. Since it is not a case of winding up of the company, the relief under the said section 397 is not available to the Indian Group. [Gnanasambandam v. Tamilnad Transporters (Coimbators) p. Ltd. (1971) 41 Comp. Cas. 26] In view of the position discussed, the contention of the Indian Group is not tenable.

(ii) The powers of the Company Law Tribunal (Company Law Board till National Company Law Tribunal becomes functional) referred to as CLB hereinafter) under the provisions of section 397 of the Companies Act 1956, are discretionary in character. Apart from the general powers envisaged therein, the CLB under section

402 (b) of the said Act, may order the purchase of the shares of one group by the other group. In the case of Yashovardhan Saboo Vs. Groz Beckert Saboo Ltd. 1933 1 Comp. L.J. 20, the presiding officer ordered the foreign group to buy out the shares of the minority group at the fair price with deadlock and the matters are not sorted out by any other means, an order for winding up of the company may also be made under the jest and equitable clause, [Kishan Kumar Ahuja Vs. Suresh Kumar Ahuja]. Thus, if the Indian Group of the French Group fail to buy out the shares of the other group, the CLB may order the winding up of the company.

(b) (i) The appointment and re-appointment of auditor in the case of a Government Company is governed by the provisions of section 619 of the Companies Act, 1956. The said section states that the auditor of a Government on the advice of Comptroller and Auditor General of India. The provision for appointment of auditor by Central Government of the advice of Comptroller and Auditor General of India has been amended by the Companies (Amendment) Act, 2000 with effect from 13.12.2000.

(ii) The situation as stated in the question is covered by the provisions of section 224 (6) of the Companies Act, 1956. Clause (A) of the said section states that the Board of Directors may fill nay casual vacancy in the office of an auditor, but proviso thereto states that were such vacancy is caused by the resignation of an auditor, the vacancy shall only be filled by the company in general meeting. Hence, in the case of registration by the auditor, the company is required to convene and hold a general meeting and appoint the auditor thereat.

(iii) The case of appointment of auditor of a company who's 25% or more of the Subscribed capital is held by Government, financial institution, nationalized banks. General insurance companies are governed by the provisions of section 224A of the Companies Act, 1956. According to the provision of the said section in the case of a company in which not less than twenty-five per cent of the subscribed share capital is held, whether singly or in any combination, by-

(a) a public financial institution or a Government Company or Central Government or any state Government, or

(b) any financial or other institution established by any Provincial or State Act which a State Government holds not less than fifty-one per cent of the subscribed share capital, or

(c) a nationalized bank or an insurance company carrying on general insurance business,

the appointment or re-appointment at each annual general meeting of an auditor or auditors or auditors shall be made by a special resolution.

In view of the above provisions of the companies Act, 1956, since the combined holding of the nationalized bank, general insurance company and the financial institution covered by the said provisions is 30% which exceeds the limit of 25% of

the subscribed capital of the company, the company has to appoint its auditors in the Annual general Meeting by passing a special resolution.

Question 8

(a) MNC Ltd., a company, whose paid up capital was Rs. 4.00 Crores, has issued rights shares in the ratio of 1:1. The said company is listed with Mumbai Stock Exchange. Whether the company is required to appoint any Audit Committee and if yes, draft a suitable Board Resolution to appoint an Audit committee covering the aspects as provided in the Companies Act, 1956 and the listing Agreement with the Stock Exchange. In case the company is not required to appoint any Audit Committee, state the provisions of the Companies Act, 1956 in respect of appointment of Audit Committee by a Company. (8 Marks)

(b) An allegation was leveled against PQR Ltd. that the funds of the company are misused. Mr. Z, one of the Directors of the company wants to inspect the books of account of the company in order to ascertain whether the allegation was true. But since Mr. Z does not have the knowledge of accounting, he apponts Mr. A, his friend and a practicing Chartered Accountant to go through the books of accont of the company on his behalf. The company seeks your advice as to whether Mr. A may be allowed to inspect the books of account of the company on behalf of Mr. Z. You are required to give your advice to the company on behalf of Mr. Z. You are required to give your advice to the company keeping in view the provisions of the Companies Act, 1956.

What would be your advice if Mr. Z would have been a shareholder only and not a Director of the company ? (7 Marks)

Answer

(a) As per provision of section 292A of the Companies Act, 1956, a public company having a paid up capital of Rs. 5.00 Crores or more is are required to have an Audit Committee. Since, after the rights issue by MNC Ltd. its paid up capital has increased to Rs. 8.00 Crores, it is required to appoint an Audit Committee.

The relevant Board Resolution for appointment of an Audit Committee is as follows:

Resolved that pursuant to the provision contained in section 292A of the companies Act 1956 and clause 49 of Listing Agreement with the Mumbai Stock Exchange, an Audit Committee of the Company be and is hereby constituted as under:

1. Mr. A -- An Independent Director.
2. Mr. B -- An Independent Director
3. Mr. C -- Director nominated by IDBI
4. Mr. D -- An Independent Director
5. Mr. FD -- Financial Executive
6. Mr. MD -- Managing Director

Further resolved that the Chairman of the Committee, who shall be an independent Director, be elected by the members from amongst themselves.

Further resolved that the quorum for a meeting of the Audit Committee shall be 1/3rd of the total number of members or two directors (other than the Managing Director), whichever is higher.

Further resolved that the Audit Committee shall comply with the following:

(1) The Audit Committee shall have meetings periodically as it may deem fit with at least three meeting in a year, viz., one meeting before finalization of annual accounts and one every six months.

(2) The Audit Committee shall invite such of the executives (and particularly the head of the finance function) to be present at the meeting of the Committee whenever required by it.

(3) The finance Director, head of internal audit and the auditors of the company shall attend and participate at the meeting without right to vote.

Further resolved that the audit Committee shall have the authority to investigate into nay matter that may be prescribed under the said section 292A of the Companies Act, 1956 and the matters as mentioned in the Listing Agreements entered into between the Company and the Mumbai Stock Exchange and all the matters as may be referred to it by the Board from time to time and for this purpose the Audit Committee shall have full access to information contained in the records of the Company and external professional advice, if necessary.

Further resolved that the Audit committee shall conduct discussions with the auditors periodically about internal control system, the scope of audit including the observations of the auditors.

Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations, if any.

Further resolved that the recommendations made by the Audit Committee on any matter relating to financial management including the audit report shall be binding on the Board. However, where such recommendations are not accepted by the Board, the reasons for the same shall be recorded in the minutes of the Board meeting or communicated to the shareholders.

Further resolved that the Audit Committee have the minutes of its meetings drawn and approved by the Chairman of the Committee and the same be circulated to the members of the Board within thirty days from the date of such meeting.

Further resolved that the Company Secretary of the Company shall be the Secretary to the Audit Committee.

Further resolved that the Chairman of the Audit Committee shall attend the annual general meeting of the Company to provide any clarifications on matters relating to audit as may be required by the members of the company.

Further resolved that the Board's Report/Annual Report to the members of the Company shall include the particulars of the constitution of the Audit Committee.

(b) Section 209 (4) of the Companies Act 1956 provides that the books of account and other books and papers shall be open to inspection by any director during the business hours.

The right of inspection given by this sub-section is not so restricted that it can only be exercised personally by the director in Vakharia Vs Supreme General Film Exchange CO. Ltd it was held that a director is entitled to take inspection of accounts personally or through an agent provided that there is no reasonable objection to the person chosen and the agent undertakes not to utilize the information obtained by him for any purpose other than the purpose of his principal.

As the right of inspection is a statutory right given under this sub-section, a director who is prevented from or refused inspection may enforce his right through court.

As such, Mr. Z being the director, can appoint Mr., A to inspect the Books of accounts of the company.

In case Mr. Z is the member of the company

As per the provisions of the Act the board shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulation, the accounts and books of the company, or any of them, shall be open to inspection of members not being directors. No member (Not being a director) shall have any right to inspection any account or books or document of the company except as conferred by law or authorized by the board or by the company in general meeting.

In case Mr. Z is a member of the company, he shall be able to inspect the books of account only if he is given such a right by ordinary resolution of the members or if authorized by the board. But even in such case Mr. Z would have to exercise the right personally and not through a proxy i.e. he can himself inspect the books but cannot ask Mr. A to inspect the books in his behalf.

Question 9

(a) Following information is available from the audited Balance Sheet as at 31st fMarch, 2007 of ASK Ltd.:

Capital & Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
Equity Share Capital		Goodwill	10,00,000
(5,00,000 shares of Rs. 10 each fully paid up in cash)		Land & Buildings	75,00,000
		Plant & Machinery	1,50,00,000
	50,00,000	Furniture & Other	
Less: Calls in arrear	50,000	Assets	2,50,000
	49,50,000	Investments:	

Less: Calls in arrear	15,00,000	Equity Shares in wholly owned Subsidiary Company -	
Share Application Money	10,00,000		
Reserves & Surplus:			
Securities Premium	15,00,000	KMC Ltd.	12,50,000
Capital Redemption Reserve	12,00,000	Equity Shares representing 90% of MTC Ltd.	
Fixed Assets Revaluation Reserve	10,50,000	Share Capital of MTC Ltd.	4,50,000
General Reserve	40,00,000	Debentures in SKT Ltd.	
Profit and loss Account	22,00,000	SKT Ltd.	12,00,000
Dividend Eualisiation Reserve	6,00,000	Preference Shares in HUT Ltd.	5,00,000
Secured Loans:			
Cash credit facility from Bank	1,00,00,000	Capital account balance in Partnership Firm - BKP & Co.	8,00,000
		Current Assets:	
Fixed Deposits (From general public maturing after 31.02.2007)	20,00,000	Stock and Book Debts	14,00,000
Current Liabilities & Provisions:		Cash & Bank Balances	1,00,000
Current Liabilities	12,50,000	Loans & Advances:	
Provision for Taxation	10,00,000	Inter-corporate	
		Deposits	25,00,000
		Business Advances	14,00,000
	3,33,50,000		3,33,50,000

The directors of the company want to make further investments stated below by taking a decision in the meeting of Board of Directors without seeking approval of the shareholders :

		Rs.
(a)	Loan to KMC Ltd.	25,00,000
(b)	Loan to MTC Ltd.	15,00,000
(c)	Purchase of further debentures in SKT Ltd.	8,00,000
(d)	Purchase of shares from the open market in Glaxo Ltd.	15,00,000

You are required to state, with reference to the relevant provisions of the Companies Act, 1956, whether the directors can do so and mention the relevant calculations. (10 Marks)

(b) X Ltd. and Y Ltd. are two listed companies engaged in the business of telecommunication. The companies are not making profits and as such their share's market prices have gone down. A substantial portion of their share capital is held by Central Government as well as some Public Financial Corporations. In order to increase the share value, the Central Government wants to amalgamate the aforesaid two companies into a single company.

Examine the powers of Central Government to amalgamate the two companies in public interest as per the provisions of the Companies Act, 1956. (5 Marks)

Answer

(a) According to the provisions of section 372A of the Companies Act, 1956, a public company and private company, which is a subsidiary of the public company shall not, directly or indirectly:

(a) make any loan to any other body corporate.

(b) give any guarantee, or provide security, in connection with a loan made by any person to, or to any other person, by any body corporate; and

(c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate.

exceeding 60% of its Paid up Share Capital and free reserves or 100% of its free reserves, whichever is more without prior authorization by way of a special resolution passed in a general meeting.

In order to arrive at the conclusion whether the directors of ASK Ltd. can make the proposed investments without seeking approval from the shareholders, the amount upto which they can invest has to be arrived at. In the given case, the Paid up Share Capital and free reserves are as follows:

Paid up Share Capital

Equity Share Capital (500,000 shares of Rs. 10/- each fully paid up in cash)	Rs. 5,000,000/-
Less: Calls in arrear	Rs. 50,000/-
	Rs. 4,950,000/-
Preference Share Capital	Rs. 1,500,000/-
Total of Paid up Share Capital	Rs. 6,450,000/-
Free Reserves:	Rs. 1,500,000/-
	Rs. 4,000,000/-
	Rs. 2,2000,000/-
	Rs. 600,000/-
Total Free Reserves	Rs. 8,300,000/-
Total of paid up share capital and Free Reserves:	Rs. 14,750,000/-

As per explanation to the said section, "Free Reserves" means those reserves which, as per the latest, audited balance sheet of the company, are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money.

Accordingly, for the purpose of calculating the amount of Free Reserves, the amounts lying in the accounts of Share Application Money and reserves not available for distribution as dividend being Capital Redemption Reserves, Fixed Assets Revaluation Reserve and Sinking Fund Reserve are excluded.

Ceiling limit for investments:

60% of Paid up Share Capital and free reserves (i.e., 60% of Rs. 14,750,000/-)	Rs. 88,50,000
100% of Free Reserves (i.e., 100% of Rs. 83,00,000/-	Rs. 83,00,000

Since 60% of Paid up Share Capital and free reserves is Rs. 88,50,000//- which is higher than 100% of Free Reserves, the directors of ASK Ltd. can advance loans and make investments in other bodies corporate upto a total limit of Rs. 88,50,000/- without obtaining prior approval from the shareholders.

For arriving at a decision for further investments, the extent of present investment is to be determined and the directors can make further loans and investments upto the residual amount.

The present investments and loans of ASK Ltd. calculated as per the provisions of section 372A of the Companies Act, 1956 are as follows:

Equity Shares in wholly owned 'Subsidiary Company – KMC Ltd.

(not to be counted since as per provisos of Section 372(8)(e), investments in wholly owned subsidiary company is outside the purview of this section)

Equity Shares representing 90% of share capital of MTC Ltd.	Rs. 4,50,000/-
Debentures in SKT Ltd.	Rs. 12,00,000/-
Preference shares in HUT Ltd.	Rs. 5,00,000/-
Inter-corporate Deposits	Rs. 25,00,000/-
Total investments of ASK Ltd. within the meaning of Section 372A	Rs. 46,50,000/-
Limit upto which directors can make investments as calculated above	Rs. 88,50,000/-
Less existing investments	Rs. 46,50,000/-
further investments which directors can make without shareholders' special resolution	Rs. 42,00,000/-

Proposed additional investments within the meaning of section 372 is to be calculated as follows:

(a)	Loan to KMC Ltd.	--
	(Not to be counted since as per provisions of section 372 (8)(c) Loan to Wholly owned subsidiary company is outside the purview of this section)	
(b)	Loan to MTC Ltd.	Rs 15,00, 000/-
(c)	Purchase of further debentures in SKT Ltd.	Rs 8,00,000/-
(d)	Purchase of share from the open market in Glaxo Ltd.	Rs 15,00,000/-
		38,00,000/-

Since the proposed additional investment is within the amount permissible as calculated above, the directors, by passing a unanimous resolution in a Board Meeting, can make the proposed additional investment, Since the total investments do not exceed the limit as calculated above, the directors are not required to obtain the approval of shareholder, In absence of any term loan from any public financial institution, the question of their permission does not arise. Moreover, the fixed deposits from public are not yet due for repayment and hence there is no default on this account. In the light of above, it can be concluded that the directors can make the proposed investments.

(b) According to section 396 (1) of the Companies Act 1956 where the Central Government is satisfied that it is essential in public interest that two public limited companies should amalgamate the said Government may, by order notified in the Official Gazette, provide for the amalgamation of the said two companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order. This power of Central Government is notwithstanding anything contained in section 394 and 395 of the Act that deal with amalgamation and reconstruction of companies. The Central Government has also the power to pass and provide for any consequential, incidental and supplementary provisions in connection with the amalgamation including the continuation by or against the transferee company of any legal proceedings pending by or against the transferor company. Any member or creditor who is aggrieve by the order of the amalgamation resulting in any financial loss is entitled to compensation, which will be assessed by such authority as, may be prescribed. Any person aggrieved by the order of compensation can file an appeal to the Company Law Board (now tribunal) within 30 days of the publication of the order of compensation. Any order passed by the central government under this section can be made only where the draft copy thereof is sent to both the companies who have right to make an appeal and the same has been either disposed of or no appeal has been filed within the time provided thereof . The Central Government has duty to make such modifications In the light of any suggestions and objections received. All copies of the orders made under this section shall be laid before both the houses of parliament as soon as the same has been made.

SUMMARY OF EXAMINERS' COMMENTS ON THE PERFORMANCE OF CANDIDATES

PAPER – 1 : ADVANCED ACCOUNTING

General Comments

The performance of the candidates has not been satisfactory. The answers of the candidates showed lack of knowledge and understanding of the subject, particularly the accounting standards and guidance notes. The candidates are advised to brush up their skills regarding practical problems based on application of accounting standards. A thorough practice and lots of reading of the subject is required to maintain the level of knowledge expected from the students of Final Level.

Specific Comments

Question1. The performance of the candidates was not up to the mark. Most of the candidates erred in analysis of profits of the subsidiary companies between pre and post acquisition which resulted in wrong calculation of cost of control, minority shareholders' interest, consolidated profit and loss account and consequently, the consolidated balance sheet. Some of them were confused about the treatment for payment of dividend.

Question 2. Majority of the candidates computed the EPS, PE ratios and the number of preference shares to be issued to the equity shareholders for loss of dividend but could not arrive at the correct value of equity shares of B Ltd. Some of them could not compute purchase consideration and goodwill correctly. Few candidates failed to give the required journal entries relating to issue of debentures, liquidation expenses and statutory reserve.

Question 3. The candidates have performed badly in this question. The candidates erred in the calculating average capital employed and future maintainable profit and consequently, could not compute goodwill and intrinsic value of shares.

Question 4.(a) Most of the candidates answered this question on the basis of assumptions without applying Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options.

(b) The performance of the candidates was very poor and only a few candidates could correctly work out the amount of equity capital raised.

Question 5. By and large the performance of the candidates was satisfactory. However, some candidates could not apply the relevant provisions of the accounting standards in the required manner. Even if the conclusions were correct in most of the cases, reasoning was not accurate.

Question 6. In general, answers of the candidates to this theory question were not brief, concise and to the point. Most of the candidates could not write about interest rate swaps. Few candidates discussed the environmental issues rather than issues involved in environmental accounting. In part (d) of the question, they could not discuss impairment of assets without reference to its application to inventory. Some of the candidates did not appreciate part (f) of the question and wrote about the treatment of investments in preparing the consolidated balance sheet.

PAPER – 2 : MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS

General Comments

(i) The conceptual clarity of candidates is not adequate.

(ii) Candidates presentation in general was poor.

(iii) The candidates did not seem to follow the requirements of the question paper.

(iii) Many candidates failed to give working notes.

(iv) Candidates did not commence the answers to the questions on a fresh page.

(v) Some of the candidates did not mention the question Nos. Moreover, questions having different parts were answered at different places.

Specific Comments

Question 1.(a) Most of the candidates could not measure the sensitivity of the project properly in relation to various parameters given in the question.

(b) Most of candidates answered this question by writing general concepts of Financial Management rather than focusing on role of Financial Advisor in Public Sector Undertakings (PSUs).

Question 2.(a) Candidates failed to calculate various strategies for Foreign Exchange Risk Management.

(b) Most of the candidates calculated Beta properly but they failed to calculate Security Market Line (SML) and Alphas of the two stocks.

(c) Most of the candidates answered this question properly.

Question 3.(a) Performance of students was not found to be satisfactory in all parts of this question. Some of them gave partially correct answer and very few could give completely correct solution.

(b) Many candidates used borrowing rate instead of depositing rate and vice-a-versa. Some of the candidates solved some parts of this question properly, however, they could not conclude properly.

(c) Some of the candidates solved first part of the question properly. They could not however solve the second and third part of the question.

Question 4.(a) In this part, candidates could not prepare the projected balance sheet, projected cash flows and the present value of projected cash flows.

(b) This part was discussed properly.

(c) This part was also properly attempted by the candidates.

Question 5.(a) Most of the candidates solved this question based on lease finance properly. But following are the common mistakes committed by them:

Many candidates deducted salvage value while calculating depreciation, while the question

says that the machine will be fully depreciated.

Many candidates solved the question on the basis of equated annual installments while question clearly says that the principal amount of loan will be paid in 5 equal instalments to be paid annually.

Many candidates did not consider the capital gain on sale of the machine.

(b) Performance of candidates on this question was average.

Question 6.(a) Most of the candidates applied proper formulas for solving this question but they committed silly mistakes while doing the calculations.

(b) Most of the candidates attempted this question but hardly some could give proper answer for this question. They wrongly explained the Concept, Leveraged Buyouts (LBOs').

(c) This question was based on duration of bonds, hardly a few candidates could solve this question.

PAPER – 3 : ADVANCED AUDITING

General Comment

The overall performance of the candidates was not upto the mark expected at CA Final level. The answers of the candidates showed lack of knowledge of the subject. It was also observed that candidates have written unnecessary and irrelevant texts to enlarge the length of answers. Candidates should understand that every question has clear cut answers and there is no scope for imagination and needless extra flow of words.

Specific Comments

Question 1. (a) This part of the question was answered reasonably well by majority of the candidates. However, quite a good number of candidates failed to highlight the remaining requirements i.e. with reference to paid up capital & reserve exceeding Rs. fifty lakhs and turnover exceeding Rs. Five crores.

(b) This part of the question was answered reasonably well by majority of the candidates. However, most of the candidates failed to refer to the provisions of section 227 (1A) (e) of the Companies Act, 1956 and consequent inquiry by the auditor about the charging of said expenses to the revenue.

(c) This part of the question was answered satisfactorily by almost all the candidates.

(d) Candidates in general were unaware that the terms of issue of debentures were to be looked into to find out for what purpose the funds were raised and whether the end use was actually for different purpose.

Question 2. (a) Most of the candidates answered correctly.

(b) Fairly well done, though some have not understood that permission can be granted by the Council in this case.

(c) Most of the candidates answered this part of the question correctly. Few candidates had

wrongly stated that there is no professional misconduct in giving power of attorney to an employee chartered accountant to sign reports and financial statements.

(d) Most of the students were unaware about the fact that statutory auditors of PSUs/Govt. Companies/Listed Companies and Public Companies having a turnover of Rs. 50 crores or more in a year cannot accept any other work where that fee exceeds the statutory audit fees of the same organization/undertaking.

Question 3. (a) Candidates generally attempted this question on correct lines.

(b) This part of the question was answered quite satisfactorily by majority of the candidates.

Question 4. (a) Very few candidates attempted this question and those who did attempt, did not know the answer fully.

(b) Very few candidates attempted this question and those who did attempt, did not know what items were covered under Acceptances, Endorsements and other obligations. Therefore candidates could not say what procedure needed to be followed.

Question 5. (a) Most of the Candidates attempted this question on correct lines.

(b) Candidates attempted this question quite satisfactorily.

Question 6. (a) Many candidates have not understood the difference between assignment for compilation work and audit work and hence have lost marks for the entire question. Even those who did understand have not covered all the major points.

Question 7. (a) This part of the question was answered satisfactorily by majority of the candidates.

(b) Candidates did not know how to answer this question as their conception was not clear about what a Management Audit was all about and naturally therefore they did not know how to organise such an audit.

Question 8. (a) Fairly well attempted by majority of the candidates.

(b) Very few have answered this question correctly.

(c) Though many have described the methods of accounting, the comments on the details of change and the effect on the profit and loss account, have not been given clearly.

(d) Very few have answered correctly

(e) Fairly well attempted.

(f) Fairly well attempted.

PAPER – 4 : CORPORATE LAWS AND SECRETARIAL PRACTICE

General Comments

The performance in general was 'average'. The level of knowledge as expected at the final level was lacking. Instead of writing generalized answers, candidates need to improve their presentation of answers in accordance with the relevant provisions of law.

Specific Comments

Question 1. The overall performance to the all the sub-parts of the question was moderate. In respect of sub-part (c) of the question relating to powers of SEBI to amend rules of the stock exchange, candidates did not affirmatively wrote that SEBI has the power under section 29A of the SCRA, 1956 to amend the rules of its own if concerned stock exchange does not do so.

Question 2. Questions relating to the FEMA, 1999 and the Competition Act, 2002 was not answered well by many of the candidates. Candidates were not adequately prepared and did not have the grasp of the relevant provisions.

Question 3. Candidates did not pay much attention to the SEBI (DIP) Guidelines, 2000 and as a result the performance was not upto the mark.

Question 4. Candidates were not able to segregate the legal liability of directors before and after their appointment were declared invalid. The provisions of section 290 of the Companies Act, 1956 was not referred. Also the procedure to adopted for passing a Board Resolution in the form of circulation by resolution was not in proper order.

Question 5. The performance was unsatisfactory. Candidates did not have a clear idea of the operational scope of section 237 dealing with appointment of inspectors to investigate the affairs of a company. The drafting of application under the said section was also not proper. In respect of problem oriented question relating to removal of director under section 284 of the Companies Act, 1956, answers were satisfactory.

Question 6. Most of the candidates did not write the definition of Accounting Standards as per section 211(3C) of the Companies Act, 1956. The answers to other parts of the question relating to responsibilities of directors and statutory auditors for non-conformity of financial statements with some of the mandatory Accounting Standards of the ICAI were vague.

Question 7. The powers of the CLB in regard to section 402 of the Companies Act, 1956 in case of oppression was not explained correctly.

Question 8. The performance to the question on Audit Committee under section 292A of the Companies Act, 1956 was poor. Most of the candidates did not draft Board's Resolution to appoint an audit committee properly. The problem oriented question on section 209 was also not solved by many of the candidates.

Question 9. Very few candidates were able to solve the problem on Inter Corporate Loans and Investments under section 372A of the Companies Act, 1956. The powers of the Central Government to amalgamate two companies in public interest under section 396 was not referred in most of the answers.

PUBLICATIONS OF THE BOARD OF STUDIES

	English Rs.	Hindi Rs.	Postal Charges by Regd. Parcel English Rs.	Postal Charges by Regd. Parcel Hindi Rs.
I. STUDY MATERIALS				
COMMON PROFICIENCY TEST (CPT)				
Fundamentals of Accounting	200	140		
Mercantile Laws	50	40		
General Economics	100	70		
Quantitative Aptitude	250	150		
Self Assessment CD	40	40		
	640	440	145	145
PROFESSIONAL COMPETENCE COURSE (PCC)				
Group I				
Advanced Accounting Vol. I & Vol. II	500	500		
Auditing and Assurance Vol.I	175	175		
Auditing and Assurance Standards & Guidance Note (English) Vol.II	100			
Law, Ethics and Communication	275	275		
	1050	950	215	215
Group II				
Cost Accounting & Financial Management	300	300		
Taxation	200	200		
Information Technology	150	150		
Strategic Management	100	100		
	750	750	180	180
Both Groups	1800	1700	395	395
Professional Competence Course (Study Material) in CD in English.				
FINAL (NEW COURSE)				
Group I				
Financial Reporting	600			
Strategic Financial Management	260			
Advanced Auditing and Professional Ethics	520			
Corporate and Allied Laws	200			
	1580		320	

	English Rs.	Hindi Rs.	Postal Charges by Regd. Parcel English Rs.	Postal Charges by Regd. Parcel Hindi Rs.
Group II				
Advanced Management Accounting	240			
Information Systems Control and Audit	150			
Direct Tax Laws	340			
Indirect Tax Laws	290			
	1020		225	
Both Groups	2600		540	
PROFESSIONAL EDUCATION (COURSE – I)				
Fundamentals of Accounting	150	75		
Mathematics and Statistics	100	75		
Economics	100	100		
Business Communication	50	75		
Organisation and Management	100	75		
	500	400	135	120
PROFESSIONAL EDUCATION (COURSE – II)				
Group I				
Accounting Vol. I & Vol. II (English version – Rs.125 each Volume)	250	150		
Auditing Vol. I & Vol. II	150	125		
Business and Corporate Laws	100	125		
	500	400	165	105
Group II				
Cost Accounting & Financial Management (English version Cost A/c – Rs.100, F.M. – Rs.50)	150	150		
Income-Tax and Central Sales Tax	100	100		
Information Technology	150	150		
	400	400	120	135
Both Groups	900	800	235	200
FINAL COURSE				
Group I				
Advanced Accounting	150	225		
Management Accounting & Financial Analysis	200	275		
Advanced Auditing	300	350		
Corporate Laws and Secretarial Practice	200	250		
	850	1100	200	140

	English Rs.	Hindi Rs.	Postal Charges by Regd. Parcel English Rs.	Postal Charges by Regd. Parcel Hindi Rs.
Group II				
Cost Management	200	250		
Management Information & Control Systems	150	175		
Direct Taxes	150	250		
Indirect Taxes	150	225		
	650	900	165	140
Both Groups	1500	2000	300	300
Information Technology Training Course Material				
Information Technology Training Programme - Modules - I & II	500		90	
100 Hours Information Technology Training Course Material in Cds (7 Nos.) (Self Assessment and Summarised Study Material.)				

II. COMPILATIONS OF SUGGESTED ANSWERS

		English Rs.	Postal Charges English Rs.
Professional Education (Examination –I)			
1.	Fundamentals of Accounting (June 1993 to Nov. 2004)	40	40
2.	Mathematics and Statistics (June 1993 to Nov. 2004)	40	55
3.	Economics (June 1993 to May 2005)	40	40
4	A. : Business Communication (Nov. 2002 to Nov. 2004)	25	40
	B : Organisation & Management (Nov. 1994 to Nov. 2004)	25	40
	Complete Set	170	110
Professional Education (Examination –II)			
1.	Accounting (Nov. 1994 to Nov. 2006)	60	40
2.	Auditing (May, 2000 to November 2006)	40	40
3.	Business and Corporate Laws (May 2000 to November 2006)	60	40
4.	A.: Cost Accounting (May 1981 to November 2006)	60	55
	B : Financial Management (May 1996 to November 2006)	60	40
5.	Income Tax and Central Sales Tax (May, 1996 to November 2005)	40	40
6.	Information Technology (November 2002 to November 2006)	60	40
	Complete Set	380	110
Final			
1.	Advanced Accounting (May 1996 to November 2006)	70	40
2.	Management Accounting & Financial Analysis (May 1996 to November 2006)	70	40
3.	Advanced Auditing (May 2000 to November 2006)	60	40
4.	Corporate Laws and Secretarial Practice (May 2000 to November 2006)	60	40
5.	Cost Management (May 1996 to May 2006)	70	40
6.	Management Information and Control Systems (May 1996 to November 2006)	60	40
7.	Direct Taxes (May 2000 to November 2005)	60	40
	Complete Set	450	150

		English Rs.	Hindi Rs.	Postal Charges by Regd. Parcel English Rs.	Hindi Rs.
III	COMPILATION OF QUESTIONS SET IN PREVIOUS EXAMINATIONS				
	Professional Education (Course - I) (Nov. 2002 to Nov. 2005)	40		40	
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