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PAPER – 1 : ADVANCED ACCOUNTING

QUESTIONS

1. Laxman Ltd. is absorbed by Ram Ltd. The consideration is as follows:
 - (i) taking over of liabilities.
 - (ii) the payment of cost of amalgamation not exceeding Rs. 8,000;
 - (iii) a payment of Rs. 15 per share in cash and allotment of one 14% preference share of Rs. 100 each and 5 equity shares of Rs. 100 each fully paid for every 4 shares in Laxman Ltd.

The market value of the equity shares of Ram Ltd. is Rs. 140 but it is desired that entries should be made on the basis of par value only. The actual cost of amalgamation came to Rs. 10,000.

The following is the balance sheet of Laxman Ltd. on the date of amalgamation:

Liabilities	Rs.	Assets	Rs.
Share Capital:		Land and Buildings	16,00,000
20,000 shares of Rs. 100 each, fully paid up	20,00,000	Plant and Machinery	14,00,000
General Reserve	13,00,000	Patent Rights	3,50,000
Sinking Fund 12% Loan	1,00,000	Investment against Sinking Fund	1,00,000
	4,00,000	Staff Provident Fund	1,50,000
Sundry Creditors	1,40,000	Investments	
Employees Profit Sharing Reserve	1,00,000	Stock	2,00,000
Staff Provident Fund	1,50,000	Debtors	4,00,000
		Less: Provision for bad debts	<u>40,000</u>
		Cash at Bank	<u>30,000</u>
	<u>41,90,000</u>		<u>41,90,000</u>

Stock of Laxman Ltd. include goods valued at Rs. 56,000 purchased from Ram Ltd. which was invoiced at cost plus $16\frac{2}{3}\%$. The creditors include Rs. 80,000 due by Laxman Ltd. to Ram Ltd.

Journalise the closing entries of Laxman Ltd. and the opening entries of Ram Ltd. Does it make any difference if the shares in Ram Ltd. are valued at Rs. 140 but entries are made at par?

2. Following are the draft Balance Sheets of two companies A Ltd. and B Ltd. as at 31.03.2006:

	(Rs. in lakhs)			
	A Ltd.	B Ltd.	A Ltd.	B Ltd.
Liabilities			Assets	
Share Capital			Fixed Assets	5.00
(Rs. 100 each)	6.00	3.00	Investment:	
Profits:			2,400 Shares in B Ltd.	3.00
Capital Profit	0.80	0.85	1,200 Shares in A Ltd.	—
Revenue Profit	3.20	0.29	Current Assets:	
Creditors	1.50	0.81	Debtors	2.00
			Stock	0.40
			Cash and Bank	<u>1.10</u>
	<u>11.50</u>	<u>4.95</u>		<u>1.50</u>
				<u>4.95</u>

The following adjustments were not yet made:

1. Stock worth Rs. 5,000 in B Ltd. was found to be obsolete with no value.

2. A Ltd. acquires an asset costing Rs. 50,000 on 31.3.2006. No effect has been given for both the purchase and payment.
3. During the year A Ltd. sold an asset for Rs. 60,000 (original cost Rs. 40,000). The profit was included in the revenue profit.
4. Debtors of A Ltd. included a sum of Rs. 50,000 owed by B Ltd.

You are required to prepare the consolidated Balance Sheet of both the companies as on 31.3.2006 after giving effect to the above adjustments.

3. The Balance Sheet of Y Limited as on 31st March, 2007 was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
5,00,000 Equity Shares of Rs. 10 each fully paid	50,00,000	Goodwill	10,00,000
9% 20,000 Preference shares of Rs. 100 each fully paid	20,00,000	Patent	5,00,000
10% First debentures	6,00,000	Land and Building	30,00,000
10% Second debentures	10,00,000	Plant and Machinery	10,00,000
Debentures interest outstanding	1,60,000	Furniture and Fixtures	2,00,000
Trade creditors	5,00,000	Computers	3,00,000
Directors' loan	1,00,000	Trade Investment	5,00,000
Bank O/D	1,00,000	Debtors	5,00,000
Outstanding liabilities	40,000	Stock	10,00,000
Provision for Tax	1,00,000	Discount on issue of debentures	1,00,000
	<u>96,00,000</u>	Profit and Loss Account (Loss)	<u>15,00,000</u>
			<u>96,00,000</u>

Note: Preference dividend is in arrears for last three years.

A holds 10% first debentures for Rs. 4,00,000 and 10% second debentures for Rs. 6,00,000. He is also creditors for Rs. 1,00,000. B holds 10% first debentures for Rs. 2,00,000 and 10% second debentures for Rs. 4,00,000 and is also creditors for Rs. 50,000.

The following scheme of reconstruction has been agreed upon and duly approved by the court.

- (i) All the equity shares be converted into fully paid equity shares of Rs. 5 each.
- (ii) The preference shares be reduced to Rs. 50 each and the preference shareholders agree to forego their arrears of preference dividends in consideration of which 9% preference shares are to be converted into 10% preference shares.
- (iii) Mr. 'A' is to cancel Rs. 6,00,000 of his total debt including interest on debentures and to pay Rs. 1 lakh to the company and to receive new 12% debentures for the Balance amount.
- (iv) Mr. 'B' is to cancel Rs. 3,00,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance amount.
- (v) Trade creditors (other than A and B) agreed to forego 50% of their claim.
- (vi) Directors to accept settlement of their loans as to 60% thereof by allotment of equity shares and balance being waived.
- (vii) There were capital commitments totalling Rs. 3,00,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.
- (viii) The Directors refund Rs. 1,10,000 of the fees previously received by them.
- (ix) Reconstruction expenses paid Rs. 10,000.

- (x) The taxation liability of the company is settled at Rs. 80,000 and the same is paid immediately.
- (xi) The assets are revalued as under:

	Rs.
Land and Building	28,00,000
Plant and Machinery	4,00,000
Stock	7,00,000
Debtors	3,00,000
Computers	1,80,000
Furniture and Fixtures	1,00,000
Trade Investment	4,00,000

Pass Journal entries for all the above mentioned transactions including amounts to be written off of Goodwill, Patents, Loss in Profit & Loss Account and Discount on issue of debentures. Prepare Bank Account and working of allocation of Interest on Debentures between A and B.

4. The directors of a public limited company are considering the acquisition of the entire share capital of an existing company X Ltd engaged in a line of business suited to them. The directors feel that acquisition of X will not create any further risk to their business interest.

The following is the Balance Sheet of X Ltd., as at 31st December, 2005:

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed assets	6,00,000
4,000 equity shares of Rs.100 each fully paid-up	4,00,000	Current assets:	
General reserve	3,00,000	Stock	2,00,000
Bank overdraft	2,40,000	Sundry debtors	3,40,000
Sundry creditors	<u>3,00,000</u>	Cash and bank balances	1,00,000
	<u>12,40,000</u>		<u>12,40,000</u>

X's financial records for the past five years were as under:

	2005	2004	2003	2002	2001
	Rs.	Rs.	Rs.	Rs.	Rs.
Profits	80,000	74,000	70,000	60,000	62,000
Extra ordinary item(s)	<u>3,500</u>	<u>4,000</u>	<u>(6,000)</u>	<u>(8,000)</u>	<u>1,000</u>
	83,500	78,000	64,000	52,000	61,000
Dividends	<u>48,000</u>	<u>40,000</u>	<u>40,000</u>	<u>32,000</u>	<u>32,000</u>
	<u>35,500</u>	<u>38,000</u>	<u>24,000</u>	<u>20,000</u>	<u>29,000</u>

Additional information:

- (i) There were no changes in the issued capital of X during this period.
- (ii) The estimated values of X Ltd.'s assets on 31.12.2005 are:

	Replacement cost	Realisable value
	Rs.	Rs.
Fixed assets	8,00,000	5,40,000
Stock	3,00,000	3,20,000

- (iii) It is anticipated that 1% of the debtors may prove to be difficult to be realized.
- (iv) The cost of capital to the acquiring company is 10%.

- (v) The current return of an investment of the acquiring company is 10%. Quoted companies with similar businesses and activities as X have a P/E ratio approximating to 8, although these companies tend to be larger than X.

Required:

Estimate the value of the total equity capital of X Ltd., on 31.12.2005 using each of the following bases:

- Balance sheet value
- Replacement cost
- Realisable value
- P/E ratio model.

5. 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		
	<u>32,00,000</u>		<u>32,00,000</u>

Additional Information:

- 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).
- 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.
- 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.
- 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 goodwill on the basis of 3 years purchase of super profit. Depreciation is charged on machinery @ 10% on reducing system.

6. On the basis of the following Profit and Loss Account of Zed Limited and the supplementary information provided thereafter, prepare Gross Value Added Statement of the company for the year ended 31st March, 2007. Also prepare another statement showing reconciliation of Gross Value Added with Profit before Taxation.

Profit and Loss Account of Zed Limited for the year ended 31st March, 2007.

	Amount (Rs. in lakhs)	Amount (Rs. in lakhs)
Income		
Sales		5,010
Other Income		<u>130</u>
		<u>5,140</u>
Expenditure		
Production and Operational Expenses	3,550	
Administrative Expenses	185	
Interest	235	
Depreciation	<u>370</u>	<u>4,340</u>
Profit before Taxation		800
Provision for Taxation		<u>280</u>
Profit after Taxation		520
Credit Balance as per last Balance Sheet		<u>40</u>
		<u>560</u>
Appropriations		
Transfer to General Reserve		100
Preference Dividend (Interim) paid		50
Proposed Preference Dividend (Final)		50
Proposed Equity Dividend		300
Balance carried to Balance Sheet		<u>60</u>
		<u>560</u>
Supplementary Information		
Production and Operational Expenses consist of:		
Raw Materials and Stores consumed		1,900
Wages, Salaries and Bonus		610

Local Taxes including Cess	220
Other Manufacturing Expenses	<u>820</u>
	<u>3,550</u>

Administrative Expenses consist of:

Salaries and Commission to Directors	60
Audit Fee	24
Provision for Bad and Doubtful Debts	20
Other Administrative Expenses	<u>81</u>
	<u>185</u>

Interest is on:

Loan from Bank for Working Capital	35
Debentures	<u>200</u>
	<u>235</u>

- 7 The following information is available of a concern; calculate E.V.A.:

Debt capital 12%	Rs. 2,000 crores
Equity capital	Rs. 500 crores
Reserve and surplus	Rs. 7,500 crores
Capital employed	Rs. 10,000 crores
Risk-free rate	9%
Beta factor	1.05
Market rate of return	19%
Equity (market) risk premium	10%
Operating profit after tax	Rs.2,100 crores
Tax rate	30%

8. The Institute for Global Management Research maintains a combined Development Fund in respect of which the following information is available for the year ended 31st March, 2005:

	Rs.
Govt. Grants received for acquisition of land	60,00,000
Private Grants received for construction of buildings	30,00,000
Foreign Private Grant for purchase of computing equipment USD	5,00,000
Transfer from unrestricted fund for purchase of furniture	10,00,000
Cost of Assets so far acquired:	
Land	59,00,000
Buildings in progress (payments to Contractors)	15,00,000
Furniture	3,00,000

The USD grant has been received into a bank account in USA on 29.3.2005 and is expected to be utilized therefrom for purchases to be made abroad. The rate of exchange on 31.3.2005 is 1 USD = Rs. 44.

You are required to prepare

- A Statement showing changes in the Development Fund for the year; and
 - Balance Sheet of the Development Fund as at 31.3.2005.
9. (a) After the HAVOC caused by earthquake, a group of companies undertakes during the period from January, 2006 to March, 2006 various commercial activities, having granted considerable subsidy, along the affected area. The management intends to highlight the

results of such activities while publishing financial statements for the year 2005-2006. What is the scope?

- (b) Explain the circumstances under which SEBI can order an investigation of affairs of a stock broker.
10. On 24th January, 2006 A of Chennai sold goods to B of Washington, U.S.A. for an invoice price of \$40,000 when the spot market rate was Rs.44.20 per US \$. Payment was to be received after three months on 24th April, 2006. To mitigate the risk of loss from decline in the exchange-rate on the date of receipt of payment, A immediately acquired a forward contract to sell on 24th April, 2006 US \$ 40,000 @ Rs.43.70. A closed his books of account on 31st March, 2006 when the spot rate was Rs.43.20 per US \$. On 24th April, 2006, the date of receipt of money by A, the spot rate was Rs.42.70 per US \$.

Pass journal entries in the books of A to record the effect of all the above mentioned effects.

11. While closing its books of account on 31st March, 2006 a Non-Banking Finance Company has its advances classified as follows:

	Rs.in lakhs
Standard assets	16,800
Sub-standard assets	1,340
Secured positions of doubtful debts:	
– upto one year	320
– one year to three years	90
– more than three years	30
Unsecured portions of doubtful debts	97
Loss assets	48

Calculate the amount of provision, which must be made against the Advances.

12. Explain the concept of “opportunity cost” in the context of human resource accounting.
13. Define non-performing assets as per NBFC Prudential Norms (RBI).
14. Write short note on Books of account required to be maintained by a Stock Broker.
15. Explain the accounting issues involved in Environmental Accounting in brief.
16. Give an account of the growing scope of human capital reporting.
17. Explain the procedure for recognition of difference between forward rate and exchange rate on the date of transaction in case of a forward contract.
18. Differentiate restricted funds with unrestricted funds in case of a not-for-profit organization.
19. Distinguish between Indian Accounting Standards and International Accounting Standards on the issue of recognition of revenue.

Questions based on Accounting Standards and Guidance Notes

20. (a) Discuss with reference to the Accounting Standards, the nature of classification and disclosure requirements in the statement of profit and loss of an entity in the following cases
- Losses sustained as a result of enemy action.
 - Disposal of long-term investments of a trading entity.
21. How refund of revenue grant received from the Government is disclosed in the Financial Statements?
22. (a) What are the principles for recognition of deferred taxes under AS 22?
- (b) Describe the disclosure requirements for 'deferred tax assets' and 'deferred tax liabilities' as per AS 22.
23. Explain the concept of related party transactions under AS 18.

24. Distinguish between
- Integral foreign operation and Non-integral foreign operation.
 - Operating lease and Non-operating lease.
25. Explain the treatment of intra-segment transactions while preparing segment reports.
26. X Co. Limited purchased goods at the cost of Rs.40 lakhs in October, 2005. Till March, 2006, 75% of the stocks were sold. The company wants to disclose closing stock at Rs.10 lakhs. The expected sale value is Rs.11 lakhs and a commission at 10% on sale is payable to the agent. Advise, what is the correct closing stock to be disclosed as at 31.3.2006.
27. AB Ltd. launched a project for producing product X in October, 2004. The Company incurred Rs.20 lakhs towards Research and Development expenses upto 31st March, 2006. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years.
- Advise the Company as per the applicable Accounting Standard.
28. ABC Ltd. could not recover Rs. 10 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalized for the year ended 31.3.2005 by making a provision @ 20% of the amount due from the said debtor.
- The debtor became bankrupt in April, 2005 and nothing is recoverable from him.
- Do you advise the company to provide for the entire loss of Rs. 10 lakhs in the books of account for the year ended 31st March, 2005?
29. In April, 2004 a Limited Company issued 1,20,000 equity shares of Rs. 100 each. Rs. 50 per share was called up on that date which was paid by all shareholders. The remaining Rs. 50 was called up on 1.9.2004. All shareholders paid the sum in September, 2004, except one shareholder having 24,000 shares. The net profit for the year ended 31.3.2005 is Rs. 2,64,000 after dividend on preference shares and dividend distribution tax of Rs. 64,000. Calculate basic earnings per share.
30. On 1.4.2001 ABC Ltd. received Government grant of Rs. 300 lakhs for acquisition of a machinery costing Rs. 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 2004 due to non-fulfillment of certain conditions.
- How you would deal with the refund of grant in the books of ABC Ltd.?
31. A private limited company manufacturing fancy terry towels had valued its closing stock of inventories of finished goods at the realizable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goods had not been transferred to the foreign buyers.
- Comment on the valuation of the stocks by the company.
32. A Company has its share capital divided into shares of Rs. 10 each. On 1st April, 2004 it granted 10,000 employees' stock options at Rs. 40, when the market price was Rs. 130. The options were to be exercised between 16th December, 2004 and 15th March, 2005. The employees exercised their options for 9,500 shares only; the remaining options lapsed. The company closes its books on 31st March every year.
- Show Journal Entries.
33. ABC Ltd. gave 50,000 equity shares of Rs.10 each (fully paid up) in consideration for supply of certain machinery by X & Co. The shares exchanged for machinery are quoted on Bombay Stock Exchange (BSE) at Rs.15 per share, at the time of transaction. In the absence of fair market value of the machinery acquired, how the value of machinery would be recorded in the books of the company?

34. A company took a construction contract for Rs.100 lakhs in January, 2006. It was found that 80% of the contract was completed at a cost of Rs.92 lakhs on the closing date i.e. on 31.3.2007. The company estimates further expenditure of Rs.23 lakhs for completing the contract. The expected loss would be Rs.15 lakhs. Can the company recognize the loss in the financial statements prepared for the year ended 31.3.2007?
35. 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 X correct in his proposal? Discuss.

36. 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.

37. 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.
38. A fixed asset was revalued upwards in the year 2005. It was originally acquired in year 2001 at a cost of Rs.60 lakhs and estimated residual value was Rs.6 lakhs with a useful life of 9 years. The asset was revalued upwards to Rs.45 lakhs at the end of year 2005. At the end of the year 2007, the indications of impairment were observed. The recoverable amount is estimated at Rs.14 lakhs. What should be the accounting treatment for the year 2007, if-
- (a) The company has transferred an amount equal to the incremental depreciation due to upward revaluation to the Profit & Loss account from revaluation reserve.
 - (b) The company has not made any such transfer as mentioned in (a) above.

Company follows the method of straight line depreciation. Tax rate applicable to company is 30%.

39. During 2006-07, Enterprise A gives a guarantee of certain borrowings of Enterprise B, whose financial condition at that time is sound. During 2007-08, the financial condition of Enterprise B deteriorates and at 30 September, 2007 Enterprise B goes into liquidation. How it will be dealt with by 'A'?
40. A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.

SUGGESTED ANSWERS/HINTS

1. Calculation of consideration:

Form	Amount
	Rs.
(i) Cash = 20,000 shares × Rs. 15	3,00,000
(ii) 14% Preference shares = $\frac{20,000 \text{ shares}}{4} \times \text{Rs. } 100$	5,00,000
(iii) Equity shares = $\frac{20,000 \text{ shares}}{4} \times 5 \times \text{Rs. } 100$	<u>25,00,000</u>
	<u>33,00,000</u>

In the books of Laxman Ltd.
Realisation Account

Dr.	Rs.	Cr.	Rs.
To Land and Buildings	16,00,000	By Provisions for Bad Debts	40,000
To Plant and Machinery	14,00,000	By Sinking Fund	1,00,000
To Patents Rights	3,50,000	By 12% Loan	4,00,000
To Investment against Sinking Fund	1,00,000	By Sundry Creditors	1,40,000
To Staff Provident Fund Investment	1,50,000	By Employees' Profit sharing Reserve	1,00,000
To Stock	2,00,000	By Staff Provident Fund	1,50,000
To Debtors	4,00,000	By Ram Ltd. (consideration)	33,00,000
To Cash at Bank	30,000	By Ram Ltd. (expenses)	8,000
To Bank (expenses)	<u>10,000</u>	By Equity Shareholders Account (loss)	2,000
	<u>42,40,000</u>		<u>42,40,000</u>

Ram Ltd.

Dr.	Rs.	Cr.	Rs.
To Realisation Account (consideration)	33,00,000	By Bank	3,00,000
To Realisation Account (for expenses)	<u>8,000</u>	By 14% Preference Shares in Ram Ltd.	5,00,000
	<u>33,08,000</u>	By Equity Shares in Ram Ltd.	25,00,000
		By Bank (for expenses)	<u>8,000</u>
			<u>33,08,000</u>

Cash Book (Bank Columns)

Dr.	Rs.	Cr.	Rs.
To Balance b/d	30,000	By Realisation Account (transfer)	30,000
To Ram Ltd.	3,00,000	By Realisation Account (expenses)	10,000
To Ram Ltd. (for expenses)	8,000	By Equity Shareholders Account	

	(distribution)	<u>2,98,000</u>
<u>3,38,000</u>		<u>3,38,000</u>

Equity Shareholders Account

Dr.		Rs.			Cr.
					Rs.
To	Realisation (loss)	2,000	By	Equity Share Capital Account	20,00,000
To	Equity Shares in Ram Ltd.	25,00,000	By	General Reserve	13,00,000
To	14% Preference Shares in Ram Ltd.	5,00,000			
To	Bank	<u>2,98,000</u>			
		<u>33,00,000</u>			<u>33,00,000</u>

Books of Ram Ltd.
Journal

		Dr.	Cr.
		Rs.	Rs.
Business Purchase Account	Dr.	33,00,000	
To Liquidator of Laxman Ltd.			33,00,000
(Being the purchase price agreed to be paid for the business of Laxman Ltd.)			
Land and Buildings	Dr.	16,00,000	
Plant and Machinery	Dr.	14,00,000	
Patent Rights	Dr.	3,50,000	
Stock	Dr.	2,00,000	
Sundry Debtors	Dr.	4,00,000	
Investments against Sinking Fund	Dr.	1,00,000	
Investments against Staff Provident Fund	Dr.	1,50,000	
Cash at Bank	Dr.	30,000	
To Provision for Doubtful Debts			40,000
To Sinking Fund Account			1,00,000
To 12% Loan			4,00,000
To Sundry Creditors			1,40,000
To Employees Profit Sharing Reserve			1,00,000
To Staff Provident Fund			1,50,000
To Business Purchase Account			33,00,000
(Being assets and liabilities taken over by Ram Ltd. for purchase consideration)			
Liquidator of Laxman Ltd.	Dr.	33,00,000	
To 14% Preference Share Capital Account			5,00,000
To Equity Share Capital Account			25,00,000
To Bank			3,00,000
(Being an allotment of 14% preference shares and equity shares and payment of cash in satisfaction of the consideration for business)			

Capital Reserve	Dr.	8,000	
To Bank			8,000
(Being reimbursement of expenses of Laxman Ltd. to the extent of Rs. 8,000)			
Profit and Loss Account	Dr.	8,000	
To Stock			8,000
(Being elimination of unrealized profit from the stock sold to Laxman Ltd.)			
Sundry Creditors Account	Dr.	80,000	
To Sundry Debtors Account			80,000
(Being elimination of Rs. 80,000 included in creditors of Laxman Ltd. and in debtors of Ram Ltd. being the sum owed by the former to the latter)			

Note: Whereas the market price of the equity shares in Ram Ltd. is Rs. 140, making entries at par does not really make a difference. Had the entries been made at Rs. 140, the amount of goodwill would have been increased but, then, Rs. 40 per share would have been credited to Securities Premium Account. Shareholders of Laxman Ltd. have also not suffered at all because, although in the books the equity shares in Ram Ltd. have been recorded at Rs. 100, they have in fact received shares worth Rs. 140.

This shows that if a transferee company does not want to show both goodwill and premium on shares resulting from the acquisition of another company, it should record the issue of its shares at par. One should remember that once an amount is credited to Securities Premium Account, it cannot be used to write off assets like Goodwill.

2. Consolidated Balance Sheet of A Ltd. and its subsidiary B Ltd.
as at 31st March, 2006

		(Rs. in thousands)	
Liabilities	Amount	Assets	Amount
Share Capital		Fixed Assets	
(less: 1,200 shares held by B Ltd.)	480	A Ltd.	550
Minority Interest	105	B Ltd.	<u>150</u>
Capital profit	60		700
Revenue Profit	304	Cost of Control	40
Creditors		Current Assets:	
A Ltd.	150	Stock	
B Ltd.	<u>81</u>	A Ltd.	40
	231	B Ltd.	<u>25</u>
Less: Mutual indebtedness	<u>50</u>		65
	181	Debtors	
		A Ltd.	200
		B Ltd.	<u>80</u>
			280
		Less: Mutual indebtedness	<u>50</u>
			230
		Cash and Bank	

A Ltd.	110	
Less: Payment for asset	<u>50</u>	
	60	
B Ltd.	<u>35</u>	
		<u>95</u>
	<u>1,130</u>	<u>1,130</u>

Working Notes:

(1) Adjustment of Revenue and Capital Profits:

	(Rs. in lakhs)	
	A Ltd.	B Ltd.
Revenue profits	3.20	0.29
Less: Stock written off	—	0.05
Less: Transfer to capital profit	0.20	—
(Profit on sale of asset)	<u>3.00</u>	<u>0.24</u>
Capital profits	0.80	0.85
Add: Transfer from revenue profit	<u>0.20</u>	<u>—</u>
	<u>1.00</u>	<u>0.85</u>

(2) Calculation of Minority Interest in Revenue Profits

$$\begin{aligned}
 \text{Let } A &= \text{Revenue profits of A Ltd., and} \\
 B &= \text{Revenue profit of B Ltd.} \\
 A &= 3,00,000 + (4/5) \times B \\
 B &= 24,000 + (1/5) \times A \\
 B &= 24,000 + (1/5) \times [3,00,000 + (4/5) \times B] \\
 B &= 24,000 + 60,000 + (4/25) \times B \\
 B &= 84,000 + (4/25) \times B \\
 (21/25) \times B &= 84,000 \\
 B &= \text{Rs. } 1,00,000
 \end{aligned}$$

Minority interest in revenue profits is 1/5 of Rs. 1,00,000 or Rs. 20,000. Total revenue profits being Rs. 3,24,000 for A Ltd. and B Ltd. together, Rs. 3,04,000 remains for the group.

(3) Calculation of Minority Interest in Capital Profits

$$\begin{aligned}
 \text{Let } A &= \text{Capital profits of A Ltd., and} \\
 B &= \text{Capital profits of B Ltd.} \\
 A &= 1,00,000 + (4/5) B \\
 B &= 85,000 + (1/5) \times A \\
 B &= 85,000 + (1/5) \times [1,00,000 + (4/5) \times B] \\
 B &= 85,000 + 20,000 + (4/25) \times B \\
 B &= 1,05,000 + (4/25) \times B \\
 (21/25) \times B &= 1,05,000 \\
 B &= \text{Rs. } 1,25,000
 \end{aligned}$$

Minority interest (1/5) would be Rs. 25,000. Shares of A Ltd. will be Rs. 1,00,000. Capital profits of A Ltd. = 1,85,000 – 1,25,000 = Rs. 60,000.

(4) Total Minority Interest

	Rs.
Shares held by outsiders	60,000
Revenue profit	20,000
Capital profit	<u>25,000</u>
Minority Interest	<u>1,05,000</u>

(5) Cost of control

	Rs.
Amount paid by both companies	5,00,000
Less: Face value of shares in B Ltd.	2,40,000
Face value of shares in A Ltd.	1,20,000
Capital profits	<u>1,00,000</u>
	<u>4,60,000</u>
Cost of control	<u>40,000</u>

Note: In adjustment no. 3 given in the question, the period (whether pre-acquisition or post-acquisition) in which the sale of asset took place, is not specified. The answer has been given on the basis of assumption that the asset was sold in the pre-acquisition period and accordingly the profit on sale has been treated as capital profit.

3. Journal Entries in the Books of Y Ltd.

	Dr.	Cr.
	Rs.	Rs.
(i) Equity Share Capital (Rs. 10 each) A/c	Dr. 50,00,000	
To Equity Share Capital (Rs. 5 each) A/c		25,00,000
To Reconstruction A/c		25,00,000
(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of Rs. 5 each as per scheme of reconstruction.)		
(ii) 9% Preference Share Capital (Rs.100 each) A/c	Dr. 20,00,000	
To 10% Preference Share Capital (Rs.50 each) A/c		10,00,000
To Reconstruction A/c		10,00,000
(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of Rs. 50 each and claims of preference dividends settled as per scheme of reconstruction.)		
(iii) 10% First Debentures A/c	Dr. 4,00,000	
10% Second Debentures A/c	Dr. 6,00,000	
Trade Creditors A/c	Dr. 1,00,000	
Interest on Debentures Outstanding A/c	Dr. 1,00,000	
Bank A/c	Dr. 1,00,000	
To 12% New Debentures A/c		7,00,000

	To Reconstruction A/c		6,00,000	
	(Being Rs. 6,00,000 due to A (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)			
(iv)	10% First Debentures A/c	Dr.	2,00,000	
	10% Second Debentures A/c	Dr.	4,00,000	
	Trade Creditors A/c	Dr.	50,000	
	Interest on Debentures Outstanding A/c	Dr.	60,000	
	To 12% New Debentures A/c			4,10,000
	To Reconstruction A/c			3,00,000
	(Being Rs. 3,00,000 due to B (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)			
(v)	Trade Creditors A/c	Dr.	1,75,000	
	To Reconstruction A/c			1,75,000
	(Being remaining creditors sacrificed 50% of their claim.)			
(vi)	Directors' Loan A/c	Dr.	1,00,000	
	To Equity Share Capital (Rs. 5) A/c			60,000
	To Reconstruction A/c			40,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of Rs. 5 each as per scheme of reconstruction.)			
(vii)	Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment made for cancellation of capital commitments.)			
(viii)	Bank A/c	Dr.	1,10,000	
	To Reconstruction A/c			1,10,000
	(Being refund of fees by directors credited to reconstruction A/c.)			
(ix)	Reconstruction A/c	Dr.	10,000	
	To Bank A/c			10,000
	(Being payment of reconstruction expenses.)			
(x)	Provision for Tax A/c	Dr.	1,00,000	
	To Bank A/c			80,000
	To Reconstruction A/c			20,000
	(Being payment of tax for 80% of liability in full settlement.)			
(xi)	Reconstruction A/c	Dr.	47,20,000	
	To Goodwill A/c			10,00,000
	To Patent A/c			5,00,000
	To Profit and Loss A/c			15,00,000
	To Discount on issue of Debentures A/c			1,00,000

To Land and Building A/c	2,00,000
To Plant and Machinery A/c	6,00,000
To Furniture & Fixture A/c	1,00,000
To Computers A/c	1,20,000
To Trade Investment A/c	1,00,000
To Stock A/c	3,00,000
To Debtors A/c	2,00,000

(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction.)

Working Notes:

- (1) Outstanding interest on debentures have been allocated between A and B as follows:

A's Share		Rs.
10% First Debentures	4,00,000	
10% Second Debentures	<u>6,00,000</u>	<u>10,00,000</u>
10% on Rs. 10,00,000 i.e. (A)	<u>1,00,000</u>	
B's Share		
10% First Debentures	2,00,000	
10% Second Debentures	<u>4,00,000</u>	<u>6,00,000</u>
10% on Rs. 6,00,000 i.e. (B)	<u>60,000</u>	
Total (A) + (B)	<u>1,60,000</u>	

- (2) Bank Account

	Rs.		Rs.
To A (reconstruction)	1,00,000	By Balance b/d	1,00,000
To Reconstruction A/c		By Reconstruction A/c	15,000
(paid by directors)	1,10,000	(capital commitment penalty paid)	
		By Reconstruction A/c	
		(reconstruction expenses paid)	10,000
		By Provision for tax A/c (tax paid)	80,000
		By Balance c/d	<u>5,000</u>
	<u>2,10,000</u>		<u>2,10,000</u>

4.

	Rs.	Rs.
(a) Balance Sheet Value		
Capital	4,00,000	
Reserve	<u>3,00,000</u>	7,00,000
(b) Replacement cost value		
Capital	4,00,000	
Reserve	3,00,000	
Appreciation:		
Fixed assets	2,00,000	
Stock	<u>1,00,000</u>	<u>3,00,000</u>
		10,00,000

(c) Realizable value		
Capital	4,00,000	
Reserve	3,00,000	
Appreciation in stock	1,20,000	
Depreciation in fixed assets	(60,000)	
Book debts (Bad)*	<u>(3,400)</u>	7,56,600

(d) P/E ratio model

Comparable quoted companies have a P/E ratio of 8. X Ltd. is prima facie small company.

If a P/E ratio of 6 is adopted, the valuation will be $80,000 \times 6 = \text{Rs.} 4,80,000$

If a P/E ratio of 7 were to be adopted, the valuation will be $80,000 \times 7 = \text{Rs.} 5,60,000$

5. Calculation of Goodwill:

(i) Calculation of Average Capital Employed (Net Tangible Assets) as on 31st December, 2006.

	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
Vehicles	<u>2,00,000</u>
	21,32,450
Add: Appreciation @ 5%	<u>1,06,623</u>
	22,39,073
Trade Investment $(3,00,000 \times \frac{20}{100} - 12,000)$	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	<u>2,00,000</u>
	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	<u>2,00,000</u>
	<u>8,70,000</u>

* It has been assumed that estimated bad debts would not be relevant for estimating values under bases (a) and (b).

Capital employed at the end of the year 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	<u>1,52,380</u>	<u>2,28,570</u>

Average capital employed 18,73,503

(ii) Future Maintainable Profits:

Statement of Average Profit

Particulars	2004	2005	2006
	Rs.	Rs.	Rs.
Profit after Tax	<u>2,10,000</u>	<u>1,90,000</u>	<u>2,00,000</u>
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			<u>(5,000)</u>
	<u>4,53,000</u>	<u>3,41,500</u>	<u>3,80,950</u>
Total profit for the three years			<u>11,75,450</u>
Average Profit $\frac{11,75,450}{3} =$			3,91,817
Less: Depreciation @ 10% on increase in the value of machinery			
8,36,450 x 0.05 x 0.1		4,182	
Expected increase in expenditure		20,000	
Annual R & D Expenses		<u>30,000</u>	<u>54,182</u>
Future Maintainable profit before tax			3,37,635
Less: Tax @ 40% of Rs.3,37,635			<u>1,35,054</u>
Future Maintainable Profit After Tax			<u>2,02,581</u>
Computation of Goodwill:		Rs.	
Future Maintainable Profit (After Tax)		2,02,581	
Less: Normal Profit (10% of Rs.18,73,503)		<u>1,87,350</u>	
Super Profit		<u>15,231</u>	
Value of Goodwill = Super Profit x No. of years' purchase			
= 15,231 x 3		<u>45,693</u>	

6. Gross Value Added Statement of Zed Ltd.
for the year ended 31st March, 2007

	Rs. in lakhs	Rs. in lakhs
Sales		5,010
Less: Cost of raw materials, stores and other services consumed	2,720	
Administrative expenses	125	
Interest on loan from bank for working capital	<u>35</u>	<u>2,880</u>
Value added by manufacturing and trading activities		2,130
Add: Other income		<u>130</u>
Total value added		<u>2,260</u>

Application of Value Added

	Rs.in lakhs	Rs. in lakhs	%
To pay employees Wages, salaries and bonus		610	26.99
To pay directors Salaries and commission to Directors		60	2.66
To pay Government Local taxes including cess Income tax	220 <u>280</u>	500	22.12
To pay providers of capital Interest on debentures Preference dividend Equity dividend	200 100 <u>300</u>	600	26.55
To provide for the maintenance and expansion of the company: Depreciation Transfer to general reserve Retained profit Rs.(60 – 40) lakhs	370 100 <u>20</u>	<u>490</u>	<u>21.68</u>
		<u>2,260</u>	<u>100</u>

Statement showing Reconciliation between
Gross Value Added with Profit before Taxation

	Rs. in lakhs	Rs. in lakhs
Profit before taxation		800
Add back:		
Wages, salaries and bonus	610	
Salaries and commission to Directors	60	
Local taxes including cess	220	
Interest on debentures	200	
Depreciation	<u>370</u>	<u>1,460</u>
Gross Value Added		<u>2,260</u>

7. E.V.A. = NOPAT – COCE

NOPAT = Net Operating Profit after Tax

COCE = Cost of Capital Employed

COCE = Weighted Average Cost Of Capital $\times$ Average Capital Employed
 = WACC $\times$ Capital Employed

Debt Capital Rs.2,000 crores

Equity capital 500 + 7,500 = Rs.8,000 crores

Capital employed = 2,000+8,000 = Rs.10,000 crores

Debt to capital employed = $\frac{2,000}{10,000} = 0.20$

Equity to Capital employed = $\frac{8,000}{10,000} = 0.80$

Debt cost before Tax 12%

Less: Tax (30% of 12%) 3.6%Debt cost after Tax 8.4%

According to Capital Asset Pricing Model (CAPM)

Cost of Equity Capital = Risk Free Rate + Beta $\times$ Equity Risk Premium

Or

= Risk Free Rate + Beta (Market Rate – Risk Free Rate)

= 9 + 1.05 $\times$ (19-9)= 9 + 1.05 $\times$ 10 = 19.5%WACC = Equity to CE $\times$ Cost of Equity capital + Debt to CE $\times$ Cost of debt= 0.8 $\times$ 19.5% + 0.20 $\times$ 8.40%

= 15.60% + 1.68% = 17.28%

COCE = WACC $\times$ Capital employed= 17.28% $\times$ 10,000 crores = 1728 crores

E.V.A. = NOPAT – COCE

= Rs. 2,100 – Rs. 1,728 = Rs. 372 crores

8. The Institute for Global Management Research
Statement of Changes in Development Fund

	Rs.	Rs.
Receipts		
Government grants	60,00,000	
Private grants	30,00,000	
Foreign private grant (in USD 5,00,000)	2,20,00,000	
Transfer from unrestricted fund	<u>10,00,000</u>	3,20,00,000
Deductions/Transfers		
Cost of land acquired	59,00,000	
Furniture purchased	<u>3,00,000</u>	<u>62,00,000</u>
Balance as at 31.3.2005		<u>2,58,00,000</u>

Development Fund
Balance Sheet as at 31.3.2005

Liabilities	Rs.	Assets	Rs.
Fund Balance	2,58,00,000	Buildings in progress	15,00,000
		Bank balances	
		in India	23,00,000
		outside India	<u>2,20,00,000</u>
	<u>2,58,00,000</u>		<u>2,43,00,000</u>
			<u>2,58,00,000</u>

Bank A/c (in India)

	Rs.		Rs.
To Government grant	60,00,000	By Land	59,00,000
To Private grant	30,00,000	By Furniture	3,00,000
To Transfer	10,00,000	By Payments to contractors for buildings	15,00,000
		By Balance c/d	<u>23,00,000</u>
	<u>1,00,00,000</u>		<u>1,00,00,000</u>

9. (a) Corporate social reporting is information communique with respect to discharge of social responsibilities of corporate entity. Through 'Corporate Social Report' the corporate enterprises disclose the manner in which they are discharging their social responsibilities. More specifically, it is addressed to the public or society at large, although it can be squarely used by other user groups also.

In the given case, the group of companies has positively contributed to the social cause and the commercial activities undertaken by them come under the purview of corporate social reporting. Normally, such information is not required to be given mandatorily in the financial report due to the lack of any generally accepted standard of social responsibility for business entities. However, everyone agrees that all business entities should be socially responsible but how the individual entity weighs its priorities of social responsibility depends on the personal choice or preference of the group of persons in the management of an enterprise.

The group of companies (referred in the question) can voluntarily highlight the results of various commercial activities, undertaken by them along the earthquake affected area through a 'note to accounts' while publishing financial statements for the year ended 2005-2006. Infact bringing out the results of such relief activities in the affected areas may imbibe a sense of social responsibility among other entities through 'Corporate Social Report'.

- (b) SEBI may appoint one or more persons as inspecting authority to undertake inspection of the books of account, other records and documents of the stock brokers for any of the following purposes :
- (i) to ensure that the books of account and other books are being maintained in the required manner;
 - (ii) that the provisions of the Act, rules, regulations and the provisions of the Securities Contract (Regulation) Act, and the rules made thereafter are being complied with;
 - (iii) to investigate into the complaints received from investors, other stock brokers, sub-brokers or any other person on any matter having a bearing on the activities of the stock brokers; and
 - (iv) to investigate suo motu, in the interest of securities business or investors' interest into the affairs of the stock-brokers.

10. Journal Entries in the books of A

			Rs.	Rs.
2006				
Jan. 24	B	Dr.	17,68,000	
	To Sales Account			17,68,000
	(Credit sales made to B of Washington, USA for \$40,000 recorded at spot market rate of Rs.44.20 per US \$)			
" "	Forward (Rs.) Contract Receivable Account	Dr.	17,48,000	
	Deferred Discount Account	Dr.	20,000	
	To Forward (\$) Contract Payable			17,68,000
	(Forward contract acquired to sell on 24 th April, 2006 US \$40,000 @ Rs.43.70)			
March 31	Exchange Loss Account	Dr.	40,000	
	To B			40,000
	(Record of exchange loss @ Re.1 per \$ due to market rate becoming Rs.43.20 per US \$ rather than Rs.44.20 per US \$)			
" "	Forward (\$) Contract Payable	Dr.	40,000	
	To Exchange Gain Account			40,000
	(Decrease in liability on forward contract due to fall in exchange rate)			
" "	Discount Account	Dr.	14,667	
	To Deferred Discount Account			14,667
	(Record of proportionate discount expense for 66 days out of 90 days)			
April 24	Bank Account	Dr.	17,08,000	
	Exchange Loss Account	Dr.	20,000	
	To B			17,28,000
	(Receipt of \$40,000 from B, USA customer @ Rs.42.70 per US \$; exchange loss being Rs.20,000)			
" "	Forward (\$) Contract Payable Account	Dr.	17,28,000	
	To Exchange Gain Account			20,000
	To Bank Account			17,08,000
	(Settlement of forward contract by payment of \$40,000)			
" "	Bank Account	Dr.	17,48,000	
" "	To Forward (Rs.) Contract Receivable			17,48,000
	(Receipt of cash in settlement of forward contract receivable)			
" "	Discount Account	Dr.	5,333	
	To Deferred Discount Account			5,333
	(Recording of discount expense for 24 days: $\text{Rs.20,000} \times \frac{24 \text{ days}}{90 \text{ days}} = \text{Rs.5,333}$)			

11. Calculation of provision required on advances as on 31st March, 2006:

	Amount Rs. in lakhs	Percentage of provision	Provision Rs. in lakhs
Standard assets	16,800	NIL	NIL
Sub-standard assets	1,340	10	134

Secured portions of doubtful debts—

–upto one year	320	20	64
– one year to three years	90	30	27
–more than three years	30	50	15
Unsecured portions of doubtful debts	97	100	97
Loss assets	48	100	<u>48</u>
			<u>385</u>

12. Opportunity cost is one of the economic value models used for measurement and valuation of Human assets. As per this model, opportunity cost is the value of an employee in his alternative use. This opportunity cost is used as a basis for estimating the value of Human resources. Opportunity cost value may be established by competitive bidding within the firm so that in effect, Managers must bid for any scarce employee. A Human asset will have a value only if it is a scarce resource, that is, when its employment in one division denies it to another division. This method excludes employees of the type of which can be readily hired from outside the firm. Also, it is in very rare cases that managers would like to bid for an employee.
13. “Non–Performing Asset” as per NBFC Prudential Norms (RBI) directions means:
- An asset, in respect of which, interest has remained past due for six months;
 - A term loan inclusive of unpaid interest, when the instalment is overdue for more than six months of which interest amount remained past due for six months;
 - A bill which remained overdue for six months;
 - The interest in respect of a debt or the income on receivables under the head ‘other current assets’ in the nature of short term loans/advances that remained overdue for a period of six months;
 - Any dues on account of sales of assets or services rendered or reimbursement expenses made, which remained overdue for a period of six months;
 - The lease rental and hire purchase instalment, which has become overdue for a period of more than twelve months;
 - In respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities made available to borrower /beneficiary when anyone of the credit facilities becomes NPA.

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

14. Every stock broker is required to maintain the following books of account and records as per Rule 15 of the Securities Contracts (Regulation) Rules, 1957 and Regulation 17 of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992:
- Register of transactions (Sauda book)/Daily transaction list;
 - Clients ledger;
 - General ledger;
 - Journals;
 - Cash book;
 - Bank Pass Book;
 - Documents register/Inward-outward register showing full particulars of shares and securities received and delivered;

- (h) Members' contract book showing details of all contracts entered into by him with other members of the stock exchange or counterfoils or duplicates of memos of confirmation issued to such other members;
- (i) Counterfoils or duplicates of contract notes issued to clients;
- (j) Written consent of clients in respect of contracts entered into as principals;
- (k) Margin deposit book;
- (l) Register of accounts of sub-brokers;
- (m) An agreement with a sub-broker specifying the scope of authority and responsibilities of the stock broker and such sub-brokers.

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

15. 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) Capitalisation 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 resourced to and/or persuaded to follow environmental accounting, the adverse impact in EPS is a major concern. Accordingly many Western Corporations prefer to capitalise environment costs instead of immediate expensing and adopt an amortisation policy extending upto 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. Recognising 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 (UNCTAD) 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.

16. Of late there is a growing trend of shift from the traditional focus on financial reporting of quantifiable resources (which can be measured in monetary terms) to a more comprehensive approach of reporting under which human resources are also considered as measurable assets. Having followed the methods of accounting of fixed assets, one can take into account the

employee-related costs like cost of recruitment, training and orientation of employees, for the purpose of capitalization and then the appropriate portion thereof can be amortised each year over the estimated years of effect of such costs.

The relevance of human resource information lies in the fact that it concerns organizational changes in the firm's human resources. The ratio of human to non-human capital indicates the degree of labour intensity of an organization. Comparison of the specific values of human capital based on the organisation's scales of wages and salaries with the general industry standards, can be a good source of information to the management. There is no standard human capital reporting format as employment reporting is relatively a new form of reporting. Usually, the report inter alia contains data pertaining to employee numbers, employment and training policies, collective bargaining arrangements, industrial disputes, pension and pay arrangement and disabled employee numbers.

Human capital reporting provides scope for planning and decision-making in relation to proper manpower planning. Also, such reporting can bring out the effect of various rules, procedures and incentives relating to work force, and in turn, can act as an eye opener for modifications of existing statutes, laws and the like.

17. Para 13 of AS 11 Revised – “Accounting for the Effects of changes in Foreign Exchange Rate” states that an enterprise may enter into a forward exchange contract or another financial instrument that is in substance a forward contract , to establish the amount of the reporting currency required or available at the settlement date of a transaction. The difference between the forward rate and the exchange rate on the date of the transaction should be recognized as income or expense over the life of the contract except in respect of liabilities incurred for acquiring fixed assets in which case such difference should be adjusted in the carrying amount of the respective fixed assets.
18. In a not-for-profit organization, revenue funds are received to meet operating expenses but the use of revenue funds may be restricted or unrestricted. Restricted funds account for resources whose use, by the not-for-profit organization, is restricted by the donor. For example, a grant may be received by a university from the Government for the specific purpose of research on cancer. This grant will constitute a restricted fund. The unrestricted funds account for resources that may be expended to carry out the primary purposes of the institution (e.g. instructions, research, maintenance etc.) and are not restricted to specific purposes. However, the not-for-profit organization may convert part of the unrestricted fund into a restricted fund by earmarking a certain sum for a specified purpose.
19.

	Position under IAS / IFRS	Position under Indian AS
Revenue recognition	Revenue from sale of goods cannot be recognized if entity retains continuing managerial ownership or effective control over the sold goods.	Under AS 9, such stipulation is not there.
	In case of revenue from rendering of services, IAS 18 allows only percentage of completion method.	AS 9 allows both completed service contract method and percentage of completion method.
	Under IAS 18, payments received in advance for goods yet to be manufactured cannot be recognized as revenue until such goods are delivered to the buyer.	AS 9 permits recognition when the goods are manufactured, identified and ready for delivery in such cases.
20. (a) (i) Losses sustained as a result of enemy action constitute an extraordinary item since it is an event which is clearly distinct from the ordinary activities of the enterprise and is not expected to recur frequently or regularly. As per AS 5, the nature and amount of each

extraordinary item should be separately disclosed in a manner that its impact on current profit or loss can be perceived.

- (ii) AS 13 on "Accounting for Investments" requires that on disposal of an investment, the difference between the carrying amount and net disposal proceeds should be charged or credited to profit and loss account. AS 5 (Revised) requires separate disclosure of items of income/expense from ordinary activities if their size, nature or incidence makes their disclosure relevant to explain entity's performance. The disposal of long-term investments, may fall in this category requiring separate disclosure particularly in view of the fact that "disposal of long-term investments" is visualized as one of the circumstances in AS 5 itself.
21. The amount refundable in respect of a grant related to revenue should be applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount should be charged to profit and loss statement. The amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.
22. (a) Taxable income is calculated in accordance with tax laws. In some circumstances the requirements of these laws to compute taxable income differ from the accounting policies applied to determine accounting income. This results in a difference between the taxable and the accounting income. Such differences are classified into Permanent and Timing differences. The tax effect of the timing differences is known as Deferred Tax and is included as tax expense in the statement of profit and loss and as deferred tax assets or as deferred tax liabilities, in the balance sheet.

Prudence would dictate that deferred tax liabilities are provided for without exception, even in situations where an enterprise is incurring losses. Deferred tax assets should be recognized and carried forward only to the extent that there is reasonable certainty that sufficient future taxable income will be available against which such deferred tax asset can be realized. Reasonable certainty can be demonstrated by providing robust and realistic estimates of profits for the future. A company with a track record of losses with no immediate visibility of a turnaround should not recognise a deferred tax asset as a matter of prudence. In the case of an unabsorbed depreciation and carry forward losses under the tax laws, the recognition principles are more stricter, i.e. deferred tax asset should be recognized only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax asset can be realized. The existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available.

In that situation there has to be convincing evidence that sufficient future taxable income will be available against which such deferred tax asset can be realized. This is a matter of judgement and the conclusion would depend on facts and circumstances of each case.

- (b) The disclosure requirements under AS 22 are as under:
 - (a) Deferred tax assets and liabilities should be distinguished from current tax assets and liabilities. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.

A deferred tax asset is more liquid as compared to fixed assets and investments and less liquid as compared to current assets. Thus, in case of a company, it should be presented after the head 'Investments'. Similarly, a deferred tax liability should be presented after the head 'Unsecured Loans'. (ASI 7 issued by Council of ICAI).

- (b) The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.
- (c) The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

23. According to AS 18, "Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions."

A related party transaction involves a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

Following are the examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:

- ◆ Purchases or sales of goods (finished or unfinished);
- ◆ Purchases or sales of fixed assets;
- ◆ Rendering or receiving of services;
- ◆ Agency arrangements;
- ◆ Leasing or hire purchase arrangements;
- ◆ Transfer of research and development;
- ◆ Licence agreements;
- ◆ Finance (including loans and equity contributions in cash or in kind);
- ◆ Guarantees and collateral etc.
- ◆ Management contracts including for deputation of employees.

24. (a)

	Integral Foreign Operation (NFO)	Non-Integral Foreign Operation (NFO)
Meaning	It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise.	It is a foreign operation that is not an integral Foreign Operation.
Business	The business of IFO is carried on as if it were an extension of the reporting enterprise's operations.	The business of NFO is carried on in a substantially independent manner by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowings, in its local currency.
Example	Sale of goods imported from the reporting enterprise and remittance of proceeds to the reporting enterprise.	Production in a foreign country out of resources available in such nation independent of the reporting enterprise.
Currencies operated	Generally, IFO carries on business in a single foreign currency, i.e. of the country where it is located.	NFO business may also enter into transactions in foreign currencies, including transactions in the reporting currency.
Cash flows from operations	Cash flows from operations of the reporting enterprise are directly and immediately affected by a change in the exchange rate between the	Change in the exchange rate between the reporting currency and the local currency, has little or no direct effect on the present and

	reporting currency and the currency in the country of IFO.	future Cash Flows from Operations of either the NFO or the reporting enterprise.
--	--	--

Effect of Change in Exchange Rate	Change in the exchange rate affects the individual monetary items held by the IFO rather than the reporting enterprise's Net Investment in the IFO.	Change in the exchange rate affects the reporting enterprise's net investment in the NFO rather than the individual monetary and non-monetary items held by that NFO.
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- (b) Leases are classified based on the extent to which risks and rewards incident to ownership of a leased asset lie with the Lessor or the Lessee.

Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions.

Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.

A lease is called a Finance Lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred. A lease is called an Operating Lease if it does not transfer substantially all the risks and rewards incident to ownership.

25. Treatment of intra-segment transactions while preparing segment reports can be explained as follows:

- (i) Prior Determination of item: Segment Revenue, Segment Expense, Segment Assets and Segment Liabilities are determined before intra-enterprise balances.
- (ii) Elimination: Intra-enterprise transactions are eliminated as part of the process of preparation of enterprise Financial Statements.
- (iii) No-elimination: When intra-enterprise balances and transactions are within a single segment, they are NOT eliminated.

26. As per Para 5 of AS 2 "Valuation of Inventories", the inventories are to be valued at lower of cost and net realizable value.

In this case, the cost of inventory is Rs.10 lakhs. The net realizable value is $11,00,000 \times 90\% = \text{Rs.}9,90,000$. So, the stock should be valued at Rs.9,90,000.

27. As per Para 41 of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Therefore, the manager cannot defer the expenditure write off to future years.

Hence, the expenses amounting Rs. 20 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2006.

28. As per AS 4 'Contingencies and Events occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the Balance Sheet date.

In the given case, bankruptcy of the debtor in April, 2005 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.3.2005. Therefore, the company should be advised to provide for the entire amount of Rs. 10 lakhs according to para 8 of AS 4.

$$29. \text{ Basic earnings per share (EPS)} = \frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{\text{Rs. 2,64,000}}{88,000 \text{ shares (as calculated in working note)}} = \text{Rs. 3}$$

Working Note:

Calculation of weighted average number of equity shares

	Number of shares	Nominal value of shares	Amount paid
1st April, 2004	1,20,000	100	50
1st September, 2004	96,000	100	100
	24,000	100	50

As per para 19 of AS 20 on Earnings per share, Partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividends relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividends to the extent of amount paid, weighted average number of shares will be calculated as:

$$\begin{aligned}
 &\text{Shares} \\
 &1,20,000 \times \frac{1}{2} \times \frac{5}{12} = 25,000 \\
 &96,000 \times \frac{7}{12} = 56,000 \\
 &24,000 \times \frac{1}{2} \times \frac{7}{12} = 7,000 \\
 &\underline{\hspace{1cm}} \\
 &88,000 \text{ shares}
 \end{aligned}$$

30. According to para 21 of AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. The accounting treatment in both the alternatives can be given as follows:

Alternative 1:

		Rs. (in lakhs)
1st April, 2001	Acquisition cost of machinery (Rs. 1,500 – 300)	1,200.00
31st March, 2002	Less: Depreciation @ 20%	<u>240.00</u>
	Book value	960.00
31st March, 2003	Less: Depreciation @ 20%	<u>192.00</u>
	Book value	768.00
31st March, 2004	Less: Depreciation @ 20%	<u>153.60</u>
1st April, 2004	Book value	614.40
May, 2004	Add: Refund of grant	<u>300.00</u>
	Revised book value	<u>914.40</u>

Depreciation @ 20% on the revised book value amounting Rs. 914.40 lakhs is to be provided prospectively over the residual useful life of the asset i.e. years ended 31st March, 2005 and 31st March, 2006.

Alternative 2:

ABC Ltd. can also debit the refund amount of Rs. 300 lakhs in capital reserve of the company.

31. Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realisable value. AS 9 on "Revenue Recognition" states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods invoiced are often valued at Net-realisable value."

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing stock of finished goods (Fancy terry towel) should have been valued at lower of cost and net-realisable value and not at net realisable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing stock of inventories of finished goods is not correct.

		Journal Entries			
		Particulars		Dr. Rs.	Cr. Rs.
2004					
April 1		Employee Compensation Expense	Dr.	9,00,000	
		To Employee Stock Options Outstanding			9,00,000
		(Being grant of 10,000 stock options to employees at Rs. 40 when market price is Rs. 130)			
2005					
16th Dec. to 15th March		Bank	Dr.	3,80,000	
		Employee stock options outstanding	Dr.	8,55,000	
		To Equity share capital			95,000
		To Securities premium			11,40,000
		(Being allotment to employees of 9,500 equity shares of Rs. 10 each at a premium of Rs. 120 per share in exercise of stock options by employees)			
March 16		Employee stock options outstanding	Dr.	45,000	
		To Employee compensation expense			45,000
		(Being entry for lapse of stock options for 500 shares)			
March 31		Profit and Loss A/c	Dr.	8,55,000	
		To Employee compensation expense			8,55,000
		(Being transfer of employee compensation expense to profit and loss account)			

33. As per AS-10 (Para 22) fixed asset acquired in exchange for shares or other securities should be recorded at its fair market value or the fair market value of the securities issued, whichever is more clearly evident. Since, the market value of the shares exchanged for the asset is more clearly evident, the company should record the value of machinery at Rs.7,50,000. (i.e., 50000 shares x 15 per share being the market price)
34. As per AS-7, Para 31, an expected loss on the construction contract must be recognized irrespective of (i) whether or not the work has commenced on the contract or (ii) the stage of completion of the contract or (iii) the amount of profits expected to arise in other contracts. Hence, the company must recognise the loss immediately.

35. The write-back of the balance of Maintenance provision, 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 amount so written-back (If material) should be disclosed as an extraordinary item as per AS-5.
36. As per AS-10, the purpose of trial production is to ascertain whether the Plants and Machinery and other relevant facilities, as installed, give the intended output in terms of quality and quantity. If during the trial run, the production standards are not met, normally, the production is stopped and necessary alternations/modifications in the P & M are made. It may be necessary to carry out trial runs further until the output of desired quality and quantity is obtained.

In the present case, the company did not do so, but continued the sub-standard production, in view of the fact that it had invested huge sums in the project. Due to commercial reasons, this decision was taken. Accordingly, capitalization should cease in the given case at the end of the trial run, since the cut-off date would be the date when the trial run was completed.

37. Entries in the Books of Seller

		Dr. Amount Rs.	Cr. Amount Rs.
At the time of inception:-			
30 August Equity Stock option Margin A/c (60 x100)	Dr.	6,000	
To Bank A/c			6,000
(Being the initial Margin paid on option)			
Bank A/c (100 x10)	Dr.	1,000	
To Equity Stock 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			
Situation I - Option is exercised			
Sept. 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)			
Situation II - Option is not exercised			
Equity Stock option Premium A/c	Dr.	1,000	
To Profit & Loss A/c			1,000
(Being premium on option recognized as income)			
(ii) Accounting treatment of Equity Stock Option which are settled in Cash			
Situation I Option is exercised			
September Profit & Loss A/c [(160 – 150) x 100]	Dr.	1,000	
To Bank A/c			1,000
(Being Premium on option recognized)			

Situation II Option is not exercised

Equity Stock Option Premium A/c	Dr.	1,000	
To Profit & Loss A/c			1,000
(Being Premium on option recognized as income)			

- 38 In year 2005, the asset was revalued upwards. The company would have charged a depreciation of Rs.6 lakhs. [i.e., $(60-6) \div 9$] per annum from 2001 to 2004 and its carrying amount at the end of year 2004 would be Rs.60 – 24 = Rs.36 lakhs. Revaluation reserve will be credited by Rs.9 lakhs in year 2005 and asset account debited by Rs.9 lakhs. The depreciation that would have been charged in years 2005 to 2007 $\frac{\text{Rs.45 lakhs} - \text{Rs.6 lakhs}}{5 \text{ years (remaining useful life)}} = \text{Rs.7.8 lakhs}$

In situation (a), the company would have transferred incremental depreciation (Rs.7.8 – 6.0) = Rs.1.8 lakhs from revaluation reserve to profit & loss account in each of years 2005, 2006 & 2007. So carrying amount of asset at the end of 2007 = Rs.45 – 23.4 lakhs = Rs.21.6 lakhs and that of revaluation reserve at the end of year 2007 = Rs.9 lakhs – 5.4 (i.e. 1.8 x 3) = lakhs transfer to P&L) = Rs.3.6 lakhs.

Now, recoverable amount is Rs.14 lakhs against carrying amount of Rs.21.6 lakhs. Therefore, an impairment loss of Rs.7.6 lakhs is to be recognized.

Of this, Rs.3.6 lakhs will be debited to revaluation reserve and balance Rs.4.0 lakhs to Profit & Loss Account. A deferred tax asset in respect of only Rs.4.0 lakhs = $4 \times 0.30 = 1.2$ lakhs to be created.

In situation (b), the entire Rs.7.6 lakhs will be debited to Revaluation Reserve. Since, no transfer was made from revaluation reserve, its balance is intact at Rs.9 lakhs. No deferred tax assets will be recognized since no part of impairment loss is recognized in Profit & Loss account.

39. (a) At 31st March, 2007

The giving of the guarantee, gives rise to a possible obligation.

No outflow of benefits is probable at 31st March, 2007, since financial position of B is sound.

Hence, no provision is recognised. The guarantee, is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

- (b) At 31st March, 2008

The obligating event is the giving of the guarantee, which gives rise to a legal obligation to make good enterprise B's defaults.

At 31st March, 2008, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, since enterprise B has gone into liquidation.

A provision should be recognized for the best estimate of the obligation.

40. According to para 8 of AS 4 (Revised 1995), the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. The retrospective increase in the petrol price should not be considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.

APPENDIX

ACCOUNTING STANDARDS

Accounting Standard (AS) 15 (revised 2005) on 'Employee Benefits' comes into effect in respect of accounting periods commencing on or after April 1, 2006. AS 15 (revised 2005) was originally published in March, 2005 issue of the ICAI's Journal 'The Chartered Accountant'. Subsequently, the ICAI, in January 2006, made limited revision to AS 15 (revised 2005) primarily with a view to bring the disclosure requirements of the standard relating to the defined benefit plans in line with the corresponding International Accounting Standard (IAS) 19, Employee Benefits; to clarify the application of the transitional provisions; and to provide relaxation/exemption to the small and medium-sized enterprises (SMEs). The limited revision has been duly incorporated by the ICAI in AS 15 (revised 2005), which has been published in the 'The Chartered Accountant', March 2006 (page nos. 1354 to 1385).

Note: AS 1 to AS 29 [including AS 15 (Revised 2005)] are applicable for November, 2007 Examination

ACCOUNTING STANDARDS INTERPRETATIONS

The authority of the Accounting Standards Interpretations (ASI) is the same as that of the Accounting Standard to which it relates. The contents of the ASI are intended for the limited purpose of the Accounting Standard to which it relates. ASI is intended to apply only to material items. The Institute of Chartered Accountants of India has, so far, issued 30 ASIs and has also revised some of the existing ASIs. These interpretations are available at the institute's website www.icai.org. The same can also be seen from the Compendium of the Accounting Standards (as on July 1, 2006).

GUIDANCE NOTES

Guidance Notes are primarily designed to provide guidance to members of ICAI on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. In recent years several Guidance Notes on accounting aspects have been issued promptly responding to the need for accounting guidance on contemporary issues, which arise due to amendments in laws and other developments related to economic reforms in the country. The council of the Institute of Chartered Accountants of India has, so far issued 23 Guidance Notes* till July 1, 2006. The list of the relevant Guidance Notes is given under "Applicability of various publications for Final Examination" at the end of this RTP. For the text of the applicable Guidance Notes, the students are advised to refer the July, 2006 edition of "Compendium of Guidance Notes–Accounting".

* Two guidance notes are under the process of revision.

PAPER – 2 : MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS

QUESTIONS

- A Rs.100 perpetual bond is currently selling for Rs.95. The coupon rate of interest is 14.5 per cent and the appropriate discount rate is 16 per cent. Calculate the value of the bond. Should it be bought? What is its yield at maturity?
 - A company proposes to sell ten-year debentures of Rs.10,000 each. The company would repay Rs.1,000 at the end of every year and will pay interest annually at 15 per cent on the outstanding amount. Determine the present value of the debenture issue if the capitalization rate is 18 per cent.
- An investor holds two equity shares x and y in equal proportion with the following risk and return characteristics:

$$\begin{array}{ll} E(R_x) = 26 & E(R_y) = 20\% \\ \sigma_x = 28\% & \sigma_y = 23\% \end{array}$$

The returns of these securities have a positive correlation of 0.8. You are required to calculate the portfolio return and risk. Further, suppose that the investor wants to reduce the portfolio risk (σ_p) to 15 per cent. How much should the correlation coefficient be to bring the portfolio risk to the desired level?

- A portfolio consists of three securities P, Q and R with the following paramers.

	P	Q	R	Correlation Coefficient
Expected return (%)	28	24	22	
Standard deviation (%)	30	26	24	
Correlation Coefficient				
PQ				-0.5
QR				+0.4
PR				+0.6

If the securities are equally weighted, how much is the risk and return of the portfolio of these three securities.

- From the following data compute beta of security j:
 $\sigma_j = 15\%$; $\sigma_m = 10\%$ and $\text{Cor}_{jm} = +0.63$
- Calculate the expected rate of return for security I from the following information:

$$R_f = 10\%, R_m = 18\%, \beta_j = 1.35$$

- An aggressive mutual fund promises an expected return of 16 per cent with a possible volatility (standard deviation) of 20 per cent. On the other hand, a conservative mutual fund promises an expected return of 13 per cent and volatility of 15 per cent. (a) Which fund would you like to invest in? (b) Would you like to invest in both if you have money? (c) Assuming you can borrow money from your provident fund at an opportunity cost of 10 per cent, which fund you would invest your money in? (d) Would you consider both funds if you could lend or borrow money at 10 per cent.?
- P Ltd. has an expected return of 22 per cent and standard deviation of 40 per cent. Q Ltd. has an expected return of 24 per cent and standard deviation of 38 per cent. P has a beta of 0.86 and Q 1, 24. The correlation between the returns of P and Q is 0.72. The standard deviation of the market return is 20 per cent. (a) Is investing in Q better than investing in P? (b) If you invest 30

per cent in Q and 70 per cent in P, what is your expected rate of return and the portfolio standard deviation? (c) What is the market portfolio's expected rate of return and how much is the risk-free rate? (d) What is the beta of portfolio if P's weight is 70 per cent and Q is 30 per cent?

8. The following are the returns of share S and the market (M) for the last six years:-

Year	Return (%)	
	S	M
2001	18	15
2002	9	7
2003	20	16
2004	-10	-13
2005	5	4
2006	12	7

- Calculate the covariance and correlation coefficient of returns.
 - Determine the beta coefficient for S.
 - What is S's total risk? How much is systematic risk?
9. M. M. Kusha Ltd. belongs to a risk class of which the appropriate capitalization rate is 10%. It currently has 1,00,000 shares selling at Rs.100 each. The firm is contemplating declaration of a dividend of Rs.6 per share at the end of the current fiscal year which has just begun. Answer the following questions based on Modigliani and Miller Model and assumption of no taxes:
- What will be the price of the shares at the end of the year if a dividend is not declared?
 - What will be the price if dividend is declared?
 - Assuming that the firm pays dividend, has net income of Rs.10 lakhs and makes a new investments of Rs.20 lakhs during the period, how many new shares must be issued?
 - Is the Modigliani and Miller Model realistic with respect to valuation? What factors might mar its validity?
10. An Oil company belongs to a risk class for which the appropriate P/E ratio is 10. It currently has 50,000 equity shares (outstanding) selling at Rs.100 each. The firm is contemplating the declaration of dividend of Rs.8 per share at the current fiscal year which has just started. Given the assumptions of Modigliani and Miller, answer the following questions:
- What will be the price of the share at the end of the year (a) if dividend is not declared; and (b) if it is declared?
 - Assuming that the company pays the dividend, has a net income (Y) of Rs.5,00,000 and makes new investments of Rs.10,00,000 during the period, how many new shares must be issued?
11. A company is manufacturing a consumer product, the demand for which at current price level is in excess of its ability to produce. The capacity of a particular machine, now due for replacement, is the limiting factor on production.
- The possibilities exist either of acquiring a similar machine (Project X) or of purchasing a more expensive machine with greater capacity (Project Y). The cash flows under each alternative have been estimated and given below. The company's opportunity cost of capital is 10% after tax. In deciding between the two alternatives the Managing Director favours the 'payback method'. The Chief Accountant, however, thinks that a more specific method should be used and he has calculated for each project:
- The net present value.

- (ii) The profitability index.
 (iii) The discounted payback period.

Having made these calculations, however, he finds himself still uncertain about which project to recommend. You are required to make these calculations and to discuss their relevance to the decision to be taken.

		Project Cash Flows		(Rs.000)
Data		Project X	Project Y	
Immediate outlay		(27)	(40)	
Relevant inflows: Year	1	Nil	10	
	2	5	14	
	3	22	16	
	4	14	17	
	5	14	15	

Note: Present value 10% discounting factor

Year		Year	
0	1.00	3	.75
1	.91	4	.68
2	.83	5	.62

12. Z Ltd. is foreseeing a growth rate of 12% per annum in the next 2 years. The growth rate is likely to fall to 10% for the third year and the fourth year. After that the growth rate is expected to stabilize at 8% per annum. If the last dividend paid was Rs.1.50 per share and the investors' required rate of return is 16%, find out the intrinsic value per share of Z Ltd. as of date. You may use the following table:

Years	0	1	2	3	4	5
Discounting Factor at 16%	1	0.86	0.74	0.64	0.55	0.48

13. The Beta Coefficient of Target Ltd. is 1.4. The company has been maintaining 8% rate of growth in dividends and earnings. The last dividend paid was Rs.4 per share. Return on Government securities is 10%. Return on market portfolio is 15%. The current market price of one share of Target Ltd. is Rs.36.

- (i) What will be the equilibrium price per share of Target Ltd.?
 (ii) Would you advise purchasing the share?

14. Forward Planning Ltd. is considering whether to invest in a project which would entail immediate expenditure on capital equipment of Rs. 40, 000. Expected sales from the project are as follows:

Probability	Sales Volume (Units)
0.10	2,000
0.25	6,000
0.40	8,000
0.15	10,000
0.10	14,000

Once sales are established at a certain volume in the first year, they will continue at that same volume in subsequent years. The unit selling prices will be Rs. 10, the unit variable cost Rs. 6

and the additional fixed costs will be Rs 20,000 (all cash items) The project would have a life of 6 years after which the equipment would be sold for scrap which would fetch Rs. 3,000 You are required to find out:

- (a) The expected value of the NPV of the project.
- (b) The minimum volume of sales per annum required to justify the project.

The cost of capital of the company is 10%. Discount factor of Re 1 per annum for 6 years at 10% is 4.335 and the discount factor of Re.1. at the end of the sixth year at 10% is 0.5645. Ignore Taxation.

15. Kriss Ltd. are preparing their budget for 2007. In the preparation of the budget they would like to take no chances but would like to envisage all sorts of possibilities and incorporate them in the budget. Their considered estimates as under:
 - (a) If the worst possible happens, sales will be 8,000 units at a price of Rs. 19 per unit, the material cost will be Rs. 9 per unit, direct labour Rs. 2 per unit and the variable overhead will be Re. 1.50 per unit. The fixed cost will be Rs. 60,000 per annum.
 - (b) If the best possible happens, sales will be 15,000 units at a price of Rs. 20 per unit. The material cost will be Rs. 7 per unit, direct labour Rs. 3 per unit and the variable overhead will be Re. 1 per unit. The fixed cost will be Rs. 48,000 per annum.
 - (c) It is most likely, however that the sales will be 2,000 units above the worst possible level at a price of Rs. 20 per unit. The material cost will be Rs. 8 per unit, direct labour Rs. 3 per unit and the variable overhead will be Re. 1 per unit. The fixed cost will be Rs. 50,000 per annum.
 - (d) There is a 20% probability that the worst will happen, a 10% probability that the best will happen and a 70% probability that the most likely outcome will occur.

What will be expected value of Profit as per Budget for 2007?

16. Pioneer Ltd. which makes only one product, sells 10,000 units of its product making a loss of Rs. 10,000 The Variable cost per unit of the product is Rs. 8 and fixed cost is Rs. 30,000.

The company has estimated its sale demand as under:

Sales units	Probability
10,000	0.10
12,000	0.15
14,000	0.20
16,000	0.30
18,000	0.25

- (i) What is the probability that the company will continue to make losses?
 - (ii) What is the probability that the company will make a profit of at least Rs. 6000?
17. Samreen Project Ltd. is considering accepting one of the two mutually exclusive projects X & Y. The cash flow and probabilities are estimated as under:

Project X		Project Y	
Probability	Cash flow	Probability	Cash flow
0.10	12,000	0.10	8,000
0.20	14,000	0.25	12,000
0.40	16,000	0.30	16,000
0.20	18,000	0.25	20,000
0.10	20,000	0.10	24,000

Advise Samreen Projects Ltd.

18. (a) The management of ABC company is considering the question of marketing a new product. The fixed cost required in the project is Rs. 4,000. Three factors are uncertain viz. the selling price, variable cost and the annual sales volume. The product has a life of only one year.

The management has the data on these three factors as under:

Selling Price Rs.	Probability	Variable Cost Rs.	Probability	Sales Volume (Units)	Probability
3	0.2	1	0.3	2,000	0.3
4	0.5	2	0.6	3,000	0.3
5	0.3	3	0.1	5,000	0.4

Consider the following sequence of thirty random numbers:

81, 32, 60, 04, 46, 31, 67, 25, 24, 10, 40, 02, 39, 68, 08, 59, 66, 90, 12, 64, 79, 31, 86, 68, 82, 89, 25, 11, 98, 16. Using the sequence (First 3 random numbers for the first trail etc.) simulate the average profit for the above project on the basis of 10 trials.

- (b) Daily demand (x) for pieces of bread at a grocery store is given by the following probability distribution:

X	100	150	200	250	300
Probability (x)	0.20	0.25	0.30	0.15	0.10

If a piece of bread is not sold the same day, it can be disposed of at 15 paise per piece at the end of the day. Otherwise the price of a fresh piece is 49 paise. The cost per piece to the store is 25 paise. If the optimum level of stocking is 200 pieces of bread daily, then find:

Expected Monetary Value (E.M.V.) of this optimum stock level.

Expected Value of Perfect Information (E.V.P.I)

19. A limited manufactures three different products and the following information has been collected from the books of accounts:-

	Product		
	S	T	Y
Sales mix	35%	35%	30%
Selling price	Rs. 30	40	20
Variable cost	Rs. 15	20	12
Total fixed costs		Rs. 1,80,000	
Total sales		Rs. 6,00,000	

The company has currently under discussion, a proposal to discontinue the manufacture of product Y and replace it with product M, when the following results are anticipated:-

	Product		
	S	T	M
Sales mix	50%	25%	25%
Selling price	Rs. 30	40	30
Variable cost	Rs. 15	20	15
Total fixed costs		Rs. 1,80,000	
Total sales		Rs. 6,40,000	

Will you advise the company to changeover to production of M? Give reasons for your answer?

20. A company is engaged in evaluating an investment project which requires an initial cash outlay of Rs.2,50,000 on equipment. The project's economic life is 10 years and its salvage value Rs.30,000. It would require current assets of Rs.50,000. An additional investment of Rs.60,000 would also be necessary at the end of five years to restore the efficiency of the equipment. This would be written off completely over the last five years. The project is expected to yield annual

(before tax) cash inflow of Rs.1,00,000. The company follows the sum of the years' digit method of depreciation. Income-tax rate is assumed to be 40%. Should the project be accepted if the minimum required rate of return is 20%?

Note: PVs. Of Re.1 at 20% discount rate are as follows:

Year	1	2	3	4	5	6	7	8	9	10
PV	.833	.694	.579	.482	.402	.335	.279	.233	.194	.162

21. (a) "Investment, financing and dividend decisions are all interrelated". Comment.
 (b) A company's capital structure consists of the following:

	Rs. (in Lakhs)
Equity shares of Rs.100 each	20
Retained Earnings	10
9% Preference shares	12
7% Debentures	8
Total	<u>50</u>

The company earns 12% on its capital. The income-tax rate is 50%. The company requires a sum of Rs.25 lakh to finance its expansion programme for which following alternatives are available to it:

- (i) Issue of 20,000 equity shares at a premium of Rs.25 per share.
 (ii) Issue of 10% preference shares.
 (iii) Issue of 8% debentures.

It is estimated that the P/E ratios in the cases of equity, preference and debenture financing would be 21.4, 17 and 15.7 respectively.

Which of the three financing alternatives would you recommend and why?

22. Write note on CPM/PERT.

23. The following is the Balance Sheet of Alpha Limited as at 31st March 2007:-

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
Equity shares of Rs. 100 each		Land and building	4,00,000
10,00,000		Machinery	4,50,000
Less calls in arrear 1,00,000		Motor Car	25,000
(Rs. 20 for final call).....	9,00,000	Furniture	25,000
		Investments (face Value)	50,000
		General Reserve	3,50,000
Reserve and Surplus:		Current Assets:	
Profit & Loss Account	2,50,000	Stock	7,25,000
Current Liabilities		Sundry Debtors	2,00,000
Sundry Creditors	5,00,000	Cash at bank	1,05,000
		Miscellaneous Expenditure:	
		Preliminary expenses	20,000
	<u>20,00,000</u>		<u>20,00,000</u>

Additional information is as under:

- (1) Fixed Assets are worth-

Building	Rs. 6,00,000
Machinery	Rs. 5,20,000
- (2) All investments are non-trading investments and are to be valued at 20% above cost. Dividend at uniform rate of 20% is earned on all investments.
- (3) For the purpose of valuation of share, goodwill is to be valued on the basis of 3 years purchase of super profits based on average profit (After tax) of the last 3 years.
- (4) Depreciation on appreciated value of Land and Building and machinery is not to be considered for valuation of goodwill.
- (5) Profits (After tax) are as follows:

Year	Rs.
2005	3,80,000
2006	4,20,000
2007	5,00,000
Rate of Income-tax	50%

In similar business, return on capital employed is 20% (after tax)

- (6) In 2005 machinery (Book value Rs 20,000) was sold for Rs. 20,000 but the proceeds were wrongly credited to profit and loss account. The mistake has not yet been rectified.

Depreciation has been charged on machinery @10% per annum on reducing balance method.

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

Note: Trend in profit is to be ignored for the purpose of calculation of average profit

24. A company is considering the possibility of manufacturing a particular component which at present is being bought from outside. The manufacturer of the component would call for an investment of Rs.7,50,000 in a new machine besides an additional investment of Rs.50,000 in working capital. The life of the machine would be 10 years with a salvage value of Rs.50,000. The estimated savings (before tax) would be Rs.1,80,000 p.a. The income tax rate is 50%. The company's required rate of return is 10%. Depreciation is considered on straight line system.

Should the company make this investment? Workings should form part of your answer.

Note: The present value of Re.1 at 10% discount rate is as follows:

Year	1	2	3	4	5	6	7	8	9	10
P.V.	.91	.83	.75	.68	.62	.56	.51	.47	.42	.39

The present value (at 10% discount rate) of an annuity of Re.1 payable each year for different years is as follows:

Year	1	2	3	4	5	6	7	8	9	10
P.V.	0.91	1.74	2.49	3.17	3.79	4.35	4.87	5.33	5.76	6.14

Ignore impact of income-tax from the system of depreciation followed.

25. X Ltd. whose order book is full and has been full for about 3 years, is suffering from an acute shortage of working capital. The current ratio, bad at the end of 2005, was only 0.8 at the end of

2006. Payments to suppliers are overdue to the extent of Rs. 4 lakh and this has led to stoppage of certain essential supplies. The company has approached a bank for accommodation. The bank has obtained the following information:-

	2004	2005	2006
	Rs.	Rs.	Rs.
Sales	50,00,000	63,00,000	69,30,000
Materials consumed	20,00,000	26,40,000	30,36,000
Wages	20,00,000	24,00,000	28,80,000
Factory Expenses	6,00,000	7,00,000	7,50,000
Administrative Expenses	2,50,000	3,20,000	3,50,000
Selling Expenses	50,000	2,00,000	2,50,000
Interest	-	<u>60,000</u>	<u>1,00,000</u>
	49,00,000	63,20,000	73,66,000
Profit (Loss)	1,00,000	(20,000)	(4,36,000)

The following index numbers have been worked out and are applicable to the whole of the year concerned:

	2004	2005	2006
Sale price	100	105	105
Price of Raw Materials	100	110	120
Wages	100	120	144

The bank requests you to analyse these figures, work out the extent of efficiency in operations at constant price as well as effects of price changes. Offer your comments and advise whether accommodation should be extended to the company.

26. The present output details of manufacturing department are as follows:

Average per week	48,000 units
Salable value of output	Rs.60,000
Contribution made by output towards fixed expenses and profit	Rs.24,000

The Directors plan to introduce more mechanization in the department at a capital cost of Rs.16,000. The effect of this will be to reduce the number of employees from the existing strength of 160 to 120, but to increase the output per individual employee by 60%. In order to provide the necessary incentive to achieve the increased output, the directors intend to offer a 1% increase on the existing piece work price of Re.0.10 per article for every 2% increase in average individual output achieved. To sell the increased output, it will be necessary to decrease the selling price by 4%.

Calculate the extra week contribution resulting from the proposed change and evaluate the worth of the proposal.

27. Write notes on the following:-
- Cost of Right Shares.
 - Miller-Orr Model.
 - Risk-Premium trade-off

- (d) Random Walk Theory
- (e) Profitability Index.
28. (a) The earnings per share of a company are Rs. 8 and the rate of capitalization applicable to the company is 10%. The company has before it an option of adopting a payout ratio of 25% or 50% or 75%. Using Walter's formula of dividend payout compute the market value of the company's share if the productivity of retained earnings is (i) 15% (ii) 10%, and (iii) 5%.
- (b) Explain fully what inferences can be drawn from the above exercise?
29. (a) the existing capital structure of XYZ Ltd is as under:
- | | |
|------------------------------|---------------|
| Equity Share of Rs, 100 each | Rs.40,00,000 |
| Retained Earnings | Rs.10, 00,000 |
| 9% Preference share | Rs. 25,00,000 |
| 7% Debentures | Rs. 25,00,000 |
- The existing rate of return on the company's capital is 12% and the income-tax rate is 50%. The company requires a sum of Rs. 25,00,000 to finance its expansion programme for which it is considering the following alternatives:
- (1) Issue of 20,000 equity shares at a premium of Rs. 25 per share.
 - (2) Issue of 10% preference shares.
 - (3) Issue of 8% debentures.
- It is estimated that the P/E ratios in the cases of equity, preference and debenture financing would be 20. 17 and 16 respectively.
- Which of the above alternatives would you consider to be the best?
- (b) Give reasons for your choice in (a) above.
30. Write short notes on the following:
Social Cost Benefit Analysis.
31. Discuss the methods for evaluating a leasing proposal.
32. Write Short notes on :
- Financial Forecasting
 - Bridge Finance
33. Write a note on "Reverse mortgage scheme.
34. Write a note on listing of "Securitized debt instrument".

SUGGESTED ANSWERS/ HINTS

1. (a) Value of bond = $\frac{INT}{k_d} = \frac{14.5}{0.16} = \text{Rs.}90.625$

The bond is overvalued, it should not be bought.

Yield to maturity = $\frac{\text{Interst}}{\text{Current value of bond}} = \frac{14.5}{95} = 0.152 \text{ or } 15.2 \text{ per cent}$

- (b) The cash out flow of the company every year will be Rs.1,000 plus interest on outstanding amount. The present value is determined as follows:

Year	Interest (Rs.)	Repayment (Rs.)	Cash Out Flow (Rs.)	PV Factor 18%	Present Value
(1)	(2)	(3)	(4)=(2)+(3)	(5)	(6) = (4)x(5)
1	1,500	1,000	2,500	0.847	2,117.5
2	1,350	1,000	2,350	0.718	1,687.3
3	1,200	1,000	2,200	0.609	1,339.8
4	1,050	1,000	2,050	0.516	1,057.8
5	900	1,000	1,900	0.437	830.3
6	750	1,000	1,750	0.370	647.5
7	600	1,000	1,600	0.314	502.4
8	450	1,000	1,450	0.266	385.7
9	300	1,000	1,300	0.226	293.8
10	150	1,000	1,150	0.191	219.7
Present value of debenture					9,081.8

2. The portfolio return is:

$$E(R_p) = 26(0.5) + 20(0.5) = 13 + 10 = 23\%$$

and the portfolio risk is:

$$\sigma_p = \sqrt{\sigma_p^2}$$

$$\sigma_p^2 = (28)^2 (0.5)^2 + (23)^2 (0.5)^2 + 2(0.5)(0.5)(28)(23)(0.8) = 196 + 132.25 + 257.6 = 585.85$$

$$\sigma_p = \sqrt{585.85} = 24.20$$

If the investor desires the portfolio standard deviation to be 15 per cent, the correlation coefficient will be as computed below:

$$(15)^2 = (28)^2 (0.5)^2 + (23)^2 (0.5)^2 + 2(0.5)(0.5)(28)(23) \text{ Cor}_{xy}$$

$$225 = 196 + 132.25 + 322 \text{ Cor}_{xy}$$

$$\text{Cor}_{xy} = \frac{-103.25}{322} = -0.321$$

3. The portfolio return and risk are as follows:

$$E(R_p) = (28)(1/3) + 24(1/3) + 22(1/3) = 24.42\%$$

$$\sigma_p^2 = (30)^2 (1/3)^2 + (26)^2 (1/3)^2 + (24)^2 (1/3)^2 + 2(1/3)(1/3)$$

$$(-0.5)(30)((26) + 2(1/3)(1/3)(0.4)(26)(24) + 2(1/3)(1/3)(0.6)(30)(24)$$

$$= 100 + 75.11 + 64 - 86.67 + 55.47 + 96 = 303.91$$

$$\sigma_p = \sqrt{303.91} = 17.43\%$$

$$4. \quad \beta_j = \frac{\sigma_j \sigma_m \text{Cor}_{jm}}{\sigma_m^2} = \frac{15 \times 10 \times 0.63}{10^2} = \frac{94.5}{100} = 0.945$$

5. The expected return of security I will be:

$$E(R_j) = R_f + (R_m - R_f) \beta_j = 10\% + (18\% - 10\%) 1.35 = 10\% + 10.8\% = 20.8\%$$

6. (a) it depends on your preference and risk-taking attitude.
 (b) You can achieve diversification gains if you invest in both.
 (c) The slopes of the capital market line for two funds are: aggressive fund = $(16 - 10)/20 = 0.30$; and conservative fund: $(13-10)/15=0.20$. Aggressive fund is preferable.
 (d) You would receive benefits of diversification if you invest in both funds and also lend and borrow.
7. (a) P has lower return and higher risk than Q. However, investing in both will yield diversification advantage.
 (b) (i) $r_p = 22 \times 0.7 + 24 \times 0.3 = 22.6\%$
 (ii) $\sigma_p^2 = 40^2 \times 0.7^2 + 38^2 \times 0.3^2 + 2 \times 0.7 \times 0.3 \times 0.72 \times 40 \times 38 = 1374$

$$\sigma_p = \sqrt{\sigma_p^2} = \sqrt{1374} = 37\%$$

 (c) The risk-free rate will be the same for P and Q. Their rates of return are given as follows:

$$R_p = 22 = r_f + (r_m - r_f) 0.86$$

$$R_q = 24 = r_f + (r_m - r_f) 1.24$$

$$R_p - r_q = -2 = (r_m - r_f)(-0.38)$$

$$R_m - r_f = -2 / -0.38 = 5.26\%$$

$$R_p = 22 = r_f + (5.26) 0.86$$

$$R_f = 17.5\%$$

$$R_q = 24 = r_f + (5.26) 1.24$$

$$R_f = 17.5\%$$

$$R_m - 17.5 = 5.26$$

$$R_m = 22.76\%$$

 (d) $\beta_{pq} = \beta_p \times w_p + \beta_q \times w_q = 0.86 \times 0.7 + 1.24 \times 0.3 = 0.974$

8.

Year	Return (%)				
	S	M	S ²	M ²	S ^M
2001	18	15	324	225	270
2002	9	7	81	49	63
2003	20	16	400	256	320
2004	-10	-13	100	169	130
2005	5	4	25	16	20
2006	12	7	144	49	84
Sum	54	36	1,074	764	887
Average	9	6			

$$(a) (i) \quad \text{Cov}_{SM} = \frac{1}{N} \sum_{t=1}^n (r_{St} - \bar{r}_S)(r_{Mt} - \bar{r}_M)$$

$$= \frac{1}{6} [(18-9)(15-6) + (9-9)(7-6) + (20-9)(16-6) + (-10-9)(-13-6) + (5-9)(4-6) + (12-9)(7-6)]$$

$$= \frac{1}{6}[563] = 93.83$$

$$\begin{aligned} \text{(ii) } \text{Cor}_{SM} &= \frac{N(\sum SM) - (\sum S)(\sum M)}{\left\{ [N\sum S^2 - (\sum S)^2] [N\sum M^2 - (\sum M)^2] \right\}^{1/2}} \\ &= \frac{6(887) - (54)(36)}{\left\{ [6(1074) - (54)^2] [6(764) - (36)^2] \right\}^{1/2}} \\ &= \frac{5,322 - 1,944}{[(6,444 - 2,916)(4,584 - 1,296)]^{1/2}} \\ &= \frac{3,378}{[(3,528)(3,288)]^{1/2}} = \frac{3,378}{3,406} = 0.99 \end{aligned}$$

$$\begin{aligned} \text{(b) } \text{Beta} &= \frac{N\sum SM - (\sum S)(\sum M)}{N\sum M^2 - (\sum M)^2} \\ &= \frac{6(887) - (54)(36)}{6(764) - (36)^2} = \frac{5,322 - 1,944}{4,584 - 1,296} = \frac{3,378}{3,288} = 1.03 \end{aligned}$$

$$\begin{aligned} \text{(c) } \text{Var}(rs) &= \text{Total risk} \\ &= \text{Var}(\alpha + \beta_S r_M + e) = \text{var}(\beta_S r_M) + \text{var}(e) \quad [\ominus \text{var}(\alpha) = 0] \\ &= \beta_S^2 \text{var}(r_M) + \text{var}(e) = \text{systematic} + \text{unsystematic risk} \end{aligned}$$

Var (e) is the residual variance. Thus, Cor_{SM}^2 is systematic risk :

Systematic risk = $(0.99)^2 = 0.98$ or 98% of the variance of S's returns

Unsystematic risk = $1 - 0.98 = 0.02$ or 2% of the variance of S's returns.

9. (i) Price of share of M M. Kusha Ltd. if dividend is not declared:

$$P_0 = \frac{P_1 + D_1}{1 + K_e}$$

Where P_1 = Market Price of a share at the end of Period 1.

P_0 = Prevailing market price of share

K_e = Cost of equity capital

D_1 = Dividend to be received at the end of Period 1.

$$100 = \frac{P_1 + 0}{1.10} = P_1 = \text{Rs.}110$$

- (ii) Price of Share of M. M. Kusha Ltd. if dividend is declared:

$$P_0 = \frac{P_1 + D_1}{1 + K_e} = 100 = \frac{P_1 + 6}{1.10}$$

$$\text{Or } P_1 = 110 - 6 = \text{Rs.}104$$

- (iii) Number of new shares to be issued.

$$\Delta n = \frac{I - (E - nD_1)}{P_1}$$

Where Δn = Change in number of shares outstanding during the period.

I = Total investment requirement

E = Earning of the firm during the period.

nD_1 = Total Dividend paid

$(E - nD_1)$ = Retained earnings

By substituting the figures we get

$$\begin{aligned}\Delta n &= \frac{20,00,000 - (10,00,000 - 6,00,000)}{104} \\ &= \frac{16,00,000}{104} = 15,385 \text{ shares.}\end{aligned}$$

(iv) The Modigliani-Miller Model is unrealistic regarding valuation of shares. The following practical problems are worth considering:

- (a) Tax rate difference between ordinary income and capital gains.
- (b) The presence of transaction cost and floatation cost.
- (c) Investors preference for current income, because the future income is more uncertain.

10. (i) (a) Price of share when dividend is not declared.

$$P_0 = \frac{D_1 + P_1}{(1 + K_e)}$$

$$\text{Rs. } 100 = \frac{0 + P_1}{1 + 0.1} \text{ or } P_1 = \text{Rs. } 110$$

$$K_e = \frac{1}{P/E \text{ ratio}}$$

$$= \frac{1}{10} \times 100 = 10\%$$

(b) When dividend is declared

$$\text{Rs. } 100 = \frac{\text{Rs. } 8 + P_1}{1.10}$$

$$\text{Rs. } 110 = \text{Rs. } 8 + P_1 \text{ or } P_1 = \text{Rs. } 102$$

(ii) Amount required for new financing

$$NP_1 = I - (Y - ND_1)$$

Where I = Total Investment requirement

Y = Net income of the firm

ND_1 = Total Dividend paid

By substituting the figures, we get

$$\begin{aligned}102 N &= \text{Rs. } 10,00,000 - (\text{Rs. } 5,00,000 - \text{Rs. } 4,00,000) \\ &= \text{Rs. } 9,00,000\end{aligned}$$

$$\text{Net Shares (N)} = \frac{\text{Rs. } 9,00,000}{102} = 8824 \text{ Shares}$$

11. (i) Statement showing computation of Net Present Value of Projects X and Y.

(Rs.'000)					
Year	Project X	Project Y	P.V. factor @ 10%	P.V. Project X	P.V. Project Y
0	(27)	(40)	1.00	(27.00)	(40.00)
1	Nil	10	.91	Nil	9.10
2	5	14	.83	4.15	11.62
3	22	16	.75	16.50	12.00
4	14	17	.68	9.52	11.56
5	14	15	.62	8.68	9.30
Net present value (NPV)				11.85	13.58

The NPV of each project (Project X = 11.85) and Project Y = 13.58) indicates that both the projects give return at a rate higher than the required rate of return of 10%. However, Y has a higher NPV and hence it is preferable to Project X.

(ii) Profitability Index

$$PI = \frac{\text{Present value of future cash flows}}{\text{Initial outlay}}$$

$$\text{Project X} = \frac{38.85}{27.00} \times 100 = 144\%$$

$$\text{Project Y} = \frac{53.58}{40.00} \times 100 = 134\%$$

Profitability Index is useful where the projects are mutually exclusive. In the present case, it shows that Project X is better than Project Y.

(iii) Discounted payback period

(Rs.'000)		
Discounted Cash flows		
Year	Project X	Project Y
1	Nil	9.10
2	4.15	11.62
3	16.50	12.00
Total recovery in 3 years	20.65	32.72

Proportionate recovery period in the 4th year

$$= \frac{6.35}{9.52} = .67$$

$$\frac{7.28}{11.56} = .63$$

Total payback period 3.67 years 3.63 years

The discounted payback period method takes into consideration the time value of money by discounting the cash inflows. In the present case the difference between the discounted payback period of the two projects is negligible. Hence, according to this method, both the projects can be ranked at par. However, recovery in the case of project Y is earlier than project X. Moreover, Machine Y is having more production capacity. Hence, management can give preference to Machine Y.

12. Calculation of present value of dividend stream:

(i) @ 12% p.a. in the first 2 years

$$= [1.50(1.12) \times 0.86] + [1.50(1.12)^2 \times 0.74]$$

$$= 1.45 + 1.39 = 2.84$$

(ii) @ 10% in the next 2 years

$$= [1.88(1.1) \times 0.64] + [1.88(1.1)^2 \times 0.55]$$

$$= 1.33 + 1.25 = 2.58$$

(iii) Market value of equity share at the end of 4th year applying the constant dividend growth model:

$$P_4 = \frac{D_5}{K_e - g}$$

Where

 P_4 = Market price of Equity Share at the end of 4th year. D_5 = Dividend in 5th year g = Growth rate K_e = Required rate of returnNow D_5 = $D_4 (1 + g)$

$$\therefore D_5 = \text{Rs.}2.28 (1 + 0.08) = \text{Rs.}2.46$$

$$P_4 = \frac{\text{Rs.}2.46}{0.16 - 0.08} = \text{Rs.}30.75$$

Present market value of P_4

$$= \text{Rs.}30.75 \times 0.55 = \text{Rs.}16.91$$

The intrinsic value of Equity Share of Z Ltd. Would be (i) + (ii) (iii)

$$= \text{Rs.}2.84 + \text{Rs.}2.58 + \text{Rs.}16.91 = \text{Rs.}22.33$$

13. Expected rate of return on Equity Share of Target Ltd.

$$E(R_p) = R_f + \beta_i [E(R_m) - R_f]$$

$$= 10 + 1.4(15\% - 10\%) = 17\%$$

Computation of share price based on Dividend growth model.

$$\text{Dividend growth model} = \frac{D_1}{P_0} + g$$

Where D_1 = Dividend per share in year 1 g = Growth rate of dividends P_0 = Market price/share in year 0.

$$0.17 = \frac{4(1.08)}{P_0} + 0.08$$

$$0.09 = \frac{4(1.08)}{P_0}$$

$$P_0 = \frac{4(1.08)}{0.9} = \text{Rs.48}$$

The target Ltd.'s equity share is valued at an equilibrium price of Rs.48 and its present market value is at Rs.36. Hence it is recommended to purchase at market price.

14. (a) Statement showing Expected Value of Sales volume p.a.

Sales Volume (Units)	Probability	Expected Sales Value (Units)
2,000	0.10	200
6,000	0.25	1,500
8,000	0.40	3,200
10,000	0.15	1,500
14,000	0.10	1,400
		7,800

Estimated value of contribution will be Rs. 31,200 [i.e. 7,800X(10-6)] All additional fixed costs are cash items (As given in the question). Estimated value of additional cash profits each year will therefore be Rs. 11,200.

Year	Cash Flows Rs.	Discount Factor 10%	PV of Cash Flows Rs.
0	(40,000)	1.000	(40,000)
1.6	11,200	4.355	48,776
6	3,000	0.5645	1,694
Expected Value of NPV			10470

- (b) In order to break-even, the NPV must be Zero. Assuming that the cost of the equipment and its residual value are known with certainty, we can calculate the minimum required PV of annual cash profits as given below

	Present Value (Rs.)
PV of capital out lay	40,000
Less: PV of residual value	<u>1,694</u>
PV of annual cash profit required for NPV of 0	38,306
Discount Factor of Re 1 p.a. for 6 years @ 10%	4,355
Annual cash profit required (38,306/4.355)	8,796
Add: Annual (cash) Fixed costs	20,000
	28,796
Annual contribution required for NPV =0	28,796
Contribution per unit	Rs.4
Hence, annual sales required to break-even = 28,796/4=7,199 units	
Say 7,200 Units.	

15 Kriss Ltd. Statement of Profits

Particulars		Pessimistic 8,000 units	Most likely 10,000 units	Optimistic 15,000 units
Selling price per unit		19	20	20
Sales	(a)	1,52,000	2,00,000	3,00,000
Variable cost per unit		12.50	12	11
Variable cost	(b)	1,00,000	1,20,000	1,65,000
Contribution	(a)-(b)	52,000	80,000	1,35,000
Fixed costs	(d)	60,000	50,000	48,000
Profit (Loss)	(c)-(d)	(8,000)	30,000	87,000

Statement showing Expected Value of Profit			
Estimate	Profit (Loss) Rs.	Probability	Expected Value Rs.
Pessimistic	(8,000)	0.2	(1,600)
Most likely	30,000	0.7	21,000
Optimistic	87,000	0.1	<u>8,700</u>
Expected Value of Profit			28,100

16. (i) Basic Calculation

Fixed Cost	30,000
Loss	<u>(10,000)</u>
	20,000

Contribution per unit	=Rs. 20,000/Rs. 10,000	Rs. 2
Break-even point	=Rs. 30,000/Rs.2	15,000 Units

Any sales below break-even level i.e. 15,000 units will result in loss.

Probability that the Company will continue to make losses:

Demand (Units)	Probability
10,000	0.10
12,000	0.15
14,000	0.20
	0.45

The probability of the company to continue making losses is therefore 0.45.

(ii) The probability that the company will make a profit of at least Rs. 6,000:

In order to make a profit of Rs. 6,000, the required contribution is

$$= \text{Rs. } 30,000 + \text{Rs. } 6,000 = \text{Rs. } 36,000$$

Units of product to be sold = Rs. 36,000/Rs. 2 = 18,000 units.

The probability of selling 18,000 units is 0.25 Hence, the probability of making a profit is also 0.25.

17.	Project X			Project Y		
	Probability	Cash flow	EV	Probability	Cash flow	EV
	0.10	12,000	1,200	0.10	8,000	800
	0.20	14,000	28,00	0.25	12,000	3,000
	0.40	16,000	6,400	0.30	16,000	4,800
	0.20	18,000	3,600	0.25	20,000	5,000
	0.10	20,000	<u>2,000</u>	0.10	24,000	2,400
			16,000			16,000

On the basis of EV, one tends to be indifferent. Calculating the Standard Deviation.

0.10 (12-16) ² =	1.6	0.10 (16-8) ² =	6.4
0.20 (14-16) ² =	0.8	0.25 (16-12) ² =	4.0
0.40 (16-16) ² =	00	0.30 (16-16) ² =	0.0
0.20 (18-16) ² =	0.8	0.25 (20-16) ² =	4.0
0.10 (20-16) ² =	<u>1.6</u>	0.10 (24-16) ² =	<u>6.4</u>
	4.8		20.8

$$\sigma = \sqrt{4.8} = 2.19$$

$$\sigma = \sqrt{20.8} = 4.56$$

$$\text{Coefficient of variation} = \frac{\sigma}{\text{EV}} \times 100$$

$$(2.19/16) \times 100 = 13.68\%$$

$$(4.56/16) \times 100 = 28.5\%$$

Project Y is more risky as it is more susceptible to wider degree of variation around the most likely outcome than Project X. Project X should be preferred.

- 18 (a) Firstly of all, random numbers 00-99 are allocated in proportion to the probabilities associated with each of the three variables as given under:

Particulars	Probabilities	Cumulative Probabilities	Random numbers assigned
Selling Price Rs.			
3	0.2	0.2	00-19
4	0.5	0.7	20-69
5	0.3	1.0	70-99
Variable cost (Rs.)			
1	0.3	0.3	00-29
2	0.6	0.9	30-89
3	0.1	1.0	90-99
Sales Volumes (Units)			
2,000	0.3	0.3	00-29
3,000	0.3	0.6	30-59
5,000	0.4	1.0	60-99

Now we can simulate the output of ten trails using the given random numbers in order to find the average profit for the project:

S. No.	Random No.	Selling Price (Rs.)	Random No.	Variable Cost (Rs.)	Random No.	Sales Volume (000 units)
1	81	5	32	2	60	5
2	04	3	46	2	31	3
3	67	4	25	1	24	2
4	10	3	40	2	02	2
5	39	4	68	2	08	2
6	59	4	66	2	90	5
7	12	3	64	2	79	5
8	31	4	86	2	68	5
9	82	5	89	2	25	2
10	11	3	98	3	16	2

Profit=(Selling Price-Variable Cost)X Sales volume –Fixed cost.

The profit in ten simulated trails is calculated as follows:

S. No.	Rs.	Units	Rs.	Profit Rs.
1	(5-2)	X 5,000	- 4,000	11,000
2	(3-2)	X 3,000	- 4,000	(-1,000)
3	(4-1)	X 2,000	- 4,000	2,000
4	(3-2)	X 2,000	- 4,000	(-2,000)
5	(4-2)	X 2,000	- 4,000	0
6	(4-2)	X 5,000	- 4,000	6,000
7	(3-2)	X 5,000	- 4,000	1,000
8	(4-2)	X 5,000	- 4,000	6,000
9	(5-2)	X 2,000	- 4,000	2,000
10	(3-3)	X 2,000	- 4,000	<u>(-4,000)</u>
Total				21,000

Therefore, average profit per trial = $\frac{\text{Rs.21,000}}{10} = \text{Rs.2,100}.$

(b) Cost of bread = 25 paise per piece

Selling price = 49 paise/piece if sold the same day.

= 15 paise if sold at the end of the day:

(i) The expected monetary value (EMV) for optimum level of stocking of 200 pieces of bread daily is given below:

Demand	Probability	Payoff for stocking 200 pieces (Rs.)	Expected Payoff (Rs)
100	0.20	14.00	2.80
150	0.25	31.00	7.75
200	0.30	48.00	14.40
250	0.15	48.00	7.20
300	0.10	48.00	4.80
			EMV = 36.95

- (ii) The EMV will be calculated as below if the demand is known with certainty.

Demand	Probability	Payoff (Rs.)	Expected Payoff (Rs.)
100	0.20	24.00	4.80
150	0.25	36.00	9.00
200	0.30	48.00	14.40
250	0.15	60.00	9.00
300	0.10	72.00	7.20
			EMV = 44.40

∴ Expected value with perfect information = Rs. 44.40

Expected value of perfect information (EVPI)

= Expected value with perfect information – EMV of optimum stock level.

= Rs. 44.40 - Rs. 36.95 = 7.45

So EVPI = Rs. 7.45.

19.

A Limited

Existing Production

	Product			Total
	S	T	Y	
Selling price (Rs.)	30	40	20	
Variable cost (Rs.)	Rs. 15	20	12	
Contribution per	-	-	-	
Unit (Rs.)	15	20	8	
P/V Ratio				
$\left(\frac{\text{Contribution}}{\text{Sales}} \times 100 \right)$	50%	50%	40%	
Sales mix	35%	35%	30%	
Contribution per rupee of sales				

(P/V ratio X Sales mix)	$17\frac{1}{2}\%$	$17\frac{1}{2}\%$	12%	47%
-------------------------	-------------------	-------------------	-----	-----

Total Sales Rs. 6,00,000.

Total contribution (6,00,000 X .47) Rs. 2,82,000

Fixed costs Rs. 1,80,000

Profit at present production Rs. 1,02,000

Break-even point $\frac{\text{Fixed Cost}}{\text{P/V ratio}} = \frac{1,80,000}{0.47} = \text{Rs. } 3,83,000$

Proposed Production

	Product			Total
	S	T	M	
Sales price (Rs.)	30	40	30	
Variable cost (Rs.)	15	20	15	

	-	-	-	
Contribution per Unit (Rs.)	15	20	15	
	-	-	-	
P/V Ratio	50%	50%	50%	
Sales mix	50%	25%	25%	
Contribution per rupee of Sale (P/V ratio X Sales mix)	25%	$12\frac{1}{2}\%$	$12\frac{1}{2}\%$	50%
Total Sales			Rs. 6,40,000	
Total contribution (6,40,000X.50)			3,20,000	
Less: Fixed costs			1,80,000	
Profit			1,40,000	
Break-even point :	$\frac{\text{FixedCost}}{\text{P / VRatio}} : \frac{1,80,000}{0.50} = \text{Rs.3,60,000.}$			

The proposal can be accepted because after replacement of y with product M: (i) the break even point of the company is reached at a lower level of the total sales as compared to the present situation, and (ii) also there is an increase of profit by Rs. 38,000.

20. Computation of present value of cash outflows:

	Rs.	P.V. of Cash outflows Rs.
Cash outlay 0 year:		
Cost of equipment	2,50,000	2,50,000
Current assets	50,000	50,000
Cash outlay at the end of 5 th year	60,000x0.402	24,120
Total cash outflows (Present value)		3,24,120

Computation of present value of cash inflows

Year	Cash inflow (before tax)	Depreciation	Profit before tax	Tax @ 40%	Cash inflow after tax	PVs of Re.1 @ 20%	P.V. of cash inflow
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
0							
1	1,00,000	40,000	60,000	24,000	76,000	.833	63,308
2	1,00,000	36,000	64,000	25,600	74,400	.694	51,634
3	1,00,000	32,000	68,000	27,200	72,800	.579	42,151
4	1,00,000	28,000	72,000	28,800	71,200	.482	34,318
5	1,00,000	24,000	76,000	30,400	69,600	.402	27,979
6	1,00,000	20,000	60,000	24,000	76,000	.335	25,460
		+20,000					
7	1,00,000	16,000	68,000	27,200	72,800	.279	20,311

		+16,000					
8	1,00,000	12,000	76,000	30,400	69,600	233	16,217
		+12,000					
9	1,00,000	8,000	84,000	33,600	66,400	.194	12,882
		+8,000					
10	1,00,000	4,000	92,000	36,800	63,200	.162	10,238
		+4,000					
Recovery of current assets					50,000	.162	8,100
Salvage value					30,000	.162	4,860
							3,17,458
							=====

Net present value (NPV):

Present value of cash inflows Rs.3,17,458

Present value of cash outflows -Rs.3,24,120

Net present value (NPV) -Rs.6,662

Since NPV is negative @ 20% required rate of return, project should not be accepted.

21. (a) The finance functions are divided into three major decisions, viz., investment, financing and dividend decisions. It is correct to say that these decisions are inter-related because the underlying objective of these three decisions is the same, i.e., maximization of shareholders' wealth. Since investment, financing and dividend decisions are all interrelated, one has to consider the joint impact of these decisions on the market price of the company's shares and these decisions should also be solved jointly. The decision to invest in a new project needs the financing for the investment. The financing decision, in turn, is influenced by and influences dividend decision because retained earnings used in internal financing deprive shareholders of their dividends. An efficient financial management can ensure optimal joint decisions. This is possible by evaluating each decision in relation to its effect on the shareholders' wealth.

The above three decisions are briefly examined below in the light of their inter-relationship and to see how they can help in maximizing the shareholders' wealth i.e. market price of the company's shares:

Investment decision: The investment of long term funds is made after a careful assessment of the various projects through capital budgeting and uncertainty analysis. However, only that investment proposal is to be accepted which is expected to yield atleast so much return as is adequate to meet its cost of financing. Asset management policies are to be laid down regarding various items of current assets. For example, the credit policy will determine the amount of sundry debtors which in turn will be influenced by the availability of finance and cost thereof. In a nutshell, all these have an influence on the profitability of the company and ultimately on its wealth.

Financing decision: Funds can be raised from various sources. Each source of funds involves different issues. The finance manager has to maintain a proper balance between long-term and short-term funds depending on the nature of investment requirements. He has to raise sufficient long-term funds in order to finance fixed assets, other long-term investments and to provide for the needs of working capital. Within the total volume of long-term funds, he has to ensure a proper mix of loan funds and owners' funds. The optimum financing mix will increase return to equity shareholders and thus maximize their wealth.

Dividend decision: The finance manager is also concerned with the decision to pay or declare dividend. He assist the top management in deciding as to what portion of the profit should be paid to the shareholders by way of dividends and what portion should be retained in the business. This involves a large number of considerations. An optimal dividend pay-out ratio maixmises shareholders' wealth. Economically speaking the amount to be retained or to be paid to shareholders should depend on whether the company or the shareholders can make a more profitable use of the funds. However, in practice, a large number of considerations like the trend of earnings, the trend of share market prices, the requirement of funds for future growth, the cash flow situation, the tax position of shareholders, etc. are to be kept in mind with an ultimate eye on the wealth maximization objective.

The above discussion makes it clear that investment, financing and dividend decisions are interrelated and are to be solved jointly keeping in view their joint effect on the shareholders' wealth.

- (b) An alternative which would ensure the highest market price per share should be recommended. This analysis is carried out below:

Estimated Earnings Per Share (EPS) and Market Price Per Share Under the Various Financing Plans.

	At Present	Equity Shares Plan	Preference Share Plan	Debentures Plan
	Rs.	Rs.	Rs.	Rs.
Earnings before interest and tax (EBIT) @ 12%	6,00,000	9,00,000	9,00,000	9,00,000
Less: Interest – Old	56,000	56,000	56,000	56,000
New	-	-	-	2,00,000
Profit before tax (PBT)	5,44,000	8,44,000	8,44,000	6,44,000
Less: Tax @ 50%	2,72,000	4,22,000	4,22,000	3,22,000
Profit after tax (PAT)	2,72,000	4,22,000	4,22,000	3,22,000
Less: Preference dividend				
- Old	1,08,000	1,08,000	1,08,000	1,08,000
New	-	-	2,50,000	-
Profit for equity shares	1,64,000	3,14,000	64,000	2,14,000
No. of equity shares	20,000	40,000	20,000	20,000
EPS (Rs.)	8.20	7.85	3.20	10.70
P.E. Ratio	-	21.4	17	15.7
Market price per share (Rs.) (EPS x P.E. Ratio)		167.99	54.40	167.99

Recommendation: The objective of financial management is to maximize the wealth of the owners, which in the context of companies means maximizing the market price of the company's equity shares. The above analysis shows that the market price per share is the same in the case of equity financing and debenture financing. As such any of these two financing alternatives viz., equity financing or debenture financing can be adopted. However, EPS is higher in the case of debenture financing without undue financial risk. Therefore, debenture financing alternative is recommended.

22. CPM/ PERT: CPM and PERT are techniques of project management useful in the basic managerial functions of planning, scheduling and control. CPM stands for 'Critical Path Method' and PERT is the abbreviation of "Programme Evaluation & Review Technique". These days the projects undertaken by business houses are very large and take a number of years before commercial production can start. The technique of CPM and PERT help greatly in completing the

various jobs on schedule. They minimize production delays, interruptions and conflicts. These techniques are very helpful in co-ordinating various jobs of the total project and thereby expedite and achieve completion of project on time.

The following steps are required for using CPM and PERT for planning and scheduling.

- (1) Each project consists of several independent jobs or activities. All these jobs or activities must be separately listed. It is important to identify and distinguish the various activities for the completion of the project and list them separately.
- (2) Once the list of various activities is ready the order of precedence for these jobs has to be determined. We must see which jobs have to be completed before others can be started. Obviously, certain jobs will have to be done first.

Many jobs may be done simultaneously and certain jobs will be dependent upon the successful completion of the earlier jobs. All these relationships between the various jobs have to be clearly laid down.

- (3) The next step is to draw a picture or a graph which portrays each of these job and shows the predecessor and successor relations among them. It shows which job comes first and which next. It also shows the time required for completion of various jobs. This is known as the project graph or the arrow diagram.

23 Working Notes:

- (i) Average Maintainable profits

	2005	2006	2007
	Rs.	Rs.	Rs
Reported after tax profits Less Adjustment for sale of machine credited to profit & Loss A/c (Net of tax)	3,80,000	4,20,000	5,00,000
	10,000		
	3,70,000		
Less Dividend on non trade investments net of tax			
	<u>5,000</u>	<u>5,000</u>	<u>5,000</u>
	3,65,000	4,15,000	4,95,000
Add back depreciation of Machinery sold net of tax(half of Rs. 2,000, Rs. 1,800 & Rs. 1,620)	<u>1,000</u>	<u>900</u>	<u>810</u>
	<u>3,66,000</u>	<u>4,15,900</u>	<u>4,95,810</u>

Average profits $(3,66,000 + 4,15,900 + 4,95,810) / 3 = \text{Rs. } 4,25,903$

Say Rs. 4,25, 900

(ii) Capital employed:	Rs.
Land & Building	6,00,000
Machinery	5,20,000
Motor car	25,000
Furniture	25,000
Stock	7,25,000
Debtors	2,00,000
Cash	<u>1,05,000</u>
	22,00,000
Less Creditors	<u>5,00,000</u>
	17,00,000

(iii) Super Profits	
Maintainable profits	
Working note (i)	4,25,900
Normal profits 20% on Rs. 17,00,000	
	<u>3,40,000</u>
Super profits	85,900
(iv) Goodwill at 3 Years Purchase	2,57,700
Valuation of Shares on Net assets basis	
Net assets:	
	Rs.
Capital employed vide	17,00,000
Working note (ii)	
Add Non trade Investments	60,000
Add Goodwill	2,57,700
Add Notional Calls on shares	<u>1,00,000</u>
	<u>21,17,700</u>
No. of shares	10,000
Value of fully paid shares	211.77
Value of partly paid shares	191.77
(211.57-20)	

24. Computation of net present value of machine

	Cash flow Rs.	P.V. factor @ 10%	P.V. of cash outflows
(a) Cash Outflows at the beginning			
Cost of machine	7,50,000		
Add: Additional investment in working capital	<u>50,000</u>		
Total present value of cash outflows (a)	8,00,000	1.00	8,00,000
(b) Cash Inflows			
(i) Annual cash inflows for 10 years: Savings before tax	1,80,000		
Less: Income tax (50%)	<u>90,000</u>		
	90,000		
Add: Depreciation	<u>70,000</u>		
	1,60,000	6.14	9,82,400
(ii) Cash inflows at the end of Year 10:			
Salvage value	50,000		
Release of investment from working capital	<u>50,000</u>		
	1,00,000	0.39	39,000
Total present value cash inflows (b)			<u>10,21,400</u>
Net present value (NPV). (b)-(a)			2,21,400

The investment in new machine will generate a new present value of Rs.2,21,400, the Company should, therefore, make the investment.

Working note:

$$\text{Annual Depreciation} = \frac{\text{Cost} - \text{Salvage value}}{\text{Estimated life}}$$

$$\frac{\text{Rs.7,50,000} - \text{Rs.50,000}}{10} = \text{Rs.70,000}$$

25. (a) Efficiency in operation at constant prices.

	2004		2005		2006	
	Rs.	%	Rs.	%	Rs.	%
Sales	50,00,000	100	60,00,000	100	66,00,000	100
Material	20,00,000	40	24,00,000	40.00	25,30,000	38.33
Wages	20,00,000	40	20,00,000	33.33	20,00,000	30.30
Factory expenses	6,00,000	12	7,00,000	11.67	7,50,000	11.38
Administrative Exp.	2,50,000	5	3,20,000	5.33	3,50,000	5.30
Selling Expenses	<u>50,000</u>	<u>1</u>	<u>2,00,000</u>	<u>3.33</u>	<u>2,50,000</u>	<u>3.79</u>
	49,00,000	98	56,20,000	93.66	58,80,000	89.10
Profit	<u>1,00,000</u>	<u>2</u>	<u>3,80,000</u>	<u>6.34</u>	<u>7,20,000</u>	<u>10.90</u>
	<u>50,00,000</u>	<u>100</u>	<u>60,00,000</u>	<u>100.00</u>	<u>66,00,000</u>	<u>100.00</u>

(b) Effect of Price changes:

	2005	2006
Sales	<u>3,00,000</u>	<u>3,30,000</u>
Materials	2,40,000	5,06,000
Wages	<u>4,00,000</u>	<u>8,80,000</u>
	<u>6,40,000</u>	<u>13,86,000</u>
Loss due to increases in cost	3,40,000	10,56,000
Interest (Extra payment)	<u>60,000</u>	<u>1,00,000</u>
Total loss	4,00,000	11,56,000
Profit as per (a) above	<u>3,80,000</u>	<u>7,20,000</u>
Loss as reported	<u>20,000</u>	<u>4,36,000</u>

- (c) Comments: It is evident from the above analysis that it is the pricing policy of the company that has caused it to suffer, in 2005 and 2006. In 2006, the company has suffered a huge loss of Rs.4,36,000. The sale price over 2006 has increased by 5% only, whereas other costs have gone up much more. Since the order book of the Company is full, it indicates that the company is able to use its facilities to the full extent, but this is not enough. The company should also be able to raise its selling price suitably as indicated below, using 2004 as the basis (in term of %)

	2005	2006
Material (40 × 110% & 40 × 120%)	44.00	48.00
Labour (40 × 120% & 40 × 144%)	48.00	57.60
Factory expenses	12.00	12.00

Administrative expenses	5.00	5.00
Selling expenses	<u>1.00</u>	<u>1.00</u>
	110.00	123.60
Profit assumed same amount per unit	<u>2.00</u>	<u>2.00</u>
	112.00	125.60

The above computations show that the company should have raised its selling price in 2005 by 12% and in 2006 by 25.6% above 2004 prices, even ignoring the increase in expenses other than material and labour. A suitable increase on account of these expenses is also called for.

The company resorted to borrowing in 2005 and 2006. there would have been no necessity for this, had the company taken care to revise its selling prices. In fact this is the central point. Fresh borrowing from the bank without a proper upward revision in the selling price is not advisable and the additional funds will also be lost and put the company in an even greater difficulty.

The company is to be complimented, however on the efficiency in the use of materials in 2006 but it should watch the other expenses, there is a tendency for them to increase. It has a big advantage that the labour is fixed and has done the additional work without an increase in the number of men employed. The company's only weak point appears to be its pricing policy.

Working Notes:

Note 2005 and 2006 figures in 2004 prices:

	2005	Rs.	2006	Rs.
Sales	$63,00,000 \times \frac{100}{105}$	60,00,000	$69,30,000 \times \frac{100}{105}$	66,00,000
Materials	$26,40,000 \times \frac{100}{110}$	24,00,000	$30,36,000 \times \frac{100}{120}$	25,30,000
Wages	$24,00,000 \times \frac{100}{120}$	20,00,000	$28,80,000 \times \frac{100}{144}$	20,00,000

The company has to revise upward its selling price by adopting a suitable marketing strategy and convince the bankers for granting overdraft facilities. This will enable the company to partly settle the claim to creditors and workout a phased plan so that repayment of their dues and uninterrupted supply of essential inputs is restored.

26.

	Rs.
Sales per week	60,000
Contribution per week	24,000
[Variable costs	36,000
Total Variable Cost	36,000
Less: Wages 10 p. on 48,000	4,800
Variable cost excluding labour	31,200
Units produced	48,000
Variable cost per unit excluding labour	Re.0.65
Present production	48,000 units
No. of employees	160
Output per employee (48,000/160)	300 units

Future production expected:	Units
Production per employee at existing	
Productivity	300
Add: Increase 60% of 300 units	180
	480
Total production for 120 employees 480x 120 = 57,600 units	
Expected selling price:	(Rs.)
Present price (Rs.60,000/48,000)	1.25
Less: Reduction in price 4%	0.05
Expected selling price	1.20
Expected piece rate:	(Re.)
Present rate	0.10
Add: Increase in rate 30%	
(1% for every 2% increase in output i.e., 60/2 × 1 = 30)	0.03
	0.13
Profitability	(Rs.)
Capital cost	16,000
Output per week	57,600 Units
Sales (57,600 × Rs.1.20)	69,120
Less: Variable cost:	
Others (57,600 × Re.0.65) = 37,440	
Wages (57,600 × Re.0.13) = <u>7,488</u>	<u>44,928</u>
Expected contribution	24,192
Present contribution	<u>24,000</u>
Increase in contribution per week	192

Payback period: Rs.16,000/192 = 83.33 weeks.

The above analysis shows that the project is worthwhile undertaking provided there is no increase in fixed cost.

27. (a) Cost of Right Shares: Right shares for all practical purposes are at par with the shares issued to new shareholders. The Companies Act 1956 (Section 81) requires that when a company decides to issue further equity capital, it should first offer the new equity shares to the existing shareholders on a prorata basis. Thus existing shareholders have a pre-emptive right in the allotment of additional shares. The cost of right shares would, therefore, be the same as the cost of new equity capital issued to the public directly. The cost of new equity capital is the minimum rate of return required by the shareholders to keep the market value of the shares unchanged. Since the management of the company has to strive to maximise the welfare of the shareholders, it has to ensure that minimum return on the enlarged capital which it was giving before the issue of new shares. If a company is not able to do so, the earnings per shares may be reduced and consequently the market price of shares may also come down. A company should, therefore, not issue further equity capital if it results in the deduction of wealth of shareholders. The existing value of shares can be kept intact only when the company is able to earn and pay on the additional shares the same return as it has been paying on the existing shares. The market value of shares depends on dividend and growth expected by the shareholders. Thus the cost of right shares is also the required rate of return. It may be measured as follows:

$$K_s = \frac{D_1}{P_0} + g$$

Where K_s = Cost of Right Shares

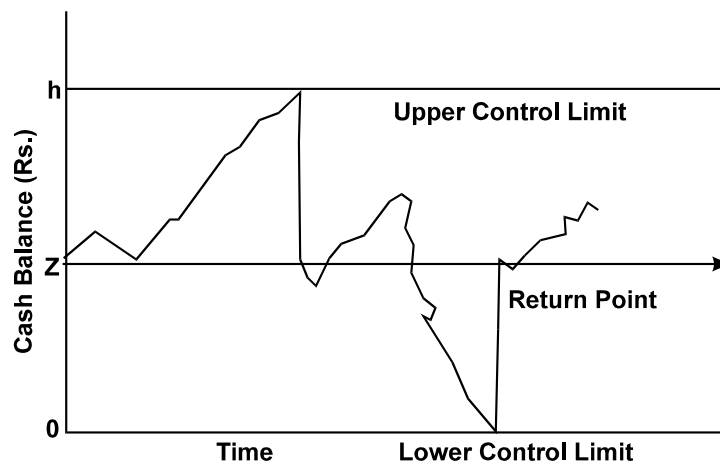
D_1 = Dividend Yield

P_0 = Market price of the share

G = Growth rate in dividend.

- (b) Miller-Orr Model. One very important objective of cash management is to determine optimal cash balance, i.e. to ensure that cash does not remain idle unnecessarily and, at the same, the firm is not confronted with a situation of cash shortage. Various cash management models attempt to achieve this objective of cash management. Merton Miller and Danial Orr's management model helps to determine the optimal level of cash balance when the demand for cash is stockastic and not known in advance. In these situations, the EOQ model is not applicable. When canages in cash balances occur randomly, the application of control theory serves a useful purpose. The Miller-Orr model is one of such control-limit are set for cash balances. These limits may consists of h as 'upper limit', z as the 'return point' and zero as the 'lower limit'. When cash balance reaches the upper limit, a transfer of cash equal to $h-z$ is effected to marketable securities; when it touches the lower limit a transfer from marketable securities to chash is made. During the period when cash balance stays between these high and low limits, no transaction between cash and marketable securities is made.

The high and low limits of cash balances are set on the basis of fixed costs associated with securities transaction, the opportunity cost of holding cash and the degree or likely fluctuation in cash balances. These limits satisfy the demand for cash at the lowest possible total cost. The following diagram illustrate the model:



MILLER-ORR CASH MANAGEMENT MODEL

- (c) Risk-Premium trade-off: There are many kinds of risks which a business enterprise has to protect itself against. It is the duty of the insurance manager to minimize these risks and to take adequate insurance policies against the risks which cannot be avoided. For example, very strict safeguards and extremely efficient fire fighting service arrangements may obviate the necessity of insurance against fire. But this is rarely the case. An insurance decision is primarily a trade-off between the nature and quantum of risks that exists for an undertaking and the amount of it may be beneficial not to insure at all with outside insurers. This is particularly true of all large organizations who may have assets of such huge values that paying insurance premiums to outside insurers may be much more expensive than the possible loss that may reasonably occur annually on account of fire, theft, or accident, etc, A typical example in this regard is that of the railways. The monitory value of the rolling stock and other assets of the railways is so huge that they do not need to insure with outsiders. Instead, they can have self insurance; every year they can create a provision for

insurance by debiting the revenue account. Thus, an insurance fund can be created out of which all losses can be met. This is exactly the function of an insurance company also, which collects premiums from many parties and thereby distributes the risk over a large number of units. If the same risks can be distributed within an organization itself there is no point taking an insurance policy with an outsider. Therefore, in larger businesses, the decision to create an insurance fund or to insure with an outside party is a very vital one. This decision should take into account the relative advantages and disadvantages of taking out policies from outsiders or creating an insurance fund.

- (d) **Random Walks Theory:** Many investment managers and stock analysts believe that the stock market prices can never be predicted because they are not a result of any underlying factors but are more statistical ups and downs. This hypothesis is known as Random Walk Hypothesis which states that the behavior of stock market prices is unpredictable and that there is no relationship between the present prices of the shares and their future prices. Proponents of this hypothesis argue that stock markets prices are independent. A British Statistician, M.G. Kendall, Found that changes in security prices behave nearly as if they are generated by a suitably designed roulette wheel for which each outcome is statistically independent of the past history. In other words, the fact that there are peaks and troughs in the stock exchange prices is a mere statistical happening-successive peaks and troughs are unconnected. In the layman's language it may be said that the prices on the stock exchange behave exactly the way a drunk would behave while walking in a blind lane, i.e. up and down, with an unsteady gait going in any direction he likes, bending on one side once and on the other side the second time.
- (e) **Profitability Index.:** In capital budgeting, there are cases when we have to compare or rank a number of proposals each involving different amount of cash flows. One of the methods of comparing/ranking such proposals is to work out what is known as profitability index (PI). It is also called benefit-cost ratio. It may be calculated as follows:-

$$PI = \frac{\text{Present value of net cash inflows}}{\text{initial cash outlay}}$$

Suppose, for example, a company is considering two projects, A and B. The present value of net cash flows and initial outlay are as follows:

	Project A	Project B
	Rs.	Rs.
Present value of net cash inflows	36,000	34,000
Initial cash outlay	30,000	29,000

In the case of the above example, Project A has profitability index of 1.20 whereas Project B's ratio is 1.17 calculated as under:

$$A \frac{\text{Rs. } 36,000}{\text{Rs. } 30,000} = 1.20$$

$$B \frac{\text{Rs. } 34,000}{\text{Rs. } 29,000} = 1.17$$

It may be noted that as long as the profitability index is equal to or greater than 1.00, the project is acceptable.

Alternatively profitability index may also be calculated as under:

$$PI = \frac{\text{Sum of discounted cash inflows}}{\text{Sum of discounted cash outflows.}}$$

28. Walter's Formula:

$$V_c = \frac{D + \frac{R_a}{R_c}(E - D)}{R_c}$$

Where, V_c = Market value per share

R_c = Market Capitalisation Rate

R_a = Productivity of Retained Earnings.

E = Earning per share

D = Dividend per share.

Market value of the company's share under different payout options:

(i) If productivity of retained Earnings is 15%	(ii) If productivity of retained Earning is 10%	(iii) If productivity of retained earning is 5%
(a) 25% Payout	(a) 25% Payout	(a) 25% Payout
$V_c = \frac{2 + \frac{.15}{.10} \times (8 - 2)}{.10}$ $= \frac{2 + 1.5 \times 6}{.10} = \frac{11}{.10}$ =Rs. 110	$V_c = \frac{2 + \frac{.10}{.10} (8 - 2)}{.10}$ $= \frac{2 + 1 \times 6}{.10} = \frac{8}{.10}$ = Rs.80	$V_c = \frac{2 + \frac{.05}{.10} (8 - 2)}{.10}$ $= \frac{2 + .5 \times 6}{.10} = \frac{5}{.10}$ =Rs.50
(b) 50% Payout	(b) 50% Payout	(b) 50% Payout
$V_c = \frac{4 + \frac{.15}{.10} (8 - 4)}{.10}$ $= \frac{4 + 1.5 \times 4}{.10} = \frac{10}{.10}$ =Rs. 100	$V_c = \frac{4 + \frac{.10}{.10} (8 - 4)}{.10}$ $= \frac{4 + 1 \times 4}{.10} = \frac{8}{.10}$ =Rs. 80	$V_c = \frac{4 + \frac{.05}{.10} (8 - 4)}{.10}$ $= \frac{4 + .5 \times 4}{.10} = \frac{6}{.10}$ =Rs. 60
(c) 75% Payout	(c) 75% Payout	(c) 75% Payout
$V_c = \frac{6 + \frac{.15}{.10} \times (8 - 6)}{.10}$ $= \frac{6 + 1.5 \times 2}{.10} = \frac{9}{.10}$ =Rs. 90	$V_c = \frac{6 + \frac{.10}{.10} (8 - 6)}{.10}$ $= \frac{6 + 1 \times 2}{.10} = \frac{8}{.10}$ =Rs. 80	$V_c = \frac{6 + \frac{.05}{.10} (8 - 6)}{.10}$ $= \frac{6 + .5 \times 2}{.10} = \frac{7}{.10}$ = Rs.70

(b) Inferences : The following inferences can be drawn from the exercise in (a) above:

In order to maximize the market value of shares, V_c , the following rules should be followed with regard to dividend policy:

- (i) If the retained earnings earn more than the market rate of capitalization (situation (i) above), keep the payout ratio, low because it will cause increase in the market value of company's share.

- (ii) If the retained earnings earn less than the market rate of capitalization, (situation (iii) above), keep the payout ratio high because the market value of company's share will be high when payout ratio is the highest.
- (iii) If the productivity of retained earnings is equal to the market rate of capitalization (situation (ii) above), the market value of the share, V_c cannot be changed by changing the payout, hence a company can adopt any payout ratio.
29. (a) An alternative which ensures the highest market price per share should be considered the best. This analysis is carried out below:

Estimated earnings per share (EPS) and Market price per share under the various financing Plans

	At present	Equity shares Plan	Preference share Plan	Debenture plan
Earning before interest and taxes	Rs.	Rs.	Rs.	Rs.
(EBIT) @ 12%	12,00,000	15,00,000	15,00,000	15,00,000
Less Interest				
Old	1,75,000	1,75,000	1,75,000	1,75,000
New	-	-	-	2,00,000
Profit before tax (PBT)	10,25,000	13,25,000	13,25,000	11,25,000
Less Tax @50 %	5,12,500	6,62,500	6,62,500	5,62,500
Profit after tax (PAT)	5,12,500	6,62,500	6,62,500	5,62,500
Less preference dividend				
Old	2,25,000	2,25,000	2,25,000	2,25,000
New	-	-	2,50,000	-
Profit for equity shares	2,87,500	4,37,500	1,87,500	3,37,500
No. of equity shares	40,000	60,000	40,000	40,000
Market price per share (Rs.)		145.80	79.73	135.04

Since the market price per share is the highest when expansion is financed by issuing equity shares, the Equity Plan may be considered to be the best.

- (b) The objective of financial management is to maximize the wealth of its owners which in the context of companies means maximizing the market price of the company's equity shares. From the analysis in (a) above, we find that the market price per share is the highest in the case of equity financing. As such equity financing is the best.
30. Social Cost Benefit Analysis: The financial evaluation of an industrial project can be made by any of the methods of capital budgeting such as the pay back period, the accounting rate of return method, the net present value method or internal rate of return method. Now-a-days a project to be finally accepted should not satisfy the test of financial viability only, it should also be socially desirable. This aspect is termed as social cost benefit analysis.

The social cost benefit analysis involves the evaluation of a project keeping in view the long-term interest of the society and the nation at large. This analysis is done with reference to the social costs of a project and expected benefits from it to the society, e.g. generation of employment etc. It is possible that some projects may not be financially viable; however, they be taken up on account of social considerations. It is being increasingly recognized that the commercial evaluation of industrial projects is not enough to justify commitment of funds to a project, specially when it belongs to the public sector. In fact, the social cost benefit analysis has acquired great

urgency in the context of the national policy of making huge public investments in various sectors of the economy.

Social cost benefit analysis is important to private corporations also. It is being increasingly felt in recent years that private entrepreneurs should also undertake such projects as are not only financially viable but also socially desirable such projects may get priority in various matters from government as well. If the private sector includes cost benefit analysis in its project evaluation techniques, it will mean that it is taking into account the long-term interest, because in the long-run only those projects will survive that are socially beneficial.

In the context of social costs benefit analysis, it may be noted that the actual costs or revenues in respect of a project do not necessarily reflect the monetary measurement of cost or benefit to the society. For this purpose, social cost benefit analysis is usually made at "opportunity cost" or shadow prices to ascertain the real impact of the project.

There are various indicators indicating the social desirability or otherwise of a project important indicators are high employment potentiality, high capital output ratio, net benefit in foreign exchange, favorable cost benefit in foreign exchange, favorable cost benefit ratio, etc.

The computation of cost benefit ratio attempts to measure the total effect of all the social benefits and costs involved in project, Social benefit in its broadest sense can be defined as any benefit to the society, whether economic or non-economic internal, or external. It is a comprehensive analysis which seeks to examine the total impact of the project.

The ascertainment of social costs and benefits of a project is a ticklish problem. The Manual of Industrial Project Analysis in Developing Countries prepared by the Organisation of Economic Co-operation and Development (OECD) provides some guidelines for social costs benefit analysis. It, however, suffers from various drawbacks. It takes into consideration only those aspects of social costs and benefits which can be quantified. But there are many other aspects such as happiness, satisfaction, aesthetic pleasure, etc. Which cannot be quantified. Therefore, further research is needed to perfect the technique.

31. A lease is a financing proposal. Normally leasing is an alternative to debt financing. Evaluation of a lease proposal is, therefore, assessing its relative merits vis-à-vis debt financing.

An analysis of a leasing decision can be divided into two parts, on the qualitative side, leasing have some advantages such as easy availability, flexibility, scope for tax planning etc. these factors have to be understood and assessed by each firm for itself.

On the quantitative side, a lease proposal can be evaluated based on cost as a criterion. There are two well-known approaches, viz, present value analysis and internal rate of return analysis, to this type of evaluation. These are briefly explained below:

- (i) In the present value analysis method, the present value of the lease payments is compared with that of the present value of payments under the debt financing alternative, in doing so, necessary adjustment for the impact of tax is made and then effective after-tax cash outflows under two options are compared. If the present value of cash outflow under the lease option is lower, it is considered advantageous and vice-versa.
- (ii) In the internal rate of return method calculations are made to find the internal rate of return instead of calculating net present value of cash outflows for the two financing alternatives. Under this method there is no need to assume any rate of discount. Internal rate of return method seeks to establish the rate at which the lease rentals, net of tax shield on depreciation are equal to the cost of leasing. This rate is called internal rate of return and is equal to the cost of leasing. This rate can be compared with that of the other available sources of finance. In fact, every lessor imputes a financial cost or charge or interest rate into the calculation of lease rentals. This may be determined either with reference to the Annuity/Present Value Tables or by the use of mathematical models for determining the compound interest rate. Internal rate of return method attempts to find this rate. This rate is used for comparison with the cost of debt and for assessing the relative advantage or disadvantage of leasing.

The third method known as “Bower-Herringer-Williamson Method” (B.H.W.) is also possible to evaluate lease versus borrowing. In this method, payment streams are divided into two parts: the cash flows associated with financing and the cash flows associated with tax savings. If the present value of comparative tax benefits (i.e.) Operating advantage is more than its financial disadvantage, lease will be preferred.

32. (i) Financial forecasting: Forecasting is the starting point in a planning process. The success of forecasting lies in the degree of accuracy as well as the simplicity of the forecasting techniques. Now-a-days, with the use of computers in financial forecasting, highly sophisticated techniques can also be employed. A few forecasting techniques are briefly considered below:
 - (1) Per cent of sales method: The simplest forecasting can be made by estimating the financial needs based on a sales forecast. Any change in sales is likely to have an impact on various items of assets and liabilities. Hence these items are expressed as per centum of sales and data developed for changes in levels of activity. A sound knowledge of the relation between sales and assets is a prerequisite to the use of the method. This method is more suitable for short term forecasting.
 - (2) Simple regression method : with sales forecast as the starting point and based on the past relationship between sales and asset items it is possible to construct a line of best fit or the regression line. It is possible to link sales with one item of asset at a time. This method is more suitable for long term forecasting.
 - (3) Multiple Regression Methods: Here sales are assumed to be a function of several variables. While in simple regression only one variable is contemplated. Multiple regression is, therefore, a superior method. The use of a particular financial forecasting method will depend upon the circumstances including the purpose of forecasting and the availability of data.
 - (ii) Bridge Finance: Bridge Finance refers to the loans taken by a company normally from the commercial bank for short period, pending disbursement of loan to companies. However, once the loans are approved by the term loans lending institutions, companies, in order not to lose further time in starting their projects, arrange short-term, loans from commercial banks. These short term loans are repaid out of the term loans as and when received from the concerned institutions. The bridge loans are normally secured by mortgaging the title deeds relating to immovable properties and hypothecating its movable assets subject to prior charges, if any. Generally, the rate of interest on bridge finance is higher as compared with that on term loans.
33. Reverse mortgage is a stream of loan payments against the homeowner's net equity stake in the property. In this scheme, the lending institution gives the borrower a fixed sum of money on monthly basis. The borrower will be allowed to stay in the house as long as he is alive though the payment made will be limited to the tenure of the scheme.

“India still has a strong joint family culture which creates a pressure on people desiring to go for such scheme”.

The housing finance company makes payments in the form of a lump sum amount or in equated monthly instalments depending upon the need of the borrower.

The company assesses the value of the property and lends about 30 per cent of the value to a customer in the age group of 60 years and about 60 per cent to those of 80 years and above.

The scheme will initially be targeted towards the urban customers. Though initially there will be a greater share of urban customers, it will have a drill down effect and slowly will cater to the needs of rural customers.

“TOUGH TASKS”: Marketing the scheme will be a challenging task. “It is difficult to market a reverse mortgage product as it targets the vulnerable section of society.”. The banks will not be able to use the aggressive methods of marketing and advertising, which they normally do in case of other loan products. The bank plans to roll out the product once the tax issues are resolved.

CUSTOMER PROFILE: An analysis shows that enquiries have been from people of all ages above 60, the application for loan has mainly come from people in the age bracket of 70 years and above. This is primarily due to the fact that people at this age are not involved in any kind of part time activities, like those in the age group of 60 years, so are practically devoid of any kind of fixed income.”

34. The corporate bond market is a big affair globally and this may well be the time for the Indian market to deepen further, the Bombay Stock Exchange, the oldest in the country, has suggested. The exchange has taken note of the securities regulator’s recent move on the public offer and listing of securitized debt instruments.

The reference is to the Securities Contracts (Regulation) Amendment Act, 2007, which has been passed to provide a framework for enabling listing and trading of securitized debt instruments. The amendment provides for a new sub-clause to include securitization certifications or instruments in the definition of securities. There is also a new section to provide for a disclosure-based regime for public issue and listing of such securitized debt instruments.

Issuers intending to offer certificates or instruments to the public will need to make an application to one or more recognized stock exchanges for securing listing.

SEBI, which has felt that for effective regulation, registration of the issuers may be “beneficial”, has indicated that listing of privately placed securitized debt instruments will be permitted on a case-to-case basis. The general rule will be that only publicly issued instruments will be listed.

PAPER – 3 : ADVANCED AUDITING

QUESTIONS

1. Explain the provisions of new sections of Chartered Accountants(Amendment) Act, 2006 that are in place of existing section 21, 22 and 22A, regarding new Disciplinary Mechanism.
2. Explain the provisions of chapter VII A inserted by Chartered Accountants(Amendment) Act, 2006 regarding Quality Review Board.
3. Explain the power of central Government to make rules to carry out the provisions of Chartered Accountants (Amendment) Act, 2006.
4. Explain the power of Central Government to issue directions under Chartered Accountants (Amendment) Act, 2006.
5. Can members of the Institute of Chartered Accountants of India form multi-disciplinary firms and offer multi- professional services in a competitive and commercial manner?
6. Can members of Institute of Chartered Accountants of India share fees or profits of professional business among the members of any other professional body?
7. X, a practicing Chartered Accountant expresses his opinion on financial statements of ABC Pvt. Ltd., in which his firm has substantial interest. He also discloses the interest in his report. Whether he shall be deemed to be guilty of professional misconduct?
8. When a member of the Institute shall be deemed to be guilty of other misconduct?
9. (a) What are Auditing and Assurance Standards(AAS)?What is the procedure for issuing AAS?
(b) What is the duty of the member of the Institute in respect of compliance with the AASs while discharging their attest function?
10. Write short notes on :
(a) Professional skepticism
(b) Sufficient Appropriate Audit Evidence
(c) Audit Risk in the Small Business
(d) Responsibility of Joint Auditors
11. (a) What do you mean by materiality as per AAS 13?
(b) What is the relationship between materiality and audit risk?
12. Briefly describe the Auditor's responsibilities regarding disqualification of Directors.
13. Discuss the control procedures which the auditor should adopt in applying CAAT (Computer Assisted Audit Technique) in an audit under EDP environment.
14. Mr. Praveen Bansal wishes to sell his proprietary business of manufacture of specialty chemicals. A Ltd. wants to buy the business and appoints you to carry out a due diligence audit to decide whether it would be worthwhile to acquire the business.
What procedures you would adopt before you could render any advice to A Ltd.?
15. (a) List three situations where the auditor would be unlikely to use audit sampling techniques.
(b) Explain what you understand by the following terms:
(i) attribute sampling (ii) Monetary-unit sampling
(c) Describe the factors which the auditor should consider when determining the size of a sample.
(d) Describe to what extent statistical sampling enhances the quality of the audit evidence.
16. You are appointed as an auditor of an insurance company. Draw up an audit programme and state the special points that you would take into consideration while drawing up programme.

17. Section 44AB of the Income Tax Act provides for the compulsory audit of accounts of certain persons carrying on business or profession. State those persons.
18. What are the key functions of an Energy Auditor?
19. What are the Management Audit Questionnaires? Give a sample questionnaire for Audit of production.

SUGGESTED ANSWERS/HINTS

1. Amended provisions of the Chartered Accountant, Act, 1949 [as amended by Chartered Accountants (Amendment) Act, 2006] regarding Disciplinary Mechanism are as follows:
 - (A) Disciplinary Directorate (Section 21):
 - (i) The Council shall, by notification, establish a Disciplinary Directorate headed by an officer of the Institute designated as Director (Discipline) and such other employees for making investigations in respect of any information or complaint received by it.
 - (ii) On receipt of any information or complaint along with the prescribed fee, the Director (Discipline) shall arrive at a prima facie opinion on the occurrence of the alleged misconduct.
 - (iii) Where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the First Schedule, he shall place the matter before the Board of Discipline and where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the Second Schedule or in both the Schedules, he shall place the matter before the Disciplinary Committee.
 - (iv) In order to make investigations under the provisions of this Act, the Disciplinary Directorate shall follow such procedure as may be specified.
 - (v) Where a complainant withdraws the complaint, the Director (Discipline) shall place such withdrawal before the Board of Discipline or, as the case may be, the Disciplinary Committee, and the said Board or Committee may, if it is of the view that the circumstances so warrant, permit the withdrawal at any stage.
 - (B) Board of Discipline (Section 21A):
 - (i) The Council shall constitute a Board of Discipline consisting of -
 - (a) a person with experience in law and having knowledge of disciplinary matters and the profession, to be its presiding officer;
 - (b) two members one of whom shall be a member of the Council elected by the Council and the other member shall be the nominated by the Central Government from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy;
 - (c) the Director (Discipline) shall function as the Secretary of the Board.
 - (ii) The Board of Discipline shall follow summary disposal procedure in dealing with all cases before it.
 - (iii) Where the Board of Discipline is of the opinion that a member is guilty of a professional or other misconduct mentioned in the First Schedule, it shall afford to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely:
 - (a) reprimand the member;
 - (b) remove the name of the member from the Register up to a period of three months;
 - (c) impose such fine as it may think fit, which may extend to rupees one lakh.

- (iv) The Director (Discipline) shall submit before the Board of Discipline all information and complaints where he is of the opinion that there is no prima facie case and the Board of Discipline may, if it agrees with the opinion of the Director (Discipline), close the matter or in case of disagreement, may advise the Director (Discipline) to further investigate the matter.

(C) Disciplinary Committee (Section 21B.):

- (i) The Council shall constitute a Disciplinary Committee consisting of the President or the Vice-President of the Council as the Presiding Officer and two members to be elected from amongst the members of the Council and two members to be nominated by the Central Government from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy:

Provided that the Council may constitute more Disciplinary Committees as and when it considers necessary.

- (ii) The Disciplinary Committee, while considering the cases placed before it shall follow such procedure as may be specified.
- (iii) Where the Disciplinary Committee is of the opinion that a member is guilty of a professional or other misconduct mentioned in the Second Schedule or both the First Schedule and the Second Schedule, it shall afford to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely:
 - (a) reprimand the member;
 - (b) remove the name of the member from the Register permanently or for such period, as it thinks fit;
 - (c) impose such fine as it may think fit, which may extend to rupees five lakh.

- (iv) The allowances payable to the members nominated by the Central Government shall be such as may be specified.

(D) Authority, Disciplinary Committee, Board of Discipline and Director (Discipline) to have powers of civil court(Section 21C): For the purposes of an inquiry under the provisions of this Act, the Authority, the Disciplinary Committee, Board of Discipline and the Director (Discipline) shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908), in respect of the following matters, namely:

- (i) summoning and enforcing the attendance of any person and examining him on oath;
- (ii) the discovery and production of any document; and
- (iii) receiving evidence on affidavit.

Explanation : for the purposes of sections 21, 21A, 21B, 21C and 22, "member of the Institute" includes a person who was a member of the Institute on the date of the alleged misconduct although he has ceased to be a member of the Institute at the time of the inquiry.

(E) Transitional provisions (Section 21 D): All complaints pending before the Council or any inquiry initiated by the Disciplinary Committee or any reference or appeal made to a High Court prior to the commencement of the Chartered Accountants (Amendment) Act, 2006, shall continue to be governed by the provisions of this Act, as if this Act had not been amended by the Chartered Accountants (Amendment) Act, 2006.

(F) Constitution of Appellate Authority (Section 22A):

- (i) The Central Government shall, by notification, constitute an Appellate Authority consisting of -
 - (a) a person who is or has been a judge of a High Court, to be its Chairperson;
 - (b) two members to be appointed from amongst the persons who have been members of the Council for at least one full term and who is not a sitting member of the

Council;

- (c) two members to be nominated by the Central Government from amongst persons having knowledge and practical experience in the field of law, economics, business, finance or accountancy.
- (ii) The Chairperson and other members shall be part-time members.
- (G) Term of office of Chairperson and members of Authority (Section 22B):
 - (i) A person appointed the Chairperson shall hold office for a term of three years from the date on which he enters upon his office or until he attains the age of sixty-five years, whichever is earlier.
 - (ii) A person appointed as a member shall hold office for a term of three years from the date on which he enters upon his office or until he attains the age of sixty-two years, whichever is earlier.
- (H) Allowances and conditions of service of Chairperson and members of Authority (Section 22C): The allowances payable to, and other terms and conditions of service of, the Chairperson and members are the manner of meeting expenditure of the Authority by the Council and such other authorities shall be such as may be specified.
- (I) Procedure to be regulated by Authority (Section 22D.):
 - (i) The office of the Authority shall be at Delhi.
 - (ii) The Authority shall regulate its own procedure.
 - (iii) All orders and decisions of the Authority shall be authenticated by an officer duly authorised by the Chairperson in this behalf.
- (J) Officers and other staff of Authority(Section 22E):
 - (i) The Council shall make available to the Authority such officers and other staff members as may be necessary for the efficient performance of the functions of the Authority.
 - (ii) The salaries and allowances and conditions of service of the officers and other staff members of the Authority shall be such as may be prescribed.
- (K) Resignation and removal of Chairperson and members(Section 22F):
 - (i) The Chairperson or a member may, by notice in writing under his hand addressed to the Central Government, resign his office:
 Provided that the Chairperson or a member shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of term of office, whichever is earlier.
 - (ii) The Chairperson or a member shall not be removed from his office except by an order of the Central Government on the ground of proved misbehaviour or incapacity after an inquiry made by such person as the Central Government may appoint for this purpose in which the Chairperson or a member concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of such charges.
- (L) Appeal to Authority(Section 22G):
 - (i) Any member of the Institute aggrieved by any order of The Board of Discipline or the Disciplinary Committee imposing on him any of the penalties referred to in sub-section (3) of section 21A and sub-section (3) of section 21B, may within ninety days of the date on which the order is communicated to him, prefer an appeal to the Authority.
 Provided that the Director (Discipline) may also appeal against the decision of the Board of Discipline or the Disciplinary Committee to the Authority, if so authorised by

the Council, within ninety days.

Provided further that the Authority may entertain any such appeal after the expiry of the said period of ninety days, if it is satisfied that there was sufficient cause for not filing the appeal in time.

- (ii) The Authority may, after calling for the records of any case, revise any order made by the Board of Discipline or the Disciplinary Committee under sub-section (3) of section 21A and sub-section (3) of section 21B and may -

- (a) confirm, modify or set aside the order;
- (b) impose any penalty or set aside, reduce, or enhance the penalty imposed by the order;
- (c) remit the case to the Board of Discipline or Disciplinary Committee for such further enquiry as the Authority considers proper in the circumstances of the case; or
- (d) pass such other order as the Authority thinks fit.

Provided that the Authority shall give an opportunity of being heard to the parties concerned before passing any order.

2. Provisions of chapter VII A inserted by Chartered Accountants (Amendment) Act, 2006 regarding Quality Review Board:

(A) Establishment of Quality Review Board (Section 28A):

- (i) The Central Government shall, by notification, constitute a Quality Review Board consisting of a Chairperson and ten other members.
- (ii) The Chairperson and members of the Board shall be appointed from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy.
- (iii) Five members of the Board shall be nominated by the Council and other five members shall be nominated by the Central Government.

(B) Functions of Board (Section 28B): The Board shall perform the following functions, namely:-

- (i) to make recommendations to the Council with regard to the quality of services provided by the members of the Institute;
- (ii) to review the quality of services provided by the members of the Institute including audit services; and
- (iii) to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.

(C) Procedure of Board (Section 28C): The Board shall meet at such time and place and follow in its meetings such procedure as may be specified.

(D) Terms and conditions of services of Chairperson and members of Board and its expenditure (Section 28D)

- (i) The terms and conditions of service of the Chairperson and the members of the Board, and their allowances shall be such as may be specified.
- (ii) The expenditure of the Board shall be borne by the Council.

3. Power of Central Government to make rules (Section 29A):

- (i) The Central Government may, by notification, make rules to carry out the provisions of this Act.
- (ii) In particular, and without prejudice to the generality of the foregoing powers, such rules may provide for all or any of the following matters, namely:-
 - (a) the manner of election and nomination in respect of members to the Council under sub-section (2) of section 9;

- (b) the terms and conditions of service of the Presiding Officer and Members of the Tribunal, place of meetings and allowances to be paid to them under sub-section (3) of section 10B;
 - (c) the procedure of investigation under sub-section (4) of section 21;
 - (d) the procedure while considering the cases by the Disciplinary Committee under sub-section (2), and the fixation of allowances of the nominated members under sub-section (4) of section 21B;
 - (e) the allowances and terms and conditions of service of the Chairperson and members of the Authority and the manner of meeting expenditure by the Council under section 22C;
 - (f) the procedure to be followed by the Board in its meetings under section 28C; and
 - (g) the terms and conditions of service of the Chairperson and members of the Board under sub-section (1) of section 28D.
4. Power of Central Government to issue directions (Section 30C):
- (i) In the event of non-compliance by the Council of any provisions of this Act, the Central Government may give to the Council such general or special directions as it considers necessary to ensure compliance and the Council shall, in the discharge of its functions under this Act, comply with such directions.
 - (ii) If, in the opinion of the Central Government, the Council has persistently made default in giving effect to the directions issued under sub-section (1), it may, after giving an opportunity of being heard to the Council, by notification, dissolve the Council, whereafter a new Council shall be constituted in accordance with the provisions of this Act with effect from such date as may be decided by the Central Government.
- Provided that the Central Government shall ensure constitution of a new Council in accordance with the provisions of this Act within a period of one year from the date of its dissolution.
- (iii) Where the Central Government has issued a notification under subsection (2) dissolving the Council, it shall, pending the constitution of a new Council in accordance with the provisions of this Act, nominate any person or body of persons not exceeding five members to manage the affairs and discharge all or any of the functions of the Council under this Act.
5. As per clause 4 of part I of the First schedule to the Chartered Accountants Act, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he enters into partnership, in or outside India, with any person other than Chartered Accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (V) of sub-section (1) of section 4 or whose qualifications are recognized by the Central Government or the Council for the purpose of permitting such partnerships;
- A Chartered Accountants in practice can enter into partnership with
- (i) A Chartered Accountant in practice, or
 - (ii) A Member of any other professional body having prescribed Qualifications.

The Council of the Institute and the central Government has power to prescribe such professional bodies to whom members, partnership can be entered into. The resident members of the institute residing abroad but entitled to be registered as a member of Institute under section 4(1)(v) or whose qualification are recognized by C.G or the Council to enter into partnership can form partnership firms with any practicing chartered Accountant. This amendment has enabled the members of the Institute to form multi-disciplinary firms and offer multi-professional services in a competitive and commercial manner. The council or the Central Government will specify the qualifications for permitting such partnership.

6. As per clause 2 of part I of the First schedule to the Chartered Accountants Act, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualification as may be prescribed, for the purpose of rendering such professional services to time in or outside India.

Explanation - In this item, "partner" includes a person residing outside India with whom a chartered accountant in practice has entered into partnership which is not in contravention of clause (4) of this Part.

Previously this clause was allowing sharing or disbursing fees or profits of professional business among the partners who were virtually members of the Institute. The amendment in Chartered Accountants Act, 1949 carried out by Act No. 9 of 2006 has changed scenario and permitted sharing of fees or profits among members of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such, professional services from time to time in or outside India.

Also as per clause 3 of part I of the First schedule to the Chartered Accountants Act, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute.

Provided that nothing herein contained shall be construed as prohibiting a member 'from entering into profit sharing or other similar arrangements, including receiving any share commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in clause (2) of this like sharing of fees & profits, receipts from others are also restricted in the same manner as in clause (2), but by new amendment above mentioned proviso is inserted in clause (3) thereby permitting the members of the Institute to enter into profit sharing or similar arrangements, including receiving any share, commission or brokerage in the fees, with a member of any other professional body or with such other persons having such qualifications as may be prescribed by the council or the Government.

7. As per clause 4 of part I of the Second Schedule to the Chartered Accountants Act, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Now, the words "unless he discloses the interest also in his report" has been deleted from this clause there by making mandatory not to express opinion on financial statement of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest. As X, a practicing Chartered Accountant has expressed his opinion on financial statements of ABC Pvt. Ltd., in which his firm has substantial interest. He shall be deemed to be guilty of professional misconduct.

8. As per Part IV of the First Schedule to the Chartered Accountants Act, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he
- (1) is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months;
 - (2) in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

These clause (1) & (2) are self explanatory and any of the member of the Institute is found guilty by any civil or criminal court and prosecuted for an imprisonment in an offence involving moral turpitude or his acts bring disrepute to the profession or the Institute, irrespective of the fact whether such acts are related to profession or not, such member will be deemed to be guilty of other misconduct in Part IV of Schedule I.

The important point to note is that if imprisonment tenure exceeds six months, this case will be covered in the clause of Part III of Second Schedule. As per Part III of Second Schedule a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.

Imprisonment awarded for a term exceeding six months in any civil/criminal matter treated as a major offence under 'other misconduct' is included in this Schedule.

9. AAS are auditing standards, which prescribe the way the auditing should be conducted. AAS are the benchmark by which the quality of audit performance can be measured and the achievement of the audit objective can be documented. By using standards an auditor can determine the professional qualities necessary for effective audit performance.

(a) Procedure for issuing AASs - Broadly, the following procedure is adopted for the formulation of AASs:

- ◆ The AASB determines the broad areas in which the AASs need to be formulated and the priority in regard to the selection thereof.
- ◆ In the preparation of AASs, the AASB is assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision is made for participation of a cross-section of members of the Institute.
- ◆ On the basis of the work of the Study Groups, an exposure draft of the proposed AAS is prepared by the Committee and issued for comments by members of the Institute.
- ◆ After taking into consideration the comments received, the draft of the proposed AAS is finalised by the AASB and submitted to the Council of the Institute.
- ◆ The Council of the Institute considers the final draft of the proposed AAS, and, if necessary, modifies the same in consultation with the AASB. The AAS is then issued under the authority of the Council.

(b) Compliance with the AASs: While discharging their attest function, it is the duty of the members of the Institute to ensure that the AASs are followed in the audit of financial information covered by their audit reports. If for any reason a member has not been able to perform an audit in accordance with the AASs, his report should draw attention to the material departures therefrom. Auditors are expected to follow AASs in the audits commencing on or after the date specified in the Standard.

10. (a) Professional skepticism : It is an attitude of the auditor that represents a questioning mind and critical assessment of audit evidence. The auditor plans and performs an audit with an attitude of professional skepticism. Such an attitude is necessary for the auditor to identify and properly evaluate, for example:

Matters that increase the risk of a material misstatement in the financial statements resulting from fraud or error (for instance, management's characteristics and influence over the control environment, industry conditions, and operating characteristics and financial stability).

Circumstances that make the auditor suspect that the financial statements are materially misstated.

Evidence obtained (including the auditor's knowledge from previous audits) that brings into question the reliability of management representations.

However, unless the audit reveals evidence to the contrary, the auditor is entitled to accept records and documents as genuine. Accordingly, an audit performed in accordance with auditing standards generally accepted in India rarely contemplate authentication of documentation, nor are auditors trained as, or expected to be, experts in such authentication.

- (b) **Sufficient Appropriate Audit Evidence** : Sufficiency and appropriateness are interrelated and apply to evidence obtained from both compliance and substantive procedures. Sufficiency refers to the quantum of audit evidence obtained; appropriateness relates to its relevance and reliability. Normally, the auditor finds it necessary to rely on evidence that is persuasive rather than conclusive. He may often seek evidence from different sources or of different nature to support the same assertion.

The auditor should evaluate whether he has obtained sufficient appropriate audit evidence before he draws his conclusions therefrom. The audit evidence should, in total, enable the auditor to form an opinion on the financial information. In forming such an opinion, the auditor may obtain audit evidence on a selective basis by way of judgmental or statistical sampling procedures.

- (c) **Audit Risk in the Small Business** : Many internal controls which would be relevant to large entities are not practical in the small business. For example, in small businesses, accounting procedures may be performed by a few persons who may have both operating and custodial responsibilities, and therefore segregation of duties may be missing or severely limited and control risk is at very high level. Inadequate segregation of duties may, in some cases, be offset by a strong management control system in which owner/manager supervisory controls exist because of direct personal knowledge of the entity and involvement in transactions. In circumstances where segregation of duties is limited and audit evidence of supervisory controls is lacking, the audit evidence necessary to support the auditor's opinion on the financial statements may have to be obtained entirely through the performance of substantive procedures.

- (d) **Responsibility of Joint Auditors**: AAS-12 on, "Responsibility of Joint Auditors" deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. The responsibilities of joint auditors, as a rule are no different from the responsibilities of individual auditors as enumerated in the Companies Act, 1956. Main features of the said AAS are discussed below:

- ◆ **Division of Work**: Where joint auditors are appointed, they should, by mutual discussion, divide the audit of identifiable units or specified areas. Certain areas of work, owing to their importance or owing to the nature of work involved would not be divided and would be covered by all the joint auditors. Such a division affected by the joint auditors should be adequately documented and preferably communicated to the auditee.
- ◆ **Coordination**: Where in the course of his work, a joint auditor comes across matters which are relevant to the areas of other joint auditors and which require joint discussion, he should communicate the same to all the other joint auditors in writing before the finalisation of audit and preparation of audit report.

In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:

- (a) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
- (b) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors.
- (c) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (d) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and
- (e) for ensuring that the audit report complies with the requirements of the relevant statute.

- (f) It is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit.
- (g) The responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors.
- (h) Each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

Normally, the joint auditors are able to arrive at an agreed report. However where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report. A joint auditor is not bound by the views of majority of joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

11. (a) Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality depends on the size and nature of the item, judged in the particular circumstances of its misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which the information must have if it is to be useful. The assessment of what is material is a matter of professional judgement.
- (b) Audit risk means the risk that the auditor gives an inappropriate audit opinion when financial statements are materially misstated. Materiality is a matter of professional judgement. The auditor should consider materiality and its relationship with audit risk when conducting an audit. There is an inverse relationship between materiality and the degree of audit risk, that is, the higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low, but the risk that it could be misstated by an extremely small amount might be very high. The auditor takes the inverse relationship between materiality and audit risk into account when determining the nature, timing and extent of audit procedures. For example, if, after planning for specific audit procedures, the auditor determines that the acceptable materiality level is lower, audit risk is increased. The auditor would compensate for this by either:
 - (a) reducing the assessed degree of control risk, where this is possible, and supporting the reduced degree by carrying out extended or additional tests of control; or
 - (b) reducing detection risk by modifying the nature, timing and extent of planned substantive procedures.
12. Auditor's Responsibilities regarding Disqualification of Directors: Section 227(3) of the Companies Act, 1956 has recently been amended by the Companies (Amendment) Act, 2000 whereby clauses (e) and (f) have been inserted. Clause (f) now inserted requires an auditor to comment 'whether any director is disqualified from being appointed as director under clause (g) of sub-section (1) of section 274. The relevant extracts of section 274(1)(g) referred to in clause (f) of section 227 (3), are reproduced below:

"274(1) A person shall not be capable of being appointed director of a company, if–

.....

- (g) such person is already a director of a public company which –
 - (A) has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999; or
 - (B) has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more;

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

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

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

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

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

13. Control Procedures and Computer-Assisted Audit Techniques (CAATs): The common types of CAATs are audit software and test data. Audit software consists of computer programmes used by the auditor to process data of audit significance from the entity's accounting systems. It may consist of package programmes, purpose-written programmes and utility programmes. Regardless of the source of programme, the auditor should substantiate their validity for audit purposes prior to use. Test Data techniques on the other hand are used in conducting audit procedures by entering data (a sample transactions) into an entity's computer systems and comparing the results obtained with the predetermined results. Test data is used to test specific controls in computer programmes, such as, on line password and data access.

Controlling the CAAT Application: The use of a CAAT should be controlled by the auditor to provide reasonable detailed specifications of the CAAT have been met and that the CAAT is not improperly manipulated by the entity's staff. The specific procedures necessary to control the use of a CAAT will depend on the particular application in establishing audit control which require the auditor should consider the need to –

- (a) Approve the technical specifications and carry out a technical review of the work involving the use of the CAAT.
- (b) Review the entity's general IT controls which may contribute to the integrity of the CAAT, e.g., control over programme changes and access to computer files. When such controls

cannot be relied upon to ensure the integrity of the CAAT, the auditor may consider processing the CAAT applications at another suitable computer facility.

- (c) Ensure appropriate integration of the output by the auditor into the audit process.

Procedures carried out by the Auditor to control Audit Software Application:

- (a) Participating in the design and testing of the computer programmes.
- (b) Checking the coding of the programme to ensure that it conforms with detailed programme specifications.
- (c) Requesting the entity's computer staff to review the operating system instructions to ensure that the software will run in the entity's computer installation.
- (d) Running the audit software on small test files before running on the main data files.
- (e) Ensuring that the correct files were used, e.g. by checking with external evidence, such as control totals maintained by the user.
- (f) Obtaining evidence that the audit software functioned as planned, for example, returning output and control information.
- (g) Establishing appropriate security measures to safeguard against manipulations of the entity's data files.

The presence of the auditor is not necessarily required at the computer facility during the running of a CAAT to ensure appropriate control procedures. However, it may provide practical advantages, such as being able to control distribution of the output and ensuring the timely corrections of errors.

Procedures carried out by the Auditor to Control Test Data Applications:

- (a) Controlling the sequence of submissions of test data where it spans several processing cycles.
- (b) Performing test runs containing small amounts of test data before submitting the main audit test data.
- (c) Predicting the results of the test data and comparing it with the actual test data output, for the individual transactions and in total.
- (d) Confirming that the answered version of the programmes was used to process the test data.
- (e) Obtaining reasonable assurance that the programmes used to process the test data were used by the entity throughout the applicable audit period.

When using a CAAT, the auditor may require the co-operation of the entity's staff who have extensive knowledge of the computer installation. In such circumstances, the auditor should have reasonable assurance that the entity's staff did not improperly influence the results of the CAAT. Finally, the standard of working papers and retention procedures for a CAAT should be consistent with that on the audit as a whole. It may be convenient to keep the technical papers relating to the use of the CAAT separate from the other audit working papers. The working papers should contain sufficient documentation to describe the CAAT application.

14. A due diligence audit on behalf of A Ltd. with a view to acquiring the business shall involve following steps:

- (1) **Studying Business History:** The principal objective of financial due diligence, is usually to look behind the initial information provided by the entity and to assess the benefits and costs of the proposed acquisition by inquiring into all relevant aspects of the past, present and future of the business to be acquired. The accountants should begin the financial due diligence review by looking into the history of the entity and the background of the promoters. The details of how the company was set up and who were the original promoters has to be gone into, before verification of financial data in detail. An eye into the history of

the target may reveal its turning points, survival strategies adopted by the entity from time to time, the market share enjoyed by the entity and changes therein, product life cycle and adequacy of resources. It could also help the accountant in determining whether, in the past, any regulatory requirements have had an impact on the business of the entity. Broadly, the accountant should make relevant enquiries about the history of business – products, markets, suppliers, expenses, operations.

- (2) **Studying the Overall Picture:** It is necessary to see whether the business is engaged in manufacture of one or two important lines of products; whether raw material is available without difficulty; whether products are marketable and have a ready market; whether there is scope for expansion of the market; whether full capacity is being utilised or whether there is scope for utilisation of idle capacity – all those factors are non-financial in nature but an enquiry into them is essential for formulation of a decision to buy or not.
- (3) **Economic environment:** The study of the impact of economic forces is important for determining factors that have been responsible for the rise or fall in the sales and profits of the business. At times, political or economic factors also may affect the fortunes of a business; for example, labour disturbances, changes in government policies in the matter of levy of excise and custom duties, imports, etc. It is therefore necessary that the impact of all these factors should be studied and their effect on the business judged on a consideration of the profits in the past.
- (4) **Examining Profit and Loss Account:** The Profit and Loss Account for the last few years should be considered – exceptional or non-recurring expenses, incomes should be eliminated to know normal profit and trends in profits. Also to be seen is the trend in sales whether the same is on the increase or decrease after allowing for unusual factors influencing sales. It should be seen whether the business is regular in payment of taxes; both Central and State Taxes; whether taxes are in arrears; whether what arrangement are to be made to clear off the arrears; if taxes and duties are in arrear whether the vendor will undertake to pay the taxes upto the point of sale.
- (5) **Examining Net-worth:** The net worth of the business should be ascertained. If the accounts are regularly audited, reliance can be placed on the books; for valuation of tangible assets, the assistance of known expert in the field may be sought; enquiries should be made whether there are unrecorded liabilities of the business; similarly about unrecorded assets. On the basis of net worth of the business, the purchase consideration may be agreed upon.

In addition to the above steps, the following further points have to be seen:

- (i) Reason for sale of business and the effect on turnover and profits due to the exist of the present proprietor.
- (ii) The length of the lease under which business has been operating.
- (iii) The unexpired period of patents if any held by the vendors.
- (iv) The age of managerial staff and prospects of their continuing in service in the new environment; the effect of trained managerial staff learning the organisation in production/sales/administrative and the financial liability to pay terminal benefits/compensation, etc.
- (v) If bulk sales are to a few limited customers, the profitability should be discounted greatly, because any substantial withdrawal of customers might cause business crashes.
- (vi) A company with a sound financial structure can better withstand the stresses and strains of business. A low debt-equity ratio would indicate an ability to grow through debt financing without raising equity.
- (vii) The cash generated from operations; the need for redeployment of resources and funds needed for repayment of laons become major factors in determining growth potential.
- (viii) The valuation of goodwill if any should be on reasonable basis having regards to all factors mentioned above.

15. (a) The auditor would be unlikely to use audit sampling techniques in the following situations.
- (i) Where the population size is so small that statistical sampling will create unacceptable margins of error. If the population is not sufficiently large then statistical methods are invalid. Also where transactions or balances are small in number and material in relation to the financial statements. For example all large unusual items should be verified.
 - (ii) Where the population is not homogeneous and requires stratification. For example stock and work in progress may need stratifying because of the diverse nature of the population and the need to increase the precision of the sampling unit. Raw material stocks, work in progress and finished good stocks are unlikely to represent a homogeneous population.
 - (iii) Where the population has not been maintained in a manner suitable for audit sampling. For example sales invoices may have been filed in customer order and not numerically. Audit sampling techniques would not be cost effective in these circumstances.
- (b) (i) Attribute sampling is a statistical method used to estimate the proportion of items in a population containing a particular characteristic. This proportion is called the occurrence rate and is the ratio of items containing the specific attribute to the total number of population items. Auditors are usually interested in the occurrence of exceptions in populations and refer to the occurrence rate as a deviation rate or an error rate. An exception in attribute sampling may be a test of an internal control deviation or a monetary error. For example the signature of the credit controller on a sales order is an attribute and the absence of a signature is a deviation/error. By design, attribute sampling enables the auditor to conclude that the population contains errors (with an allowance for statistical error) in the same proportion as in the sample. Auditors use attribute sampling to determine the appropriateness of the assessed level of control risk, although it can be used for substantive tests particularly when tests of controls and substantive tests are performed concurrently.
- (ii) Monetary unit sampling is a method of sampling which attempts to place a value on the errors in a population. The auditor is interested not only in error rates but also in the monetary effects of those errors. The population is divided up into units of one rupee and not into transactions or balances. The size of the sample is determined by the confidence level required and by the auditors tolerable error. Each transaction to which a Rs1 unit is attached is tested for accuracy and if there is an error in the transaction, the Rs1 unit is said attached is tested for accuracy and if there is an error in the transaction, the Rs1 unit is said to be 'tainted' by the percentage of the error in the transaction. Thus Rs500 recorded as Rs550 would be 'tainted' by 10%. This method of sampling enables the auditor to determine the value of the most likely error and the maximum possible error in the population.
- (c) The factors which the auditor should consider in determining the sample size are as follows:
- (i) The efficiency and effectiveness of the internal control systems to process transactions without error: The auditor has to determine the expected error rate. The auditor's estimate of this depends, amongst other things, upon his evaluation of internal control.
 - (ii) The level of assurance which the auditor requires: The auditor has to determine the amount of the risk which he is prepared to accept. This would be determined by the auditor's assessment of the audit risk attached to a particular client. There is considerable information available to the auditor about the organisation, its management and the expectations of company performance, for example, and these factors would play a role in determining sample size.
 - (iii) The results of previous audit work: The auditor has to assess the expected error rate based upon the results of audit work in this and previous years. The higher the expected error rate, the greater the sample size, although if very high error rates are

expected it may not be appropriate to use a sampling approach.

- (iv) Stratification: This is the process of dividing a population into strata so that items in each sub-population are expected to have similar characteristics. Sample sizes can be made smaller because the auditor can spend more time on those strata deemed to be high risk.
- (d) Statistical sampling provides the auditor with a sound scientific basis for the generation of audit evidence. If the techniques are correctly employed, personal bias in the choice of sample size is reduced. The auditor is able to determine the reliability or precision of the sample and the risk inherent in relying upon the sample results. Thus greater reliance can be placed upon the audit evidence, with the result that the quality of the audit evidence is enhanced. Statistical sampling enables the auditor to generate audit evidence in a consistent manner over time and across different companies. This consistency of approach again improves the quality of the audit. The interpretation of the results of the test is more objective and is expressed in quantitative terms. As the sample result is objective, the audit evidence created is defensible in a court of law. This may not be the case if judgement sampling is used.

16. Audit programme for the audit of an insurance company:

General:

- (1) Verify the system of internal control in operation.
- (2) Different categories of insurance business carried on by the company should be ascertained and it should be seen whether separate accounts in respect of each category is maintained.
- (3) It should be confirmed that Registers of policies, claims and licensed agents are properly maintained.

Specific:

- (4) Premium: This should be vouched with copies of insurance policies and cover notes of premium receipts. Under the Code of Conduct, premium is payable in advance except where the insured maintains an appropriate deposit with the insurance company. Variation in the amount of premium should be verified by reference to proper authorisation based on change in the conditions of the policy. There cannot be any outstanding premium except for those policies which are covered by bank guarantee.
- (5) Claims: Payments on account of claims should be verified by reference to payee's receipt, discharge of liabilities signed by the claimants and other supporting evidence like survey report, repairer's bill etc. In checking the computation of the claim admitted and paid, care should be taken to see that the value of salvaged materials has been deducted. Also see that the claim amount has been paid only by a crossed or order cheque. The admission and payment of the claim should be in terms of the policy.
- (6) Commissions: It should be vouched with the acknowledgement of the agent and authorised vouchers. The commission should be seen to have been paid in cheque except when it is for a very small sum. The amount of the commission should not exceed the amount calculated at the rate approved for different types of business and the category of agent. Adequate provision should be made for commission accrued but not paid. Any commission received against re-insurance should be checked with credit note, borderauz or other similar evidence. Care should be taken to see that commission is paid against policies executed through the concerned agent.
- (7) Re-insurance: Verify that premium and commission payable or receivable against re-insurance, ceded or accepted, have been properly accounted for and settled by payment or receipt or adjustment. See that claim receivable on reinsured policy has been collected from the re-insurer. Similarly claim payable on re-insurance accepted is paid or provided for. Further see that commission on re-insurance ceded or accepted has been shown separately in the Revenue Account.

- (8) Expenses of management: Satisfy that expenses have been classified in accordance with the Code of Conduct. Verify that expenses have been properly incurred and booked under the appropriate head in terms of the Code of Conduct and expenses chargeable to one head have not been charged to another. This is important because under the Code of Conduct there are limits on various expenses. Ascertain that all outstanding expenses have been provided for. Also, allocation of common expenses between the various types of insurance business should be carefully examined to see that greater load has not been passed on to the good line relieving the others. The basis of allocation should be consistent. Whatever expenses are not permissible as expense of management in terms of the Code of Conduct, should be screened out and excluded.
 - (9) Investments: Should be physically verified at the close of the year. Certificate of bank should be obtained for investments lodged with it. It should be seen that restriction on investments imposed by the Insurance Act, 1938 have not been violated.
 - (10) Cash and bank balances: Physical verification of the cash should be carried out at the close of the year. Bank confirmation should be obtained for balances with banks. Also, bank balance reconciliation statement should be verified.
 - (11) Balance Recoverable: It should be seen that all receivables from agents, other insurers and other persons are fully recoverable. If not, suitable provision should be there for the part considered doubtful of recovery. For this confirmation of balance should be obtained from the concerned parties. In addition, statement of account, where there is any, should also be examined.
 - (12) Profit should be determined after making proper provision for bad and doubtful debts, depreciation on assets, contribution to Provident Fund, superannuation fund etc., debts due to government and all other matters for which a provision is necessary.
 - (13) The accounts should be prepared in the forms prescribed under the Insurance Act, 1938.
17. Section 44AB provides for the compulsory audit of accounts of certain persons carrying on business or profession. Section 44AB reads as under:

Audit of accounts of certain persons carrying on business or profession.

Every person -

- (a) carrying on business shall, if his total sales turnover or gross receipts, as the case may be, in business exceed or exceeds forty lakhs rupees in any previous year.
- (b) carrying on profession shall, if his gross receipts, in profession exceed ten lakhs rupees in any previous year,
- (c) carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person under section 44AD or section 44AE or section 44AF or section 44BB or section 44BBB as the case may be, and he has claimed his income to be lower than the profits or gains so deemed to be the profits and gains of his business, as the case may be, in any previous year, get his accounts of such previous year audited by an accountant before the specified date and furnish by that date the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed:

Provided that this section shall not apply to the person, who derives income of the nature referred to in section 44B or section 4BBA on and from the 1st day of April, 1985 or, as the case may be, the date on which the relevant section came into force, whichever is later:

Provided further that in a case where such person is required by or under any other law to get his accounts audited, it shall be sufficient compliance with the provisions of this section if such person gets the accounts of such business or profession audited under such law before the specified date and furnishes by that date the report of the audit as required under such other law and a further report by an accountant in the form prescribed under this section.

18. Key functions of Energy Auditor : Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. In that context, energy management involves the basis approaches reducing avoidable losses, improving the effectiveness of energy use, and increasing energy use efficiency. The function of an energy auditor could be compared with that of a financial auditor. The energy auditor is normally expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues. Generally, energy auditor for the industry is an external party. The following are some of the key functions of the energy auditor:
- (i) Quantification of energy costs and quantities
 - (ii) To correlate trends of production or activity to energy cost.
 - (iii) To devise energy database formats to depict to correct picture – By product, department or consumer.
19. Management Audit Questionnaire: A management audit questionnaire is an important tool for conducting the management audit. It is through these questionnaires that the auditors make an inquiry into important facts by measuring current performance. Such questionnaires aim at a comprehensive and constructive examination of an organisation's management and its assigned tasks. Overall it is concerned with the appraisal of management actions in accomplishing the organisation's objectives. Its primary objective is to highlight weaknesses and deficiencies of the organisation. It includes a review of how well or badly the management functions of planning, organising, directing and controlling are being performed. In addition it evaluates how effective the decision-making process is accomplishing the stated organisation objectives. Within this framework, the questionnaire provides a means for evaluating an organisation's ongoing operations by examining its major functional areas. There are three possible answers to the management audit questions: "Yes", "No" and "N.A.", (not applicable). A "Yes" answer indicates that the specific area, function, or aspect under study is functioning in an acceptable manner; no written explanation is needed in that case. On the other hand, a "no" answer indicates unacceptable performance and should be explained in writing. Questionnaire comments on negative answers not only provide documentation for future reference, but, more important, provide background information for undertaking remedial action. Those questions that are not applicable and should be ignored in the audit are checked in the "N.A." column. The management audit questionnaire does not give answers, but simply asks questions. If all questions are answered with a 'yes', operations are proceeding as desired. On the other hand, if there are one or more 'no' answers, difficulties are being experienced and must be explained in writing. If the question does not apply, the N.A. (not applicable) column is checked. Thus, management audit questionnaire for this part of the audit not only serves as a management tool to analyse the current situation; more importantly, it enables the management auditors to synthesise those elements that are causing organisational difficulties and deficiencies.

Audit of production : A management audit questionnaire for audit of production is given below:

A. Long-range plans:

1. Are manufacturing facilities adequate to meet long-range company objectives?
2. Are manufacturing facilities well laid out to provide efficiency in:
 - a. production ?
 - b. materials handling?
 - c. related manufacturing functions?
3. Have production operations been free from bottlenecks?
4. Are manufacturing facilities capable of meeting long-range customer demands?
5. Are long-range manufacturing plans directed toward acquiring new:
 - a. plant ?

- b. equipment?
 - c. tooling?
- 6. Does manufacturing management have a set procedure for replacing inefficient:
 - a. plant?
 - b. equipment?
 - c. tooling?
- 7. Is factory automation utilised to the fullest extent?
- 8. Are long-range manufacturing plans directed toward manufacturing facilities that are:
 - a. well lighted?
 - b. well ventilated?
 - c. well maintained?
- 9. Does production have a long range preventive maintenance (PM) programme?
- 10. Can present capacity be expanded to meet long-range production needs?
- 11. Do manufacturing facilities lend themselves to:
 - a. a quality control programme?
 - b. utilisation of minicomputers to control automated machines and processes?
 - c. numerical control machine tools.
- 12. Does production have capable managers as:
 - a. plant superintendents?
 - b. work centre supervisors?
 - c. foremen?
- 13. Are manufacturing methods subject to constant scrutiny for improvement?
- 14. Does the company employ an effective wage incentive system to keep costs at a minimum?
- 15. Have the company's manufacturing facilities been operating at a desired level of capacity?
- B. Short- or medium-range plans:
 - 1. Do short- or medium-range manufacturing plans call for leveling out production?
 - 2. Do short- or medium-range manufacturing plans reduce or eliminate production bottlenecks?
 - 3. Do short- or medium-range manufacturing plans include a preventive maintenance (PM) programme?
 - 4. Is there adequate provision for repairs and service of equipment that has high downtime?
 - 5. Is there ample provision for:
 - a. expanding production?
 - b. contracting production?
 - 6. Is there an effective programme to remedy:
 - a. high scrappage rate?
 - b. high rejection rate?

7. Is there a programme to train employees who are not working efficiently?
8. Is there a programme for promoting factory personnel?
9. Do short- or medium-range manufacturing plans provide a method for comparing actual times to standard times?
10. Are manufacturing methods subject to constant scrutiny for improvement?
11. Are manufacturing methods designed for economy of manufacture?
12. Do short- or medium-range manufacturing plans call for increasing worker productivity?
13. Do short- or medium-range manufacturing plans call for good health and safety practices in the manufacturing process?
14. Are current quality control techniques adequate?

C. Organisational structure:

1. Are production facilities well laid out to provide efficient and economical manufacturing?
2. Are production facilities organised so that materials handling is kept to a minimum?
3. Are production facilities organised so that there is an effective preventive maintenance (PM) programme?
4. Are production facilities flexible enough to:
 - a. accommodate shifts in product demand?
 - b. expand production?
 - c. contract production?
5. Is there a definite production programme to obtain improvement, simplification, and economies in:
 - a. equipment and machinery?
 - b. manufacturing processes?
 - c. raw materials?
 - d. direct and indirect labour?
 - e. manufacturing overhead?
6. Do productive operations employ some type of wage-incentive system for manufacturing efficiency?
7. Are production facilities geared to utilise the latest technological developments, such as automatic machines, mechanical robots, and minicomputers?
8. Are production facilities well maintained so as to be safe and free from fire, explosion, and the like?
9. Is the plant well lighted and ventilated?
10. Is there security against strikes, sabotage, and the like?

D. Leadership:

1. Is there leadership evident in the production function, that is, do production personnel feel a real responsibility for production goals and behave in ways to implement them?
2. Do production personnel feel free to discuss their jobs and related problems with their supervisors?
3. Is there a friendly interaction between management and personnel with a degree of confidence and trust?
4. Is the appropriate style of leadership used for, various types of production workers:
 - a. autocratic (no participation in decisions)?

- b. consultative (some degree of participation in decisions)?
 - c. participative (large degree of participation in decisions)?
- 5. Is there a high degree of team work, encouraged by effective leadership at the production level?
- 6. Do production supervisors give the necessary leadership to initiate improvements in work methods?
- 7. Do production supervisors give the necessary leadership to provide economy and efficiency of performance within the production work centres?
- 8. Do production supervisors back up their workers in conflict situations?
- 9. Do production supervisors maintain an open atmosphere to keep labour grievances and complaints to a minimum?
- E. Communication:
 - 1. Do production workers feel free to communicate their problems, whether they be job-related or personal, to their superiors?
 - 2. Have the most efficient manufacturing methods and processes been communicated to production personnel?
 - 3. Is the feedback concept utilised to hold production personnel accountable for their operations?
 - 4. Have the detailed aspects of the incentive system been fully explained to production personnel?
 - 5. Has a preventive maintenance programme been communicated to all production personnel?
 - 6. Have good safety practices been communicated to all production personnel for their protection?
 - 7. Have good "housekeeping" procedures been communicated to all production personnel for increasing productivity?
- F. Control:
 - 1. Are production operations integrated with major input sources:
 - a. engineering?
 - b. inventory?
 - c. purchasing?
 - 2. Are actual manufacturing times compared to standard times as quickly as possible?
 - 3. Is immediate corrective action undertaken once the deficiency is detected?
 - 4. Do production reports, methods, and techniques lend themselves to economy and efficiency in ongoing manufacturing operations?
 - 5. Is there adequate control over manufacturing operations to reduce or eliminate production bottlenecks?
 - 6. Does effective control over production include a preventive maintenance (PM) programme?
 - 7. Are modern handling methods utilised for transportation of in- process manufactured items?
 - 8. Is there effective control over the movement of in-process manufactured items?
 - 9. Is the plant well laid out so as to permit materials flow in the most direct route from receiving through production to shipping?

10. Is the quality control mechanism adequate for producing products of uniform quality?
11. Are statistical quality control techniques used to monitor products at strategic control points?
12. Is there control over production rejects and rework?
13. Is there adequate review of product quality reports with the view of improving operational manufacturing performance?

Appendix 1

THE CHARTERED ACCOUNTANTS ACT, 1949

(ACT No. XXXVIII of 1949)

[As amended by the Chartered Accountants (Amendment) Act, 2006]

An Act to make provision for the regulation of the profession of Chartered Accountants.

WHEREAS it is expedient to make provision for the regulation of the [profession of chartered accountants] and for that purpose to establish an Institute of Chartered Accountants; It is hereby enacted as follows :-

CHAPTER I

PRELIMINARY

1. Short title, extent and commencement

(1) This Act may be called the Chartered Accountants Act, 1949.

(2) It extends to the whole of India [.....]

(3) It shall come into force on such date as the Central Government may, by notification in the official Gazette, appoint in this behalf.

Provided that different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the commencement of that provision.

2. Interpretation

(1) In this Act, unless there is anything repugnant in the subject or context,—

(a) “associate” means an associate member of the Institute; (aa) “Authority” means the Appellate Authority constituted under section 22A;

(aaa) “Board” means the Quality Review Board constituted under section 28A;

(b) “chartered accountant” means a person who is a member of the Institute [.....];

(c) “Council” means the Council of the Institute;

(d) “holder of a restricted certificate” means a person holding a permanent or temporary restricted certificate granted by a Provincial Government under the Restricted Certificates Rules, 1932;

(e) “Institute” means the Institute of Chartered Accountants of India constituted under this Act;

(ea) “notification” means a notification published in the Official Gazette;’.

(f) “prescribed” means prescribed by regulations made under this Act;

(g) “Register” means the Register of Members maintained under this Act;

(h) “registered accountant” means any person who has been enrolled on the Register of Accountants maintained by the Central Government under the Auditor’s Certificates Rules, 1932;

(ha) “specified” means specified by rules made by the Central Government under this Act; (hb) “Tribunal” means a Tribunal established under sub-section (1) of section 10B;

(i) "year" means the period commencing on the 1st day of April of any year and ending on the 31st day of March of the succeeding year.

(2) A member of the Institute shall be deemed "to be in practice", when individually or in partnership with chartered accountants [in practice], he, in consideration of remuneration received or to be received—

(i) engages himself in the practice of accountancy; or

(ii) offers to perform or performs services involving the auditing or verification of financial transactions, books, accounts or records, or the preparation, verification or certification of financial accounting and related statements or holds himself out to the public as an accountant; or

(iii) renders professional services or assistance in or about matters of principle or detail relating to accounting procedure or the recording, presentation or certification of financial facts or data; or

(iv) renders such other services as, in the opinion of the Council, are or may be rendered by a chartered accountant [in practice]; and the words "to be in practice" with their grammatical variations and cognate expressions shall be construed accordingly.

Explanation:— An associate or a fellow of the Institute who is a salaried employee of a chartered accountant in practice or a firm, of such chartered accountants shall, notwithstanding such employment, be deemed to be in practice for the limited purpose of the training of articled assistants.

CHAPTER II

The Institute of Chartered Accountants of India

3. Incorporation of the Institute

(1) All persons whose names are entered in the Register at the commencement of this Act and all persons who may hereafter have their names entered in the Register under the provisions of this Act, so long as they continue to have their names borne on the said Register, are hereby constituted a body corporate by the name of the Institute of Chartered Accountants of India, and all such persons shall, be known as members of the Institute.

(2) The Institute shall have perpetual succession and a common seal and shall have power to acquire, hold and dispose of property, both movable and immovable, and shall by it's name sue or be sued.

4. Entry of Names in the Register

(1) Any of the following persons shall be entitled to have his name entered in the Register, namely:-

(i) any person who is a registered accountant or a holder of a restricted certificate at the commencement of this Act;

(ii) any person who has passed such examination and completed such training as may be prescribed for members of the Institute;

(iii) any person who has passed the examination for the Government Diploma in Accountancy or an examination recognised as equivalent thereto by the rules for the award of the Government Diploma in Accountancy before the commencement of this Act, and who, although not duly qualified to be registered as an accountant under the Auditor's Certificates Rules, 1932, fulfils such conditions as the Central Government may specify in this behalf;

(iv) any person who, at the commencement of this Act, is engaged in the practice of accountancy in any [Part B State] and who, although; not possessing the requisite qualifications to be registered as an accountant under the Auditor's Certificates Rules, 1932, fulfils such conditions as the Central Government may specify in this behalf;

(v) any person who has passed such other examination and completed such other training without India as is recognised by the Central Government or the Council as being equivalent to the examination and training prescribed for members of the Institute:

Provided that in the case of any person who is not permanently residing in India, the Central Government or the Council, as the case may be, may impose such further conditions as it may deem fit;

(vi) any person domiciled in India who at the commencement of this Act is studying for any foreign examination and is at the same time undergoing training, whether within or without India, or, who, having passed such foreign examination, is at the commencement of this Act undergoing training, whether within or without India:

Provided that any such examination or training was recognised before the commencement of this Act for the purpose of conferring the right to be registered as an accountant under Auditor's Certificates Rules, 1932, and provided further that such person passes the examination or completes the training within five years after the commencement of this Act.

(2) Every person belonging to the class mentioned in clause (i) of sub-section (1) shall have his name entered in the Register without the payment of any entrance fee.

(3) Every person belonging to any of the classes mentioned in clauses (ii), (iii), (iv), (v) and (vi) of sub-section (1) shall have his name entered in the Register on application being made and granted in the prescribed manner and on payment of such fees, as may be determined, by notification, by the Council, which shall not exceed rupees three thousand:

Provided that the Council may, with the prior approval of the Central Government, determine the fee exceeding rupees three thousand, which shall not in any case exceed rupees six thousand.

(4) The Central Government shall take such steps as may be necessary for the purpose of having the names of all persons belonging to the class mentioned in clause (i) of sub-section (1) entered in the Register.

5. Fellows and Associates

(1) The members of the Institute shall be divided into two classes designated respectively as associates and fellows.

(2) Any person shall, on his name being entered in the Register, be deemed to have become an associate member of the Institute and be entitled to use the letters A.C.A. after his name to indicate that he is an associate member of the Institute of Chartered Accountants.

(3) A member, being an associate who has been in continuous practice in India for at least five years, whether before or after the commencement of this Act, or whether partly before and partly after the commencement of this Act, and a member who has been an associate for a continuous period of not less than five years and who possesses such qualifications as the Council may prescribe with a view to ensuring that he has experience equivalent to the experience normally acquired as a result of continuous practice for a period of five years as a chartered accountant shall, on payment of such fees, as may be determined, by notification, by the Council, which shall not exceed rupees five thousand and on application made and granted in the prescribed manner, be entered in the Register as a fellow of the Institute and shall be entitled to use the letters F. C. A. after his name to indicate that he is a fellow of the Institute of Chartered Accountants:

Provided that the Council may with the prior approval of the Central Government, determine the fee exceeding rupees five thousand, which shall not in any case exceed rupees ten thousand.

6. Certificate of Practice

(1) No member of the Institute shall be entitled to practise [whether in India or elsewhere] unless he has obtained from the Council a certificate of practice:

Provided that nothing contained in this sub-section shall apply to any person who, immediately before the commencement of this Act, has been in practice as a registered accountant or a holder of a restricted certificate until one month has elapsed from the date of the first meeting of the Council.

(2) Every such member shall pay such annual fee for his certificate as may be determined, by notification, by the Council, which shall not exceed rupees three thousand, and such fee shall be payable on or before the 1st day of April in each year:

Provided that the Council may with the prior approval of the Central Government, determine the fee exceeding rupees three thousand, which shall not in any case exceed rupees six thousand.

(3) The certificate of practice obtained under sub-section (1) may be cancelled by the Council under such circumstances as may be prescribed.

7. Members to be known as Chartered Accountants

Every member of the Institute in practice shall, and any other member may, use the designation of a chartered accountant and no member using such designation shall use any other description, whether in addition thereto or in substitution therefor:

Provided that nothing contained in this section shall be deemed to prohibit any such person from adding any other description or letters to his name, if entitled thereto, to indicate membership of such other Institute of accountancy, whether in India or elsewhere, as may be recognised in this behalf by the Council, or any other qualification that he may possess, or to prohibit a firm, all the partners of which are members of the Institute and in practice, from being known by its firm name as Chartered Accountants.

8. Disabilities

Notwithstanding anything contained in Section 4, a person shall not be entitled to have his name entered in or borne on the Register if he --

(i) has not attained the age of twenty-one years at the time of his application for the entry of his name in the Register; or

(ii) is of unsound mind and stands so adjudged by a competent Court; or

(iii) is an undischarged insolvent; or

(iv) being a discharged insolvent, has not obtained from the Court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part; or

(v) has been convicted by a competent Court whether within or without India, of an offence involving moral turpitude and punishable with transportation or imprisonment or of an offence, not of a technical nature, committed by him in his professional capacity unless in respect of the offence committed he has either been granted a pardon or, on an application made by him in this behalf, the Central Government has, by an order in writing, removed the disability; or

(vi) has been removed from membership of the Institute on being found on inquiry to have been guilty of professional or other misconduct:

Provided that a person who has been removed from membership for a specified period, shall not be entitled to have his name entered in the Register until the expiry of such period.

CHAPTER III

COUNCIL OF THE INSTITUTE

9. Constitution of the Council of the Institute

(1) There shall be a Council of the Institute for the management of the affairs of the Institute and for discharging the functions assigned to it under this Act.

(2) The Council shall be composed of the following persons, namely:-

(a) not more than thirty-two persons elected by the members of the Institute from amongst the fellows of the Institute chosen in such manner and from such regional constituencies as may be specified:

Provided that a fellow of the Institute, who has been found guilty of any professional or other misconduct and whose name is removed from the Register or has been awarded penalty of fine, shall not be eligible to contest the election,-

- (i) In case of misconduct falling under the First Schedule of this Act, for a period of three years;
- (ii) in case if misconduct falling under the Second Schedule of this Act, for a period of six years, from the completion of the period of removal of name from the Register or payment of fine, as the case may be;
- (b) not more than eight persons to be nominated in the specified manner, by the Central Government.
- (3) No person holding a post under the Central Government or a State Government shall be eligible for election to the Council under clause (a) of subsection (2).
- (4) No person who has been auditor of the Institute shall be eligible for election to the Council under clause (a) of sub-section (2), for a period of three years after he ceases to be an auditor.

10. Re-election or re-nomination to Council.

A member of the Council, elected or nominated under sub-section (2) of section 9, shall be eligible for re-election or, as the case may be, re-nomination:

Provided that no member shall hold the office for more than three consecutive terms:

Provided further that a member of the Council, who is or has been elected as President under sub-section (1) of section 12, shall not be eligible for election or nomination as a member of the Council.

10A. Settlement of dispute regarding election.

In case of any dispute regarding any election under clause (a) of subsection (2) of section 9, the aggrieved person may make an application within thirty days from the date of declaration of the result of election to the Secretary of the Institute, who shall forward the same to the Central Government.

10B. Establishment of Tribunal.

(1) On receipt of any application under section 10A, the Central Government shall, by notification, establish a Tribunal consisting of a Presiding Officer and two other Members to decide such dispute and the decision of such Tribunal shall be final.

(2) A person shall not be qualified for appointment,-

(a) as a Presiding Officer of the Tribunal unless he has been a member of the Indian Legal Service and has held a post in Grade 1 of the service for at least three years;

(b) as a Member unless he has been a member of the Council for at least one full term and who is not a sitting member of the Council or who has not been a candidate in the election under dispute; or

(c) as a Member unless he holds the post of a Joint Secretary to the Government of India or any other post under the Central Government carrying a scale of pay which is not less than that of a Joint Secretary to the Government of India.

(3) The terms and conditions of service of the Presiding Officer and Members of the Tribunal, their place of meetings and allowances shall be such as may be specified.

(4) The expenses of the Tribunal shall be borne by the Council.

11. Nomination in default of election or nomination

If any body of persons referred to in Section 9 fails to elect any of the members of the Council which it is empowered under that section to elect, the Central Government may nominate a person duly qualified to fill the vacancy, and any person so nominated shall be deemed to be a member of the Council as if he had been duly elected.

12. President and Vice-President

(1) The Council at its first meeting shall elect two of its members to be respectively the President and the Vice-President thereof, and so often as the office of the President or the Vice-President becomes vacant the Council shall choose another person to be the President or the Vice-President as the case may be:

Provided that on the first constitution of the Council a member of the Council nominated in this behalf by the Central Government shall discharge the functions of the President, until such time as a President is elected under the provisions of the sub- section.

(2) The President shall be the Chief Executive Authority of the Council.

(3) The President or the Vice-President shall hold office for a period of one year from the date on which he is chosen but so as not to extend beyond his term of office as a member of the Council, and, subject to his being a member of the Council at the relevant time, he shall be eligible for re-election [under sub-section (1).]

(4) On the expiration of the duration of the Council, the President and the Vice- President of the Council at the time of such expiration] shall continue to hold office and discharge such administrative and other duties as may be prescribed until such time as a new President and the Vice- President shall have been elected and shall have taken over charge of their duties.

13. Resignation of membership and casual vacancies.

(1) Any member of the Council may at any time resign his membership by writing under his hand addressed to the President, and the seat of such member shall become vacant when such resignation is notified in the Official Gazette.

(2) A member of the Council shall be deemed to have vacated his seat if he is declared by the Council to have been absent without sufficient excuse from three consecutive meetings of the Council or he has been found guilty of any professional or other misconduct and awarded penalty of fine, or if his name is, for any cause, removed from the Register under the provisions of Section 20.

(3) A casual vacancy in the Council shall be filled by fresh election from the constituency concerned or by nomination by the Central Government, as the case may be, and the person elected or nominated to fill the vacancy shall hold office until the dissolution of the Council:

Provided that no election shall be held to fill a casual vacancy occurring within [one year] prior to the date of the expiration of the duration of the Council, but such a vacancy may be filled by nomination by the Central Government after consultation with the President of the Council.

(4) No act done by the Council shall be called in question on the ground merely of the existence of any vacancy in, or defect in the constitution of, the Council.

14. Duration and dissolution of Council

(1) The duration of any Council constituted under this Act shall be three years from the date of its first meeting, on the expiry of which it shall stand dissolved and a new Council constituted in accordance with the provisions of this Act.

(2) Notwithstanding the expiration of the duration of a Council (hereinafter referred to as the former Council), the former Council shall continue to exercise its functions until a new Council is constituted in accordance with the provisions of this Act, and on such constitution, the former Council shall stand dissolved.

15. Functions of Council.

(1) The Institute shall function under the overall control, guidance and supervision of the Council and the duty of carrying out the provisions of this Act shall be vested in the Council.

(2) In particular, and without prejudice to the generality of the foregoing powers, the duties of the Council shall include --

(a) to approve academic courses and their contents;

(b) the examination of candidates for enrolment and the prescribing of fees therefor;

- (c) the regulation of the engagement and training of articled and audit assistants
- (d) the prescribing of qualifications for entry in the Register;
- (e) the recognition of foreign qualifications and training for the purposes of enrolment;
- (f) the granting or refusal of certificates of practice under this Act;
- (g) the maintenance and publication of a Register of persons qualified to practice as chartered accountants;
- (h) the levy and collection of fees from members, examinees and other persons;
- (i) subject to the orders of the appropriate authorities under the Act, the removal of names from the Register and the restoration to the Register of names which have been removed;
- (j) the regulation and maintenance of the status and standard of professional qualifications of members of the Institute;
- (k) the carrying out, by granting financial assistance to persons other than members of the Council or in any other manner, of research in accountancy;
- (l) the maintenance of a library and publication of books and periodicals relating to accountancy;
- (m) to enable functioning of the Director (Discipline), the Board of Discipline, the Disciplinary Committee and the Appellate Authority constituted under the provisions of this Act;
- (n) to enable functioning of the Quality Review Board;
- (o) consideration of the recommendations of the Quality Review Board made under clause (a) of section 28B and the details of action taken thereon in its annual report; and
- (p) to ensure the functioning of the Institute in accordance with the provisions of this Act and in performance of other statutory duties as may be entrusted to the Institute from time to time.

15A. Imparting education by Universities and other bodies.

- (1) Subject to the provisions of this Act, any University established by law or any body affiliated to the Institute, may impart education on the subjects covered by the academic courses of the Institute.
- (2) The Universities or bodies referred to in sub-section (1) shall, while awarding degree, diploma or certificate or bestowing any designation, ensure that the award or designation do not resemble or is not identical to one awarded by the Institute.
- (3) Nothing contained in this section shall enable a University or a body to adopt a name or nomenclature which is in any way similar to that of the Institute.

16. Officers and employees, salary, allowances etc.

- (1) For the efficient performance of its duties, the Council shall --
 - (a) appoint a Secretary to perform such duties as may be prescribed;
 - (b) appoint a Director (Discipline) to perform such functions as are assigned to him under this Act and the rules and regulations framed thereunder;
- (2) The Council may also—
 - (a) appoint such other officers and employees as it considers necessary;
 - (b) require and take from the Secretary or from any other officer or employee such security for the due performance of his duties, as the Council considers necessary;
 - (c) prescribe the salaries, fees, allowances of the officers and employees and their terms and conditions of service;
 - (d) with the previous sanction of the Central Government, fix the allowances of the President, Vice-President and other members of the Council and members of its Committees;

(3) The Secretary of the Council shall be entitled to participate in the meetings of the Council but shall not be entitled to vote thereat.

17. Committees of the Council.

(1) The Council shall constitute from amongst its members the following Standing Committees, namely:-

- (i) an Executive Committee,
- (ii) an Examination Committee, and
- (iii) a Finance Committee.

(2) The Council may also form such other committees from amongst its members as it consider necessary for the purpose of carrying out the provisions of this Act, and any Committee so formed may, with the sanction of the Council, co-opt such other members of the Institute not exceeding one-third of the members of the committee as it thinks fit, and any member so co-opted shall be entitled to exercise all the rights of a member of the committee.

(3) Each of the Standing Committees shall consist of the President and the Vice- President ex officio, and minimum of three and maximum of five members to be elected by the Council from amongst its members.

(4) The President and the Vice-President of the Council shall be the Chairman and Vice-Chairman respectively of each of the Standing Committees.

(5) Every member of the Standing Committee other than the Chairman and the Vice-Chairman shall hold office for one year from the date of his election, but, subject to being a member of the Council, he shall be eligible for reelection.

(6) The Standing Committees shall exercise such functions and be subject to such conditions in the exercise thereof as may be prescribed.

18. Finances of the Council.

(1) There shall be established a fund under the management and control of the Council into which shall be paid all moneys received by the Council and out of which shall be met all expenses and liabilities properly incurred by the Council.

(2) The Council may invest any money for the time being standing to the credit of the fund in any Government security or in any other security approved by the Central Government.

(3) The Council shall keep proper accounts of the fund distinguishing capital from revenue in the manner prescribed.

(4) The Council shall prepare in the manner prescribed and approve, prior to the start of the financial year, an annual financial statement (the budget) indicating all its anticipated revenues as well as all proposed expenditures for the forthcoming year.

(5) The annual accounts of the Council shall be prepared in such manner as may be prescribed and be subject to audit by a chartered accountant in practice to be appointed annually by the Council:

Provided that no member of the Council or a person who has been a member of the Council during the last four years or a person who is in partnership with such member shall be eligible for appointment as an auditor under this sub-section:

Provided further that, in the event it is brought to the notice of the Council that the accounts of the Council do not represent a true and fair view of its finances, then the Council may itself cause a special audit to be conducted:

Provided also that, if such information, that the accounts of the Council do not represent a true and fair view of its finances, is sent to the Council by the Central Government, then, the Council may, wherever appropriate cause a special audit or take such other action as it considers necessary and shall furnish an action taken report on it to the Central Government.

(5A) As soon as may be practicable at the end of each year, the Council shall circulate the audited accounts to its members at least fifteen days in advance and consider and approve these accounts in a special meeting convened for the purpose.

(5B) The Council shall cause to be published in the Gazette of India not later than the 30th day of September of the year next following, a copy of the audited accounts and the Report of the Council for that year duly approved by the Council and copies of the said accounts and Report shall be forwarded to the Central Government and to all the members of the Institute.

(6) The Council may borrow from a scheduled bank, as defined in the Reserve Bank of India Act, 1934, (II of 1934) or from the Central Government—

(a) any money required for meeting its liabilities on capital account on the security of the fund or on the security of any other assets for the time being belonging to it; or

(b) for the purpose of meeting current liabilities pending the receipt of income, by way of temporary loan or overdraft.

CHAPTER IV

REGISTER OF MEMBERS

19. Register

(1) The Council shall maintain, in the prescribed manner, a Register of the Members of the Institute.

(2) The Register shall include the following particulars about every member of the Institute, namely:-

(a) his full name, date of birth, domicile, residential and professional address;

(b) the date on which his name is entered in the Register;

(c) his qualifications;

(d) whether he holds a certificate of practice; and

(e) any other particulars which may be prescribed.

(3) The Council shall cause to be published in such manner as may be prescribed, a list of members of the Institute as on the 1st day of April of each year, and shall, if requested to do so by any such member, send to him a copy of such list on payment of such amount as may be prescribed.

(4) Every member of the Institute shall, on his name being entered in the Register, pay such annual membership fee as may be determined, by notification, by the Council, which shall not exceed rupees five thousand:

Provided that the Council may with the prior approval of the Central Government, determine the fee exceeding rupees five thousand, which shall not in any case exceed rupees ten thousand.

20. Removal from the Register.

(1) The Council may remove from the Register the name of any member of the Institute --

(a) who is dead; or

(b) from whom a request has been received to that effect; or

(c) who has not paid any prescribed fee required to be paid by him; or

(d) who is found to have been subject at the time when his name was entered in the Register, or who at any time thereafter has become subject, to any of the disabilities mentioned in Section 8, or who for any other reason has ceased to be entitled to have his name borne on the Register.

(2) The Council shall remove from the Register the name of any member in respect of whom an order has been passed under this Act removing him from membership of the Institute.

(3) If the name of any member has been removed from the Register under clause (c) of sub-section (1), on receipt of an application, his name may be entered again in the Register on payment of the

arrears of annual fee and entrance fee along with such additional fee, as may be determined, by notification, by the Council which shall not exceed rupees two thousand:

Provided that the Council may with the prior approval of the Central Government, determine the fee exceeding rupees two thousand, which shall not in any case exceed rupees four thousand.

CHAPTER V

MISCONDUCT

21. Disciplinary Directorate.

(1) The Council shall, by notification, establish a Disciplinary Directorate headed by an officer of the Institute designated as Director (Discipline) and such other employees for making investigations in respect of any information or complaint received by it.

(2) On receipt of any information or complaint along with the prescribed fee, the Director (Discipline) shall arrive at a prima facie opinion on the occurrence of the alleged misconduct.

(3) Where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the First Schedule, he shall place the matter before the Board of Discipline and where the Director (Discipline) is of the opinion that a member is guilty of any professional or other misconduct mentioned in the Second Schedule or in both the Schedules, he shall place the matter before the Disciplinary Committee.

(4) In order to make investigations under the provisions of this Act, the Disciplinary Directorate shall follow such procedure as may be specified.

(5) Where a complainant withdraws the complaint, the Director (Discipline) shall place such withdrawal before the Board of Discipline or, as the case may be, the Disciplinary Committee, and the said Board or Committee may, if it is of the view that the circumstances so warrant, permit the withdrawal at any stage.

21A. Board of Discipline.

(1) The Council shall constitute a Board of Discipline consisting of--

(a) a person with experience in law and having knowledge of disciplinary matters and the profession, to be its presiding officer;

(b) two members one of whom shall be a member of the Council elected by the Council and the other member shall be nominated by the Central Government from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy;

(c) the Director (Discipline) shall function as the Secretary of the Board.

(2) The Board of Discipline shall follow summary disposal procedure in dealing with all cases before it.

(3) Where the Board of Discipline is of the opinion that a member is guilty of a professional or other misconduct mentioned in the First Schedule, it shall afford to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely:-

(a) reprimand the member;

(b) remove the name of the member from the Register up to a period of three months;

(c) impose such fine as it may think fit which may extend to rupees one lakh.

(4) The Director (Discipline) shall submit before the Board of Discipline all information and complaints where he is of the opinion that there is no prima-facie case; and the Board of Discipline may, if it agrees with the opinion of the Director (Discipline), close the matter or in case of disagreement, may advise the Director (Discipline) to further investigate the matter.

21B. Disciplinary Committee.

(1) The Council shall constitute a Disciplinary Committee consisting of the President or the Vice-President of the Council as the Presiding Officer and two members to be elected from amongst the members of the Council and two members to be nominated by the Central Government from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy:

Provided that the Council may constitute more Disciplinary Committees as and when it considers necessary.

(2) The Disciplinary Committee, while considering the cases placed before it shall follow such procedure as may be specified.

(3) Where the Disciplinary Committee is of the opinion that a member is guilty of a professional or other misconduct mentioned in the Second Schedule or both the First Schedule and the Second Schedule, it shall afford to the member an opportunity of being heard before making any order against him and may thereafter take any one or more of the following actions, namely: -

(a) reprimand the member;

(b) remove the name of the member from the Register permanently or for such period, as it thinks fit;

(c) impose such fine as it may think fit, which may extend to rupees five lakhs.

(4) The allowances payable to the members nominated by the Central Government shall be such as may be specified.

21C. Authority, Disciplinary Committee, Board of Discipline and Director (Discipline) to have powers of civil court.

For the purposes of an inquiry under the provisions of this Act, the Authority, the Disciplinary Committee, Board of Discipline and the Director (Discipline) shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, in respect of the following matters, namely:-

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) the discovery and production of any document; and

(c) receiving evidence on affidavit.

Explanation.- For the purposes of sections 21, 21A, 21B, 21C and 22, "member of the Institute" includes a person who was a member of the Institute on the date of the alleged misconduct although he has ceased to be a member of the Institute at the time of the inquiry.

21D. Transitional Provisions.

All complaints pending before the Council or any inquiry initiated by the Disciplinary Committee or any reference or appeal made to a High Court prior to the commencement of the Chartered Accountants (Amendment) Act, 2006, shall continue to be governed by the provisions of this Act, as if this Act had not been amended by the Chartered Accountants (Amendment) Act, 2006.

22. Professional or other misconduct defined.

For the purposes of this Act, the expression "professional or other misconduct" shall be deemed to include any act or omission provided in any of the Schedules, but nothing in this section shall be construed to limit or abridge in any way the power conferred or duty cast on the Director (Discipline) under sub-section (1) of section 21 to inquire into the conduct of any member of the Institute under any other circumstances.

22A. Constitution of Appellate Authority.

(1) The Central Government shall, by notification, constitute an Appellate Authority consisting of --

(a) a person who is or has been a judge of a High Court, to be its Chairperson;

(b) two members to be appointed from amongst the persons who have been members of the Council for at least one full term and who is not a sitting member of the Council;

(c) two members to be nominated by the Central Government from amongst persons having knowledge and practical experience in the field of law, economics, business, finance or accountancy.

(2) The Chairperson and other members shall be part-time members.

22B. Term of office of Chairperson and members of Authority.

(1) A person appointed as the Chairperson shall hold office for a term of three years from the date on which he enters upon his office or until he attains the age of sixty-five years, whichever is earlier,

(2) A person appointed as a member shall hold office for a term of three years from the date on which he enters upon his office or until he attains the age of sixty-two years, whichever is earlier.

22C. Allowances and conditions of service of Chairperson and Members of Authority.

(1) The allowances payable to, and other terms and conditions of service of, the Chairperson and members and the manner of meeting expenditure of the Authority by the Council and such other authorities shall be such as may be specified.

22D. Procedure to be regulated by Authority.

(1) The office of the Authority shall be at Delhi.

(2) The Authority shall regulate its own procedure.

(3) All orders and decisions of the Authority shall be authenticated by an officer duly authorised by the Chairperson in this behalf.

22E. Officers and other staff of Authority.

(1) The Council shall make available to the Authority such officers and other staff members as may be necessary for the efficient performance of the functions of the Authority.

(2) The salaries and allowances and conditions of service of the officers and other staff members of the Authority shall be such as may be prescribed.

22F. Resignation and removal of Chairperson and members.

(1) The Chairperson or a member may, by notice in writing under his hand addressed to the Central Government, resign his office:

Provided that the Chairperson or a member shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of term of office, whichever is earlier.

(2) The Chairperson or a member shall not be removed from his office except by an order of the Central Government on the ground of proved misbehavior or incapacity after an inquiry made by such person as the Central Government may appoint for this purpose in which the Chairperson or a member concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of such charges.

22G. Appeal to Authority.

(1) Any member of the Institute aggrieved by any order of the Board of Discipline or the Disciplinary Committee imposing on him any of the penalties referred to in sub-section (3) of section 21A and sub-section (3) of section 21B, may within ninety days from the date on which the order is communicated to him, prefer an appeal to the Authority:

Provided that the Director (Discipline) may also appeal against the decision of the Board of Discipline or the Disciplinary Committee to the Authority, if so authorised by the Council, within ninety days:

Provided further that the Authority may entertain any such appeal after the expiry of the said period of ninety days, if it is satisfied that there was sufficient cause for not filing the appeal in time.

(2) The Authority may, after calling for the records of any case, revise any order made by the Board of Discipline or the Disciplinary Committee under sub-section (3) of section 21A and sub-section (3) of section 21B and may -

- (a) confirm, modify or set aside the order;
- (b) impose any penalty or set aside, reduce, or enhance the penalty imposed by the order;
- (c) remit the case to the Board of Discipline or Disciplinary Committee for such further enquiry as the Authority considers proper in the circumstances of the case; or
- (d) pass such other order as the Authority thinks fit:

Provided that the Authority shall give an opportunity of being heard to the parties concerned before passing any order.

CHAPTER VI

REGIONAL COUNCILS

23. Constitution and functions of Regional Councils.

(1) For the purpose of advising and assisting it on matters concerning its functions, the Council may constitute such Regional Councils as and when it deems fit for one or more of the regional constituencies that may be specified by the Central Government under clause (a) of sub-section (2) of Section 9.

(2) The Regional Councils shall be constituted in such manner and exercise such functions as may be prescribed.

CHAPTER VII

PENALTIES

24. Penalty for falsely claiming to be a member, etc.

Any person who --

- (i) not being a member of the Institute --
 - (a) represents that he is a member of the Institute; or
 - (b) uses the designation Chartered Accountant; or
- (ii) being a member of the Institute, but not having a certificate of practice, represents that he is in practice or practises as a chartered accountant, shall be punishable on first conviction with fine which may extend to one thousand rupees, and on any subsequent conviction with imprisonment which may extend to six months or with fine which may extend to five thousand rupees, or with both.

24A. Penalty for using name of the Council, awarding degree of chartered accountancy, etc.

(1) Save as otherwise provided in this Act, no person shall—

- (i) use a name or the common seal which is identical with the name or the common seal of the Institute or so nearly resembles it as to deceive or as is likely to deceive the public;
- (ii) award any degree, diploma or certificate or bestow any designation which indicates or purports to indicate the position or attainment of any qualification or competence similar to that of a member of the Institute; or
- (iii) seek to regulate in any manner whatsoever the profession of chartered accountants.

(2) Any person contravening the provisions of sub-section (1) shall, without prejudice to any other proceedings which may be taken against him, be punishable with fine which may extend on first conviction to one thousand rupees, and on any subsequent conviction with imprisonment which may extend to six months, or with fine which may extend to five thousand rupees, or with both.

25. Companies not to engage in accountancy.

- (1) No company, whether incorporated in India or elsewhere, shall practise as chartered accountants.
- (2) If any company contravenes the provisions of sub-section (1), then, without prejudice to any other proceedings which may be taken against the company, every director, manager, secretary and any other officer thereof who is knowingly a party to such contravention shall be punishable with fine which may extend on first conviction to one thousand rupees, and on any subsequent conviction to five thousand rupees.

26. Unqualified persons not to sign documents.

- (1) No person other than a member of the Institute shall sign any document on behalf of a chartered accountant in practice or a firm of such chartered accountants in his or its professional capacity.
- (2) Any person who contravenes the provisions of sub-section (1) shall, without prejudice to any other proceedings, which may be taken against him, be punishable on first conviction with a fine not less than five thousand rupees but which may extend to one lakh rupees, and in the event of a second or subsequent conviction with imprisonment for a term which may extend to one year or with fine not less than ten thousand rupees but which may extend to two lakh rupees or with both.

27. Maintenance of branch offices.

- (1) Where a chartered accountant in practice or a firm of such chartered accountants has more than one office in India, each one of such offices shall be in the separate charge of a member of the Institute:

Provided that the Council may in suitable cases exempt any chartered accountant in practice or a firm of such chartered accountants from the operation of this sub-section.

- (2) Every chartered accountant in practice or a firm of such chartered accountants maintaining more than one office shall send to the Council a list of offices and the persons in charge thereof and shall keep the Council informed of any changes in relation thereto.

28. Sanction to prosecute.

No person shall be prosecuted under this Act except on a complaint made by or under the order of the Council or of the Central Government.

CHAPTER VIIA

QUALITY REVIEW BOARD

28A. Establishment of Quality Review Board.

- (1) The Central Government shall, by notification, constitute a Quality Review Board consisting of a Chairperson and ten other members.
- (2) The Chairperson and members of the Board shall be appointed from amongst the persons of eminence having experience in the field of law, economics, business, finance or accountancy.
- (3) Five members of the Board shall be nominated by the Council and other five members shall be nominated by the Central Government.

28B. Functions of Board.

The Board shall perform the following functions, namely:-

- (a) to make recommendations to the Council with regard to the quality of services provided by the members of the Institute;
- (b) to review the quality of services provided by the members of the Institute including audit services; and
- (c) to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.

28C. Procedure of Board.

The Board shall meet at such time and place and follow in its meetings such procedure as may be specified.

28D. Terms and conditions of services of Chairperson and members of Board and its expenditure.

(1) The terms and conditions of service of the Chairperson and the members of the Board, and their allowances shall be such as may be specified.

(2) The expenditure of the Board shall be borne by the Council.

CHAPTER VIII

MISCELLANEOUS

29. Reciprocity.

(1) Where any country, specified by the Central Government in this behalf by notification in the official Gazette, prevents persons of Indian domicile from becoming members of any institution similar to the Institute of Chartered Accountants of India or from practising the profession of accountancy or subjects them to unfair discrimination in that country, no subject of any such country shall be entitled to become a member of the Institute or practise the profession of accountancy in India.

(2) Subject to the provisions of sub-section (1), the Council may prescribe the conditions, if any, subject to which foreign qualifications relating to accountancy shall be recognised for the purposes of entry in the Register.

29A. Power of Central Government to make rules.

(1) The Central Government may, by notification, make rules to carry out the provisions of this Act.

(2) In particular and without prejudice to the generality of the foregoing powers, such rules may provide for all or any of the following matters, namely:-

(a) the manner of election and nomination in respect of members to the Council under sub-section (2) of section 9;

(b) the terms and conditions of service of the Presiding Officer and Members of the tribunal, place of meetings and allowances to be paid to them under sub-section (3) of section 10B;

(c) the procedure of investigation under sub-section (4) of section 21;

(d) the procedure while considering the cases by the Disciplinary Committee under sub-section (2), and the fixation of allowances of the nominated members under sub-section (4) of section 21B;

(e) the allowances and terms and conditions of service of the Chairperson and members of the Authority and the manner of meeting expenditure by the Council under section 22C;

(f) the procedure to be followed by the Board in its meetings under section 28C; and

(g) the terms and conditions of service of the Chairperson and members of the Board under sub-section (1) of section 28D.

30. Power to make regulations.

(1) The Council may, by notification in the "Gazette of India", make regulations for the purpose of carrying out the objects of this Act.

(2) In particular, and without prejudice to the generality of the foregoing power, such regulations may provide for all or any of the following matters:—

(a) the standard and conduct of examinations under this Act;

(b) the qualifications for the entry of the name of any person in the Register as a member of the Institute;

- (c) the conditions under which any examination or training may be treated as equivalent to the examination and training prescribed for members of the Institute;
- (d) the conditions under which any foreign qualification may be recognised;
- (e) the manner in which and the conditions subject to which applications for entry in the Register may be made;
- (f) the fees payable for membership of the Institute and the annual fees payable by associates and fellows of the Institute in respect of their certificates;
- (g) the manner in which elections to [.....] the Regional Councils may be held;
- (h) the particulars to be entered in the Register;
- (i) the functions of Regional Councils;
- (j) the training of articled and audit Assistants, the fixation of limits within which premia may be charged from articled Assistants and the cancellation of articles and termination of audit service for misconduct or for any other sufficient cause;
- (k) the regulation and maintenance of the status and standard of professional qualifications of members of the Institute;
- (l) the carrying out of research in accountancy;
- (m) the maintenance of a library and publication of books and periodicals on accountancy;
- (n) the management of the property of the Council and the maintenance and audit of its accounts;
- (o) the summoning and holding of meetings of the Council, the times and places of such meetings, the conduct of business thereat and the number of members necessary to form a quorum;
- (p) the powers, duties and functions of the President and the Vice- President of the Council;
- (q) the functions of the Standing and other Committees and the conditions subject to which such functions shall be discharged;
- (r) the terms of office, and the powers, duties and functions of the Secretary and other officers and servants of the Council; [and]

[(s) Omitted]

(t) any other matter which is required to be or may be prescribed under this Act.

(3) All regulations made by the Council under this Act shall be subject to the condition of previous publication and to the approval of the Central Government.

(4) Notwithstanding anything contained in sub-sections (1) and (2) the Central Government may frame the first regulations for the purposes mentioned in this section, and such regulations shall be deemed to have been made by the Council, and shall remain in force from the date of the coming into force of this Act, until they are amended, altered or revoked by the Council.

30A. Powers of Central Government to direct regulations to be made or to make or amend regulations.

(1) Where the Central Government considers it expedient so to do, it may, by order in writing, direct the Council to make any regulations or to amend or revoke any regulations already made within such period as it may specify in this behalf.

(2) If the Council fails or neglects to comply with such order within the specified period, the Central Government may make the regulations or amend or revoke the regulations made by the Council, as the case may be, either in the form specified in the order or with such modifications thereof as the Central Government thinks fit.

30B. Rules, regulations and notifications to be laid before Parliament.

Every rule and every regulation made and every notification issued under this Act shall be laid, as soon as may be after it is made or issued, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule, regulation or notification, or both Houses agree that the rule, regulation or notification should not be made or issued, the rule, regulation or notification, shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule, regulation or notification.

30C. Power of Central Government to issue directions.

(1) In the event of non-compliance by the Council of any provisions of this Act, the Central Government may give to the Council such general or special directions as it considers necessary to ensure compliance and the Council shall, in the discharge of its functions under this Act, comply with such directions.

(2) If, in the opinion of the Central Government, the Council has persistently made default in giving effect to the directions issued under subsection (1), it may, after giving an opportunity of being heard to the Council, by notification, dissolve the Council, whereafter a new Council shall be constituted in accordance with the provisions of this Act with effect from such date as may be decided by the Central Government:

Provided that the Central Government shall ensure constitution of a new Council in accordance with the provisions of this Act within a period of one year from the date of its dissolution.

(3) Where the Central Government has issued a notification under sub-section (2) dissolving the Council, it shall, pending the constitution of a new Council in accordance with the provisions of this Act, nominate any person or body of persons not exceeding five members to manage the affairs and discharge all or any of the functions of the Council under this Act.”;

30D. Protection of action taken in good faith.

No suit, prosecution or other legal proceeding shall lie against the Central Government or the Council or the Authority or the Disciplinary Committee or the Tribunal or the Board or the Board of Discipline or the Disciplinary Directorate or, any officer of that Government, Council, Authority, Disciplinary Committee, Tribunal, Board, Board of Discipline or the Disciplinary Directorate, for any thing which is in good faith done or intended to be done under this Act or any rule, regulation, notification, direction or order made thereunder.

30E. Members, etc., to be public servants.

The Chairperson, Presiding Officer, Members and other officers and employees of the Authority, Disciplinary Committee, Tribunal, Board, Board of Discipline or the Disciplinary Directorate shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code.

31. Construction of references.

Any reference to a chartered accountant or a registered accountant or a certified or qualified auditor in any other law or in any document whatsoever shall be construed as a reference to a chartered accountant in practice within the meaning of this Act.

32. Act not to affect right of accountants to practise as such in Acceding States.

Nothing contained in this Act shall affect the right of any person who, at the commencement of this Act, is entitled to engage himself in the practice of accountancy in any [Part B State] under any law in force in that State, to continue to engage himself in the practice of accountancy in that State after the commencement of this Act.

33. [Repealed.]

[THE FIRST SCHEDULE]

[See sections 21(30, 21A(3) and 22]

PART I

Professional misconduct in relation to chartered accountants in practice

A chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he —

(1) allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him;

(2) pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Explanation. - In this item, "partner" includes a person residing outside India with whom a chartered accountant in practice has entered into partnership which is not in contravention of item (4) of this Part;

(3) accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute:

Provided that nothing herein contained shall be construed as prohibiting a member from entering into profit sharing or other similar arrangements, including receiving any share commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in item (2) of this Part;

(4) enters into partnership, in or outside India, with any person other than a chartered accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (v) of sub-section (1) of section 4 or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships;

(5) secures, either through the services of a person who is not an employee of such chartered accountant or who is not his partner or by means which are not open to a chartered accountant, any professional business:

Provided that nothing herein contained shall be construed as prohibiting any arrangement permitted in terms of items (2), (3) and (4) of this Part;

(6) solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means:

Provided that nothing herein contained shall be construed as preventing or prohibiting --

(i) any chartered accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice ; or

(ii) a member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence;

(7) advertises his professional attainments or services, or uses any designation or expressions other than chartered accountant on professional documents, visiting cards, letter heads or sign boards, unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the Institute of Chartered Accountants of India or of any

other institution that has been recognised by the Central Government or may be recognised by the Council:

Provided that a member in practice may advertise through a write up setting out the services provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council;

(8) accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing;

(9) accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of section 225 of the Companies Act, 1956 [9 1 of 1956] in respect of such appointment have been duly complied with;

(10) charges or offers to charge, accepts or offers to accept in respect of any professional employment, fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulation made under this Act;

(11) engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage:

Provided that nothing contained herein shall disentitle a chartered accountant from being a director of a company (not being a managing director or a whole time director) unless he or any of his partners is interested in such company as an auditor;

(12) 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.

PART II

Professional misconduct in relation to members of the Institute in service

A member of the Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person --

(1) pays or allows or agrees to pay directly or indirectly to any person any share in the emoluments of the employment undertaken by him;

(2) accepts or agrees to accept any part of fees, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

PART III

Professional misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he --

(1) not being a fellow of the Institute, acts as a fellow of the Institute;

(2) does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;

(3) while inviting professional work from another chartered accountant or while responding to tenders or enquiries or while advertising through a write up, or anything as provided for in items (6) and (7) of Part I of this Schedule, gives information knowing it to be false.

PART IV

Other misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he—

- (1) is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months;
- (2) in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

THE SECOND SCHEDULE

[See sections 21(3), 21B(3) and 22]

PART I

Professional misconduct in relation to chartered accountants in practice

A chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he —

- (1) discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client or otherwise than as required by any law for the time being in force;
- (2) certifies or submits in his name, or in the name of his firm, a report of an examination of financial statements unless the examination of such statements and the related records has been made by him or by a partner or an employee in his firm or by another chartered accountant in practice;
- (3) permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast;
- (4) expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest;
- (5) fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity;
- (6) fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity;
- (7) does not exercise due diligence, or is grossly negligent in the conduct of his professional duties;
- (8) fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion;
- (9) fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances;
- (10) fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

PART II

Professional misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

- (1) contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council;
- (2) being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment except as and when required by any law for the time being in force or except as permitted by the employer;
- (3) includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false;
- (4) defalcates or embezzles moneys received in his professional capacity.

PART III

Other misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.]

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PAPER – 4 : CORPORATE LAWS AND SECRETARIAL PRACTICE

QUESTIONS

1. A Public Company sought extension of time from the ROC for holding AGM upto a period of 3 months and it was granted. However, when the AGM was held and the accounts were presented, it was found that the annual accounts were upto a period beyond which it is permissible. The Company contended that since ROC granted extension of time for holding AGM upto a period of 3 months, the same would also be applicable for presentation of accounts as well. Referring to the relevant provisions of the Companies Act, 1956, whether the contention of the company shall/may hold good?
2. A Director of a Public Company has taken a loan under section 295 of the Companies Act, 1956 without obtaining the approval of the Central Government. The Central Government has issued a notice to him as to why action cannot be taken against him. The concerned director is contemplating to avoid prosecution by applying to the Central Government for approval of the loan and in case it is not possible to obtain the approval, he wants to refund the loan. Advise him whether he would succeed in his mission for avoiding the prosecution under section 295? Also examine whether the offence could get compoundable under section 621A of the Companies Act, 1956. If so when the application for compounding the offence should be made. i.e. whether before or after the institution of prosecution.
3. According to the Companies Act, 1956, an individual cannot be auditor of more than twenty companies at a time. Further, out of these twenty companies, not more than ten should be companies having a paid-up capital of Rs.25 lakhs or more. Mr. Excellent is an individual auditor wants to compute the specified number of audits and for this purpose, a list has been drawn out which identify, the company which shall be/not be taken into account for the purpose of calculating specified number of audits:
 - (i) Audit of Private Company
 - (ii) Guarantee companies not having share capital
 - (iii) Audit of non-profit companies
 - (iv) Special Audits
 - (v) Audits- of Foreign Companies
 - (vi) Branch Audits
 - (vii) Company audit where he is appointed as a joint auditor

Besides, he wants to know that as a member of the ICAI, is there any other restriction on him as a matter of self-regulation in the matter of inclusion/exclusion of audit of private companies for the purpose of calculating specified number of audit assignments. Advise.

1. The articles of a public company provides for appointment of directors by the principle of proportional representation. Referring to the relevant provisions, if any contained in the Companies Act, 1956, advise the company to the methods which it may adopt for the purpose and the procedure for the same. Illustrate your answer.
2. In a public company the total number of directors are 9 and 2 officers of the directors have fallen vacant. Referring to the relevant provisions of the Companies Act,
 - (a) What would be the quorum for the Board meeting?
 - (b) Can the articles of a company fix the quorum (higher or lower) for the Board meeting.
 - (c) Assuming if there are 15 directors in the company and of which 13 happen to be interested directors, what would be the quorum.
 - (d) How do you resolve the situation if all the directors are interested in a particular transaction?

6. Mr. A has been appointed as a director in a Public Limited Company? Referring to the provisions of the Companies Act, 1956 state:
 - (a) Whether the director should possess any share qualification?
 - (b) If so what is the number of share(s), which he should acquire and at what value?
 - (c) Whether the articles of the company can insist on the director for compulsory acquiring of share qualification?
7. Mr. X is serving in a company in the dual capacity of a director under employee? Referring to the provisions of the Companies Act, 1956. State:
 - (a) Whether there is any prohibition/restriction in serving in the dual capacity?
 - (b) If so whether a director serving as an employee would amount to holding an office or place of profit?
 - (c) Whether the remuneration drawn by the director as an employee of the company would be governed by the provisions relating to managerial remuneration?
 - (d) What would be your answer in the said director is rendering services of a professional nature?
8. A public company is contemplating setting up an Audit Committee as a part of good corporate governance. Advise the company on the Constitution, Composition, Terms of Reference and the Role of Audit Committee. In your opinion, whether setting up of such an Audit Committee is supplementary or complimentary to the Board.
9. Draft a Board Resolution for appointment of a sole selling agent who is having substantial interest in the company.
10. With reference to the relevant provisions of the Companies Act, 1956, advise the company on the matters relating to sending of notices of Board meetings:
 - (a) Mr. A, a director states that he will not be able to attend next Board meeting.
 - (b) Mr. B, goes abroad for 5 months and an alternate director has been appointed in his place.
 - (c) Mr. C, is a director residing abroad representing the foreign collaborator and articles of association of the company provides for sending notice to such directors.
11. The Board of Directors of a public company wants to donate out of its profits to charitable purposes which are not directly related to the business of the company. Advise, whether the company can do so? Would your answer be different, if the said company is working at a loss?
12. The director of a public company desire to authorize the managing director to invest from time to time surplus funds in the purchase of shares of other companies. State with reasons whether delegation of such power to the managing director is valid?
13. A shareholder/creditor of a Public Limited Company wants to file a petition praying for relief against oppression as well as for winding up of the company. Advise whether such a composite or simultaneous petition is maintainable?
14. ABC Ltd has made an offer to acquire all the equity shares of XYZ Ltd at a certain price. Members of the company who hold 90% of the shares of XYZ Ltd have accepted the offer. The remaining shares are held by 2 persons who do not agree to the deal. Explain the procedure to finalize the deal. State the steps to be taken to acquire the shares of dissenting shareholders? Also, state whether ABC Ltd can acquire all the shares in XYZ Ltd?
15. The Articles of Association of M/s ABC Ltd provides for five directors and all of them are in position. How many directors are liable to retire at the ensuing Annual General Meeting? Will it make any difference, if Mr. A, a whole-time director is not liable to retire by rotation?
16. (a) ABC Ltd is contemplating to fix a higher quorum for the Board meeting than prescribed by the Companies Act, 1956? Advise.

- (b) There are 9 directors and 2 offices of the directors have fallen vacant in a company. What would be the quorum for the meeting of the Board? In a case, where there are 15 directors in a company and of which 13 are happen to be interested directors, what would be the quorum?
17. Is a director bound to attend the meeting of the Board? What would be the position under the Companies Act, 1956 in respect of a director who did not attend or absents himself from three consecutive meetings of the Board or from all meetings of the Board without obtaining leave of absence?
 18. X Ltd. whose paid up share capital to Rs.3 crores proposes to purchase raw material of Rs.20 lakhs from Y Limited. It proposes to purchase rawmaterial of Rs.10 lakhs on cash basis and the balance on 90 days credit. A who is the Managing Director of X Limited is also a director and shareholder of Y Limited. Advise the procedure.
 19. M/s XYZ Ltd. was incorporated on 1st January, 2004. On 1st November, 2006 a political party approached the company for a contribution of Rs. Ten lakhs for political purpose. Advise in respect of the following:
 - (i) Is the company legally authorised to give this political contribution?
 - (ii) Will it make any difference, if the company was in existence on 1st October, 2003?
 - (iii) Can the company be penalised for defiance of Rules of this regard?
 20. Explain the manner in which a Director is required to disclose his interest at a Board meeting. What consequences shall follow for non-disclosure of interest by such a Director ? In what cases he is not required to make a disclosure of his interest ?
 21. What is meant by oppression'? State whether the aggrieved party would succeed in obtaining relief from Company Law Board on the ground of oppression in the following cases:
 - (i) The majority of the Board of Directors override the minority directors and the minority directors apply to Company Law Board complaining oppression by majority directors.
 - (ii) A petition by majority shareholders complaining oppression by minority shareholders.
 22. With reference to the relevant provisions of the Companies Act, 1956, advise the company on the matters sending relating to sending of Notices of Board meetings:
 - (a) Mr. A, a director states that he will not be able to attend next Board meeting.
 - (b) Mr. B, goes abroad for 5 months and an alternate director has been appointed in his place.
 - (c) Mr. C, is a director residing abroad representing the foreign collaborator and articles of Association of the company provides for sending notice to such directors.
 23. Mr. N who was appointed as a director at the last AGM resigned. The Board filled up the casual vacancy by appointing Mr. M but within a few days of his becoming director Mr. M died. The Board wishes to fill up the casual vacancy by appointing Mr. P in place of Mr. M at the next Board meeting. State the legal position.
 24. State the provisions contained in the Companies Act, 1956 relating to registration and requirements to be stated in the prospectus issued by a foreign company and also filing of returns.
 25. Advise :
 - (a) XYZ Ltd. wants to maintain its books of account on cash basis;
 - (b) It has a branch office outside India and wants to maintain accounts over there;
 - (c) A shareholder of a company wants to inspect books of account. Would your answer be different if he is acting as an agent of the director of the company?
 26. A company was using, a flat exclusively as a 'guest house' for its employees and officers. The electricity tariffs was levied on a higher tariff on the ground that it was for a 'commercial purpose.' How would you interpret and construe the meaning of the words used in this case?

27. In the context of provisions of the Companies Act, 1956 and case laws if any, answer the following:
 - (a) Amalgamation of a foreign company with an Indian company.
 - (b) Is the scheme of amalgamation requires approval by preference shareholder?
 - (c) When will Court order dissolution of the transferor company?
28. The Association of Truck Operators of India by agreement insisted that members of the association shall not deal with the non-members in transportation of goods. The Association claims that this agreement is entered for the welfare of trade and not for any other purpose. In your opinion whether the agreement would be under the purview of the Competition Act, 2002. Whether your answer would be different if the association attempts to control the provisioning of services rendered by its members.
29. Who is an authorised person? What are the powers of RBI on inspection and issuance of directions to authorised person.
30. Explain the compounding offences under the FEMA, 1999 ?
31. Briefly state the obligations and time limits by which adjudication and appeal to be completed under FEMA, 1999. Also state the procedure for appealing to and powers of Appellate Tribunal?
32. (a) An exporter after having made appropriate declaration of the value of goods exported, reports that there will be delay in the realisation of the proceeds of the exports. State whether it is a violation if any of the provisions of the FEMA, 1999?
- (b) An MNC Company based at Tokyo is having several units all over the world. It has one unit based at New Delhi and its branch is located at Colombo. What is the residential status of unit at New Delhi and that of its branch at Colombo as per the FEMA, 1999?
33. What are title to dividends?
34. What is spot delivery contract ?
35. Delhi Stock Exchange wants to establish additional Trading Floor. Explain briefly the meaning of and procedure for establishing additional Trading Floor.
36. What are the powers of SEBI in supervision of the functioning of stock exchanges under the SC(R) Act 1956?
37. A recognized stock exchange in India is contemplating the proposal for corporatisation of the exchange. State the procedure for the same.
38. What is the penalty prescribed under the SEBI Act, 1992 for the following :
 - (i) Penalty for default in case of mutual funds.
 - (ii) Penalty for non-disclosure of a acquisition of shares and take over.
39. The word 'may' does not mean 'must' or 'shall', yet the word 'may' under certain circumstances mean 'shall'." Discuss the statement in the context of the 'Interpretation of Statutes' and point out the importance of distinction between 'mandatory' and 'directory' provisions.
40. What are guidelines under SEBI (DIP), 2000 in respect of preferential issue?

SUGGESTED ANSWERS/HINTS

1. While a company may hold its AGM in a year within the time limit of 15 months as provided by Section 166(1), it may still contravene Section 210. A company and its director may commit offences if it does not fulfil the three requirements and failure to comply with any of them constitute an offence unless an extension of time has been granted for holding the meeting by the ROC. However, the extension of time for holding the AGM is only with reference to the meeting and not to that of submission of accounts.

2. According to Section 295 of the Companies Act, 1956 no public company shall make any loan to any of its directors either directly or indirectly without obtaining the previous approval of the Central Government. As the Act envisages prior approval, Central Government will not entertain any application from the company seeking approval for a loan already given to its directors.

The company has, therefore, contravened the provisions of Section 295(1) and for this offence every person who is knowingly a party to this contravention including the person to whom the loan is made shall be punishable either with fine which may extend to Rs.5,000 or with simple imprisonment for a term which may extend to six months [Section 255(4)]. Where any such loan has been repaid in full, no punishment by way of imprisonment shall be imposed and where the loan has been repaid in part, the maximum punishment which may be imposed by way of imprisonment shall be proportionately reduced. So, by refunding the loan in full, it is possible to avoid punishment in the form of imprisonment, but it is not possible to avoid prosecution and punishment in the form of fine.

All offences other than an offence which is punishable under the Companies Act with imprisonment only or with imprisonment and also with fine are compoundable under Section 621A. As the offence under Section 295 is punishable with fine or imprisonment, it is compoundable but with the permission of the court [Section 621A(2)]. The offence may be compounded either before or after the institution of prosecution. If the offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, either by the Registrar or by any shareholder or by any person authorised by the Central Government. Where the composition of any offence is made after the institution of any prosecution, such composition shall be brought to the notice of the court by the Registrar in writing and on such notice of the composition of the offence being given, the company or its officer in relation to whom the offence is so compounded shall be discharged [Section 621A(4)].

The offence may be compounded by the Regional Director where the maximum amount of fine which may be imposed for such offence does not exceed Rs.5,000 and in other cases by the Company Law Board. In this case, the offence may be compounded by Regional Director, as the maximum fine is only Rs.5,000. On receipt of applications from the persons liable for penalty under Section 295(4) along with the comments of the Registrar, the Regional Director may specify the amount not exceeding the maximum fine which shall be paid to the Central Government for compounding of the offence.

3. In computing the specified number of audits for the purpose of Section 224(1B), the following audit shall not be taken into account.
 - (a) Audit of private company.
 - (b) Audit of Guarantee Companies not having share capital.
 - (c) Special Audits.
 - (d) Audit of Foreign Companies.
 - (e) Branch Audits.

Though the audit of private companies has been excluded for the purpose of calculating the specified number of audits, as a member of ICAI, the Audit of Private Companies will come under the purview of calculating the ceiling limit as a matter of self-regulation

4. The articles of a public company or a private company which is subsidiary of a public company may adopt the principle of proportional representation for appointing not less than $\frac{2}{3}$ rd if the total number of the directors, whether by a single transferable vote or by a system of cumulative voting or otherwise. In such a case, appointments will be so made once in every three years and interim casual vacancies will be filled in conformity with the provisions of Sections 262 and 265. Cumulative voting denotes that if there are five candidates or distribute his five votes. He can cast all the five votes in favour of one candidate or distribute his five votes among different candidates. This system of voting ensures that the Board will have fair representation of the minority interest.

5. A quorum is the prescribed minimum number of qualified persons authorised to transact the business at a meeting. In relation to a Board meeting quorum implies fully qualified and disinterested directors who must be present at the meeting so as to enable the Board of which they are the constituents to legally transact the business thereat. Can the articles of a company fix such a quorum? No, in view of Section 287 which has fixed the quorum of the Board meeting. Accordingly such a quorum is one third of the total strength of Board (any fraction contained in the said one third being rounded off as one) or two directors whichever is higher. The total strength is to be derived after deducting the number of directors whose offices are vacant. Therefore, the Quorum = $1/3$ (of the total strength vacancies). Where total number of directors are 9 and 2 offices of the directors have fallen vacant, we find: $1/3$ of $(9-2) = 1/3$ of $7 = 2\frac{1}{3}$ directors. If the fraction of 3^{rd} were to be rounded off as one then 3, i.e. $2+1$ directors would constitute the quorum for the Board meetings. If at any time the number of the remaining directors exceeds or is equal to two thirds of the total strength, the number of the remaining directors who are non-interested but present at the meeting, not being less than two shall constitute the quorum. For example, there are in all 15 directors and the Board meeting commences with all the 15 directors. During the currency of the meeting, an item comes up for discussion in respect of which 13 happen to be "interested" directors. In this case, in spite of the excess of the interested directors being more than two-thirds, the prescribed minimum number of non-interested directors constituting the quorum, namely, 2 present at the meeting are to transact the particular item of business.

Now suppose all the 15 directors cited in the above illustration are equally interested in that particular item of business and the time is so vital that but for a decision thereon, the business of the company will be greatly hampered. How to resolve this impasse? The Act has not made any direct provision to take with such a situation, but the Article 48 of Table A of Schedule 1 of the Act, provides a remedy. According to the said article, the Board may, whenever it thinks fit, call an extraordinary general meeting. By invoking this Article, the Board should get the aforesaid impasse resolved by the shareholders at the general meeting. Since according to Section 173(1) (b), all business in the case of any other meeting than the annual general meeting is to be deemed special, by virtue of sub-section (2) the notice of the extraordinary meeting must annex to it a statement setting out all the material facts concerning the item of business, including, in particular, the nature of the concern or interest therein of every director.

6. The share qualification is that number of shares which a shareholder must hold in order to be eligible for election as a director. The Companies Act, 1956 does not prescribe for any share qualification for a director. However, Regulation 66 of Table A provides that the qualification for being a director of a company is the holding of at least one share in the company. The articles of a company usually prescribe for such qualifications so that a director has a personal interest in the company. In the event of such a provision by the articles, it becomes incumbent on the part of every director to hold qualification shares and if does not hold them at the time of his appointment as director, he must acquire them within two months after his appointment as director. Any provision, made in the articles of the company requiring a person proposed for directorship to hold qualification shares either before appointment or within a third shorter than two months after his appointment will be void. The nominal value of qualification shares must not exceed Rs. 5,000 and if the nominal value of each share is Rs. 5,000 or more than the number of shares prescribed as qualification will be only one. It is, of course, not necessary for any company to insist upon the holding of shares for the purpose of qualification for directors. For the purpose of share qualification, the bearer of a share warrant is not deemed to be the holder of the shares mentioned in the warrant (Section 270). A Director acting without qualification shares is punishable with fine which may extend to Rs. 500/- for every day during which he continues as director (Section 272). The provisions relating to the share qualification of a director do not apply to a private company, unless it is subsidiary of a public company (Section 273): nor do they apply to directors appointed by the Central Government under Section 408.
7. There is no prohibition contained in the Companies Act, 1956 which prohibits a person in acting in the dual capacity of being a director and an employee. If a director is appointed as an employee of the company (i.e. executive), then Section 314 shall apply. In other words, the restriction in holding office or place of profit would get attracted.

8. (1) As per section 292 A of Companies Act, 1956, every public company having paid up capital of Rs. 5 cores or more must constitute a committee of Board as 'Audit Committee'.
- (2) The audit committee shall consist of minimum 3 directors. Out of the total members of committee, at least two-third shall be on executive directors, that is those who are not managing or whole time directors. The committee shall elect its own Chairman. Terms of reference will be specified in writing by the Board (Section 292A(2)).
- (3) Draft Board resolution.

Resolved that, pursuant to section 292A of the Companies Act, 1956 an Audit committee consisting of the following directors be and is hereby constituted

1. Shri_____, Nominee of IFCI
2. Shri_____, Nominee of IDBI
3. Shri_____,
4. Shri_____,
5. Shri_____, Managing Director

Further resolved that the Charmin of the Audit Committee shall be elected by its members from amongst themselves. Further resolved that the Audit Committee shall have the authority to investigate into any matter what may be prescribed under the said section 292 A and the following matters

1. _____
2. _____
3. _____
4. _____

The setting up of the audit committee is complimentary to the Board function as Section 292A (8) & (9) provides that the recommendations of the audit committee on any matter relating to financial management including the audit report shall be binding on the board. However, if the Board does not accept the recommendations of the audit committee, it shall record the reasons therefore and communicate such reasons to the shareholders.

9. Board Resolution for appointment of Sole Selling Agent

RESOLVED that subject to the consent of the shareholders in an Extraordinary General Meeting by a special resolution and subject to the approval of the Central Government(name) be appointed as the company's sole-selling agent for a period of 5 years effective from(date) on a commission.....(per cent) pursuant of the provisions of section 294AA of the Companies Act, 1956.

RESOLVED FURTHER that an Extraordinary General Meeting of the company be convened at....(time).....(day) the.....(date) at.....(venue) to secure the consent of the members in this regard.

RESOLVED FURTHER that the Secretary of the company be authorised to submit the application to the Central Government and comply with the necessary formalities in this regard.

10. According to Section 286 of the Companies Act, 1956, notice of every board meeting shall be given in writing to every director for the time being in India, and at his usual address in India to every other director.
- (i) Notice should be given even if Mr. A expressed his inability to attend the next board meeting. Otherwise, Section 286(1) will be violated. [In re: Portuguese Consolidated Copper Mines Ltd. (1889) 42, Ch.D 160(CA). It is also worthwhile to mention in this connection that in Parmeshwari Prasad Gupta vs. Union of India, AIR 1973 SC 2389, the Supreme Court held that if the director who has not been given notice attends the subsequent meeting and confirms the proceedings of the previous meeting, it amounts to ratification and validates the resolutions passed at the previous meeting.

- (ii) Although there is no legal precedent in this regard, it would be a prudent practice (under Section 286) that notice should be served to both, the alternate director as well as the original director Mr. B who is outside of India at his usual address in India.
 - (iii) In the case of a company having foreign collaboration, Articles generally provide that notice of Board Meeting should be sent by Air Mail. But a question crops up whether such provision is valid, as Section 286(1) requires service of such notice to a director to be sent as his usual address in India. However, it must be admitted that the question is not free from doubt and in the instant case as, Articles provide that notice must be sent to Directors residing abroad, notice should be sent to Mr. C.
11. Under Section 293(1)(e) of the Companies Act, 1956 the Board of Directors of a public company can contribute or donate to charitable and other funds not directly related to the business of the company or the welfare of its employees any amount the aggregate of which will not, in any financial year exceed Rs.50,000 or 5% of its average net profits during the three financial years preceding whichever is greater. If this power of the company is not ultra vires the memorandum of the company, then only the Board can act in pursuance of the above-mentioned resolution of the company and in so acting, it can authorise the Managing Director to exercise the power on behalf of the Board. It may be noted that the power of the Board to donate to general charities is not conditional to the existence of any profits. In such case, they may contribute up to the limit given in Section 293(1)(e), even though the company may be working at a loss..
 12. The Section 292 (1)(d) of the Companies Act, 1956 empowers the Board of Directors to delegate to any committee of directors, the Managing Director, the Manager or any other Principal Officer of the Company, the power to invest the funds of the company. However, Inter-corporate investments as governed by Section 372A provides that no investment shall be made by the Board of an investing company unless it is sanctioned by a resolution passed at the meeting of the Board with the consent of all the directors present at the meeting except those not entitled to vote thereon. Section 372A overrides the provisions of Section 292 in so far as investments of share is concerned. Therefore, the delegation of such a power is invalid.
 13. The Supreme Court in *World-wide Agencies (P) Ltd., vs. Mrs. M.T. Desor*, (1990) 67 CC, 607(SC) the Supreme Court held that a composite petition under Sections 397, 398 and 433(f) of the Companies Act, 1956 is maintainable. It observed that a discretion is conferred on the court and it is only when the court is satisfied that the facts justified the making of the winding up order on the ground that it is just and equitable that the company should be wound up, but if the court is further of the opinion that it would be a remedy worst than the disease, then the court can examine whether alternative relief under Section 397 can be granted.
 14. Applying the provisions of section 395 of the Companies Act, 1956, ABC Ltd., can acquire all the shares of XYZ Ltd. including those held by 2 persons. It can acquire the shares held by 2 persons if no application is made to the court for avoiding the sale of their shares or if the court refused it accordingly. In *Bombay Gas Company (P) Ltd., vs. Central Government* (1997) (CC) 89, the Bombay High Court held that Section 394(4)(b) provides for amalgamation of a foreign country with the Indian company. The transferee company, however, cannot be a foreign country. The expression member is not only holders of equity shares but also preference shareholders who had to be taken into account and value of their shares be included. The scheme may provide for the dissolution without winding up of any transferor company [Section 394(i)].
 15. As per Section 256 of the Companies Act, 1956, at every subsequent annual general meeting, 1/3rd of directors were liable to retire by rotation. In this case, all the five directors are holding in position which means they are liable to retire by rotation. In other words, 1/3rd of five directors i.e. two directors are to retire at the Annual General Meeting. Out of five directors, if one director is a whole time director, then he is not liable to retire by rotation and would be excluded. In other words, 1/3rd of 4 i.e., $1 \times \frac{1}{3} = 1$ director would retire at every Annual General Meeting.
 16. A quorum is the prescribed minimum number of qualified persons authorised to transact the business at a meeting. In relation to a Board meeting quorum implies fully qualified and disinterested directors who must be present at the meeting so as to enable the Board of which

they are the constituents to legally transact the business thereat. In view of Section 287 which has fixed the quorum of the Board meeting, the articles cannot fix the higher quorum.. Accordingly such a quorum is one third of the total strength of Board (any fraction contained in the said one third being rounded off as one) or two directors whichever is higher. The total strength is to be derived after deducting the number of directors whose offices are vacant. Therefore, the Quorum = $1/3$ (of the total strength vacancies). Where total number of directors are 9 and 2 offices of the directors have fallen vacant, we find: $1/3$ of $(9-2) = 1/3$ of $7 = 2\frac{1}{3}$ directors. If the fraction of $3\frac{1}{3}$ were to be rounded off as one then 3, i.e. 2+1 directors would constitute the quorum for the Board meetings. If at any time the number of the remaining directors exceeds or is equal to two thirds of the total strength, the number of the remaining directors who are non-interested but present at the meeting, not being less than two shall constitute the quorum. For example, there are in all 15 directors and the Board meeting commences with all the 15 directors. During the currency of the meeting, an item comes up for discussion in respect of which 13 happen to be "interested" directors. In this case, in spite of the excess of the interested directors being more than two-thirds, the prescribed minimum number of non-interested directors constituting the quorum, namely, 2 present at the meeting are to transact the particular item of business.

17. No, he is not so bound. But nonetheless he will be guilty of breach of duty if he fails to attend the Board meetings with reasonable regularity without sufficient cause being shown for non-attendance. Willful non-attendance on his part may give rise to his liability of ground of negligence if it is patently prejudicial either to the company or to the general body of shareholders. Fairly, frequent absence from the Board meeting may however, be excused if the entire control is exercised by a single director or if the Board is pretty large in number [Re. Denham & Co. D25 Ch. D. 752; Marquis of Bute's case (1892) 2 Ch. 100]. The fewer the directors, the more onerous is the duty to attend. Although a director need not attend each Board meeting unless the articles provide otherwise, yet his continuous non-attendance say two attendances followed by two non-attendances, again followed by one attendance and so forth just by way of a guard against infringement of provision of Section 283(1)(g) may render him guilty of breach of trust which may be committed by other directors. It is true that Section 285 does not prescribe any penalty for non-compliance with the requirements of the Section. Nevertheless, Section 622A may be invoked to deal with such a situation.
18. The provisions of Section 297 are not applicable when the company from whom the materials will be purchased is a public limited company. Mr. A has to comply with the provisions of Section 299 and disclose his interest at the Board Meeting and is not to participate in discussion at the meeting, when the above contract is put up for approval of the Board. Even if the shareholding of Mr. A in Y Ltd. together with the shareholding, if any, of the directors is 2% or less in Y Ltd., disclosure of his interest as director in Y Ltd. shall be made. In terms of provision of Section 287 of the Companies Act, 1956, Quorum for meeting of Board of Directors of the Company shall be one third of its total strength or two Directors whichever is higher. Interested Directors presence shall not be considered for the purpose of quorum. In the present case, there will no quorum in the board meeting in respect of a contract as all the directors are interested therein. The remedy in such case seems to be to increase the strength of Board by appointing atleast two disinterested directors as additional directors who are not interested in said contract, if so authorised by Articles and if the said appointment shall be within the maximum number of directors as fixed by the Articles. If this is not found practicable it would be desirable to place the proposed contract before General Meeting for consent. [Department of Company Affairs Letter No. 816(l) 61-P-R dated 9/5/81].
19. Prior to amendment of Section 293 A, by the Companies (Amendment) Act 1985, there was a blanket ban on political Contributions by Companies. But the amended section seeks to continue the existing blanket ban against political contributions in case of government companies and companies which have been in existence for less than three financial years. Since XYZ Co. has not completed three years of existence on 2nd November 2002, it is not eligible to give political contribution.

- (ii) Yes, because in that case, XYZ ñ. limited shall complete three financial years of its existence, therefore, will be eligible to give political contribution subject to the condition that such a political contribution should not exceed five percent of the average net profits and a resolution authorising such contribution is passed at a meeting of the Board of Directors.
- (iii) The Amended Section 293A seeks to impose an obligation on every company to disclose in its profit and loss account contributions made by it to any political party or for any political purpose. Contravention of the provisions of this section will make a company liable to fine which may extend to three times the amount so contributed. Further every officer of the company in default would be liable to imprisonment for a term which may extend to three years and also to fine.

20. Manner for disclosure :

- (1) In the case of a proposed contract or arrangement—
 - (i) If the director is already concerned or interested at the time when it is first taken up at a meeting of the Board, the disclosure must be made at the meeting itself;
 - (ii) If the director becomes concerned or interested subsequent to the meeting at which it is first taken up for consideration, the disclosure must be made at the first meeting of the Board held next after he becomes concerned or interested.
- (2) In the case of any other contract or arrangement such as an already existing contract or arrangement or a renewal or continuance of the one already made, in which the director subsequently becomes concerned or interested, the disclosure must be made at the first meeting of the Board held next after he becomes concerned or interested.

An absentee director or one for whom an alternate director has been appointed may send the disclosure in writing. The duty to disclose applies also to an alternate director as well as every other director by whosoever or in whatever manner appointed, including Government nominees under Section 408. Where, in the case of a contract or arrangement not coming within the scope of Section 297, the matter is considered by circular resolution i.e. through the passing of a resolution by circulation as provided in Section 289, it will not be sufficient if the disclosure is made by an endorsement on the circulated draft or by means of an annexure to it. Having regard to the use of the words “at the meeting of the Board” the disclosure will; have to be made at the first meeting of the Board held next after the passing of the circular resolution in accordance with the provisions of Section 289. Where general notice is given to the Board as regards the interest of a director in any contract or arrangement, it is not effective, unless the director concerned either gives it at a meeting of the Board or takes reasonable steps to ensure that it is brought up and read at the next meeting of the Board after it is given. The notice then gets entered in the minutes of the Board meeting at which it is given or read. Once a director has given a general notice of interest, it is not necessary for him to once again disclose his interest when the matter comes up before the Board.

Consequence of non-disclosure : The Section 299 does not prohibit a director from being interested in any contract with the company. The only duty cast upon him is to make disclosure of his concern or interest as provided in the Section. Failure to comply with the requirements of this Section will cause vacation of the office of the Director [Section 283(l)(i)]. Non-disclosure makes the director concerned punishable with fine which may extend to Rs. 5 000. [Section 299 (4)]. Such non-disclosure makes the contract voidable at the option of the company, it makes the director accountable to the company for any secret profit which he has made. (Venkatachalapathy v. Guntur Mills Ltd).

Disclosure not required in the following case : Any contract or arrangement entered into or to be entered into between two companies where any of the directors of the one company or two or more of them together holds or holds not more than two percent of the paid-up share capital in the other company.

21. Oppression: The term 'oppression' is not defined in the Companies Act. Oppression, according to the Dictionary meaning of the word, is any act exercised in a manner burdensome, harsh and wrongful. The meaning of the term 'oppression' was explained by Lord Cooper in the Scottish case of *Elder v. Elder and Watson Ltd.*, as given below:

"The conduct complained of should be at the lowest involve or visible departure from the standards of fair dealing and a violation of the conditions of fair play or which every shareholder who entrusts his money to a company is entitled to rely.

- (i) Oppression of a member as a director: The oppression dealt with by section 397 is only oppression of members in their character as such; and it is only in that character they can involve section 397. The harsh treatment, for instance, of a member who is a director or other officer or employee, by the Board of Directors or management does not come within (section 397). It has been held in *Re. Bellador Silk Ltd.* that if the majority of the Board of Directors override the minority directors the latter cannot resort to section 397 and hence the minority directors will not succeed in getting relief from CLB on the ground of oppression.
 - (ii) Right not confined to minority: According to section 399, the right to apply for relief under section 397/398 is given to 100 members or 1/10th of the total number of members or any member or members holding not less than 1/10th of the issued share capital of the company. There is nothing in this section which suggests even indirectly that unless the application is made by minority shareholders it is not maintainable. The right to apply is, therefore, not confined to oppressed minority of the shareholders alone. It was held by Calcutta High Court in *Re. Sindhri Iron Foundry (P) Ltd.* that the oppressed majority also might apply for relief under section 397. Therefore, the petitioners are likely to succeed in getting relief provided the other condition laid down in section 397 (i.e. that to wind up the company would unfairly prejudice such members, but that otherwise the facts would justify the making of a winding-up order on just and equitable ground) is satisfied, even though the Delhi High Court held a contrary view in *Suresh Kumar Sanghi v. Supreme Motors Ltd.*
22. According to Section 286 of the Companies Act, 1956 notice of every board meeting shall be given in writing to every director for the time being in India, and at his usual address in India to every other director.
- (i) Notice should be given even if Mr. A expressed his inability to attend the next board meeting. Otherwise, Section 286(1) will be violated. [In *re: Portuguese Consolidated Copper Mines Ltd.* (1889) 42, Ch.D 160(CA). It is also worthwhile to mention in this connection that in *Parmeshwari Prasad Gupta vs. Union of India*, AIR 1973 SC 2389, the Supreme Court held that if the director who has not been given notice attends the subsequent meeting and confirms the proceedings of the previous meeting, it amounts to ratification and validates the resolutions passed at the previous meeting.
 - (ii) Although there is no legal precedent in this regard, it would be a prudent practice (under Section 286) that notice should be served to both, the alternate director as well as the original director Mr. B who is outside of India at his usual address in India.
 - (iii) In the case of a company having foreign collaboration, Articles generally provide that notice of Board Meeting should be sent by Air Mail. But a question crops up whether such provision is valid, as Section 286(1) requires service of such notice to a director to be sent as his usual address in India. However, it must be admitted that the question is not free from doubt and in the instant case as, Articles provide that notice must be sent to Directors residing abroad, notice should be sent to Mr. C.
23. Section 262, (Companies Act, 1956) provides that in the case of a public company or a private company which is a subsidiary of a public company, if the office of any director appointed by the company in general meeting is vacated before the expiry of his term of office in the normal course, the resulting casual vacancy may, subject to any regulations in the Articles of the company, be filled by the Board of directors at a meeting of the Board. It would thus be noted that the Board of directors is empowered to fill a casual vacancy only in respect of a director appointed by the company in general meeting. If a casual vacancy arises in the office of a director

appointed in the casual vacancy under Section 262, there is no casual vacancy within the meaning of Section 262. However, the Dept.. of Company Affairs has opined that the same may be filled by the Board of directors as a casual vacancy. Consequently Board can appoint Mr. P. in place of Mr. M.

24. A foreign company means a company incorporated outside India and having a place of business in India, whatever be the pattern, of their holding. However where not less than 50% paid up capital of foreign company is held by one or more citizens of India or by one or more bodies corporate incorporated in India, whether singly or in aggregate, such company shall comply with the provisions of the Companies Act, 1956, as if it were a company incorporated in India. A 'foreign controlled company' however, means a company in which the majority shareholding and voting power is in the hands of foreign individuals and/or bodies corporate.

Filing of Returns and Documents (Sections 592 & 593) : Foreign companies which establish a place of business in India must within one month from that date file with the Registrar,

- (a) a certified copy of the charter, statutes or memorandum and articles of the company or other instrument defining its constitution with a certified translation of the documents in the English language if they are not in that language. Rule 16 of the Central Government's General Rules, 1956 specifies the persons who are to certify the documents,
- (b) the full address of the registered or principal office of the company,
- (c) a list of directors giving with respect to each of the directors who are individuals, his name and surname, former name and surname, usual residential address, and nationality of origin if different from nationality and business occupation or particulars of any one of his other directorships and in the case of directors which are bodies corporate, with respect of each of them, its corporate name, its registered or principal office, the full name and address, nationality and nationality of origin if different from the nationality of each of its directors.
- (d) the present name and surname, former name and surname and usual residential address of the secretary if he is an individual and if a body corporate its corporate name and its registered or principal office and if a firm the partners of which are joint secretaries, the name and principal office of the firm,
- (e) the names, addresses of persons resident in India and authorised to accept service of documents, notices and processes on behalf of the company, and
- (f) the address of the principal place of business in India (Section 592).

The other category of foreign companies, namely, companies which have already established a place of business in India, have to file the documents and particulars in accordance with the provisions of Section 277(1) if they have not already done so. [Section 592(4)].

25. (a) In the absence of any express provision in the Companies Act, 1956 hitherto it was open to a company to maintain its accounts on 'cash basis' or 'accrual basis' or on hybrid basis i.e. partly on cash and partly on accrual basis. Under the Income-tax Act, 1961 an assessee can, even now, maintain its books of account by adopting any of the aforesaid methods. The controversy in so far as maintenance of accounts pursuant to the provisions of Companies Act, has now been set at rest by the amendment of sub-section (3) of section 209. Every company is now required to keep its books of account on accrual basis and according to the double entry system of accounting, popularly known as mercantile system of accounting which alone discloses a true and fair view of the state of affairs of a company the responsibility for the preparation of accounts giving a true and fair view of the company's financial state is placed fairly and squarely on the shoulders of the directors'. [Caparo Industries pie v. Dickman, (1990)].
- (b) Place of maintenance of books of accounts : Books of account shall be maintained at the company's registered office unless the Board of directors decides to keep them at another place in India [Proviso to section 209(1)]. It will be the duty of the company to inform the Registrar of Companies within 7 days of the decision in case the Board decides to maintain

books at a place other than the registered office. This has to be done by filing Form No.23AA. Where a company has a branch office whether in or outside India, it may maintain books of account with respect to the transactions effected at such branch, at that branch itself. However, in such a case, proper summarised return made up at an interval of not more than three months should be sent to the registered office or to the other place where the Board has decided to keep the books of account.

- (c) The clear cut answer shall be 'no' except where he represents a director and the inspection is not mala fide or for some ulterior motive or against the interest of the company. In *Sugrabai Alibhain v. Amtee Properties (P) Ltd.* [1984] 55 Comp. Cas. 734 (Âîò.), the Bombay High Court observed that a director is entitled to ask for inspection of books either personally or through an agent subject to the condition that the agent must give an undertaking to the company that he shall not pass on any information to any person other than the director who had appointed him to carry out the inspection.
26. For giving a plain and literal meaning to each of the words in the expression "exclusively used as a private residential premises", it is difficult to hold that the guest house maintained by a company or commercial undertaking would come within the aforesaid expression. It connotes that the premises must be exclusively used as a residential premises which in other words would mean where the premises which were used by any person privately for its own residence for a sufficiently continued period and not a premises where a person could come and spend a day or a night and then go back. Guest houses were maintained by companies or commercial undertakings as a part of their commercial ventures and such premises could not be held to be meant for exclusive use as private residential premises.
 27. (a) In *Bombay Gas Company (P) Ltd., vs. Central Government* (1997) (CC) 89, the Bombay High Court held that Section 394(4)(b) provides for amalgamation of a foreign country with the Indian company. The transferee company, however, cannot be a foreign country.
 (B) The expression member is not only holders of equity shares but also preference shareholders who had to be taken into account and value of their shares be included.
 (C) The scheme may provide for the dissolution without winding up of any transferor company [Section 394(i)].
 28. Cartel [Section 2(c)]: "Cartel" includes an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services; The term cartel like agreement has been given an inclusive meaning. Thus an association for the welfare of the trade or formed for any other purpose not mentioned in the aforesaid definition will not be a cartel. It is only when an association, by agreement amongst themselves, limits control or attempts to control the production, distribution, sale or price of, or, trade in goods or provision of services, that it will be a cartel.
 29. AUTHORISED PERSON (SECTION 10)
 - (1) The Reserve Bank may, on an application made to it in this behalf, authorise any person to be known as authorised person to deal in foreign exchange or in foreign securities, as an authorised dealer, money changer or off-shore banking unit or in any other manner as it deems fit. [Sub-section (1)].
 - (2) An authorisation under this section shall be in within and shall be subject to the conditions laid down therein [Sub-section (2)].
 - (3) An authorisation granted under sub-section (1) may be revoked by the Reserve Bank at any time if the Reserve Bank is satisfied that:
 - (a) it is in public interest so to do; or
 - (b) the authorised person has failed to comply with the condition subject to which the authorisation was granted or has contravened any of the provisions of the Act or any rule, regulation, notification, direction order made thereunder;

Provided that no such authorisation shall be revoked on any ground referred to in clause (b) unless the authorised person has been given a reasonable opportunity of making a representation in the matter.

- (4) An authorised person shall, in all his dealings in foreign exchange or foreign security, comply with such general or special directions or orders as the Reserve Bank may, from time to time, think fit to give, and, except with the previous permission of the Reserve Bank, an authorised person shall not engage in any transaction involving any foreign exchange or foreign security which is not in conformity with the terms of his authorisation under this section.
- (5) An authorised person shall, before undertaking any transaction in foreign exchange on behalf of any person, require that person to make such declaration and to give such information as will reasonably satisfy him that the transaction will not involve, and is not designed for the purpose of any contravention or evasion of the provisions of this Act or of any rule, regulation, notification, direction or order made thereunder, and where the said person refuses to comply with any such requirement or makes only unsatisfactory compliance therewith, the authorised person shall refuse in writing to undertake the transaction and shall, if he has reason to believe that any such contravention or evasion as aforesaid is contemplated by the person, report the matter to the Reserve Bank.
- (6) Any person, other than an authorised person, who has acquired or purchased foreign exchange for any purpose mentioned in the declaration made by him to authorised person under sub-section (5) does not use it for such purpose or does not surrender it to authorised person within the specified period or uses the foreign exchange so acquired or purchased for any other purpose for which purchase or acquisition of foreign exchange is not permissible under the provisions, of the Act or the rules or regulations or direction or order made thereunder shall be deemed to have committed contravention of the provision of the Act for the purpose of this section.

- Reserve Bank's powers to issue directions to authorised person (Section 11)

- (1) The Reserve Bank may, for the purpose of securing compliance with the provisions of this Act and of any rules, regulations, notifications or directions made thereunder, give to the authorised persons any direction in regard to making of payment or the doing or desist from doing any act relating to foreign exchange or foreign security.
- (2) The Reserve Bank may, for the purpose of ensuring the compliance with the provisions of this Act or of any rule, regulating, notification direction or order made thereunder, direct any authorised person to furnish such information, in such manner, as it deems fit.
- (3) Where any authorised person contravenes any direction given by the Reserve Bank under this Act or fails to file any return as directed by the Reserve Bank, the Reserve Bank may, after giving reasonable opportunity of being heard, impose on the 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.

30. COMPOUNDING OF OFFENCES IN BRIEF

Section 15 authorises the Reserve Bank and the Enforcement Directorate to compound contraventions of the provisions of Sections 7, 8, 9 and transactions relating to current account.

The Reserve Bank is empowered to compound contravention of the provision as follows:

Sum involved in contravention	By whom?
Rs. 5 lakhs or below	AGM
More than 5 lakhs but less than 20 lakhs	DGM
Rs. 20 lakhs or more but less than 50 lakhs	GM

Rs. 50 lakhs or more	Chief GM
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The power of enforcement directorate to compound contraventions is as follows:

Sum involved in contravention	By whom?
Rs. 5 lakhs or below	Deputy Director
More than 5 lakhs but less than Rs. 10 lakhs	Additional Director
Rs. 20 lakhs or more but less than Rs. 50 lakhs	Special Director
Rs. 50 lakhs or more but less than Rs. 1 crore	Special Director with Deputy Legal Advisor
Rs. 1 crore or more	Director of Enforcement with Special Director

No contravention shall be compounded unless the amount involved in such contravention is quantifiable.

- (1) Any contravention under Section 13 may, on an application made by the person committing such contravention, be compounded within one hundred and eighty days from the date of receipt of application by the Director of Enforcement or such other officers of the Directorate of Enforcement and Officers of the Reserve Bank as may be authorised in this behalf by the Central Government in such manner as may be prescribed.
- (2) Where a contravention has been compounded under sub-section (1), no proceeding or further proceeding, as the case may be, shall initiated or continued, as the case may be, against the person committing such contravention under that Section, in respect of the contravention so compounded.

Process and Procedure for Compounding

- (a) An application for compounding of a contravention under the FEMA may be submitted to the compounding authority (CA) either on being advised of a contravention under FEMA either through a memorandum or suo motu on being made or becoming aware of the contravention or suo motu on being made or becoming aware of the contravention. The application should be as per format given in the Foreign Exchange (Compounding Proceedings) Rules.
- (b) Application for compounding any contravention in prescribed form together with a copy of the memorandum, wherever applicable, with the prescribed fee has to be submitted with the relevant facts and supporting documents to the Compounding Authority [Cell for Effective Implementation of FEMA (CEFA)], Foreign Exchange Department, 11th Floor, Central Office Building, S.B.Singh Road, Fort, Mumbai 400 001.
- (c) The compounding authority may call for any information, record or any other documents relevant to the compounding proceedings.
- (d) Where additional information/document is called for, such additional information/document shall be submitted within 30 days or such additional period as may be given by the compounding authority from the date of the said letter. In case the contravener fails to submit the additional information/documents called for within the specified period, the application for compounding will be liable for rejection.
- (e) On receipt of the application for compounding, the proceedings would be concluded and order issued by the CA within 180 days from the date of the receipt of application for compounding.
- (f) The sum for which the contravention has been compounded shall be paid within fifteen days from the date of order of compounding.

- (g) The payment towards application fee and the sum for which contravention has been compounded shall be paid by demand draft in favour of the Compounding Authority ie. Reserve Bank of India and payable at Mumbai.

31. ADJUDICATION AND APPEAL

Time limits

Section No.	Obligation	Time Limit
Section 14	Penalty to be paid	Within 90 days from the date on which notice for payment of penalty is served.
Section 15	Compounding of Contravention	Within 180 days of receipt of application by Directorate of Enforcement.
Section 16	Complaint under Section 16(1) to be dealt by Adjudicated Authority	Within 1 year of receipt of complaint.
Section 17	Appeal to Special Director (Appeals)	Within 45 days from receipt of order.
Section 19	Appeal to Appellate Tribunal	Within 45 days from receipt of order.
Section 19(5)	Appeal to be dealt with by Appellate Tribunal	Will try to dispose off the appeal within 180 days from receipt of appeal.
Section 35	Appeal to High Court	Within 60 days of communication of order or decision.

- Appointment of Adjudicating Authority (Section 16)
 - (1) For the purpose of adjudication under Section 13, the Central Government may, by an order published in the Official Gazette, appoint as many officers of the Central Government as it may think fit, as the Adjudicating Authorities for holding an inquiry in the manner prescribed after giving the person alleged to have committed contravention under Section 13, against whom a complaint has been made under sub-section (2) (hereinafter in this section referred to as the said person) a reasonable opportunity of being heard for the purpose of imposing any penalty:
 Provided that where the Adjudicating Authority is of opinion that the said person is likely to abscond or is likely to evade in any manner, the payment of penalty, if levied, it may direct the said person to furnish a bond or guarantee for such amount and subject to such conditions as it may deem fit.
 - (2) The Central Government shall, while appointing the Adjudicating Authorities under sub-section (1), also specify in the order published in the Official Gazette, their respective jurisdictions.
 - (3) No Adjudicating Authority shall hold an enquiry under sub-section (1) except upon a complaint in writing made by any officer authorised by a general or special order by the Central Government.
 - (4) The said person may appear either in person or take the assistance of a legal practitioner or a chartered accountant of his choice for presenting his case before the Adjudicating Authority.
 - (5) Every Adjudicating authority shall have the same powers of a civil court which are conferred on the Appellate Tribunal under sub-section (2) of Section 28 and:
 - (a) All proceedings before it shall deemed to be judicial proceedings within the meaning of

sections 193 and 228 of the Indian Penal Code (45 of 1860);

(b) shall be deemed to be a civil court for the purposes of Sections 345 and 346 of the Code of Criminal Procedure, 1973 (2 of 1974).

- (6) Every Adjudicating Authority shall deal with the complaint under sub-section (2) as expeditiously as possible and endeavour shall be made to dispose of the complaint finally within one year from the date of receipt of the complaint:

Provided that where the complaint cannot be disposed off within the said period, the Adjudicating Authority shall record periodically the reason in writing or not disposing off the complaint within the said period.

- Appeal to Special Director (Appeals) (Section 17)

- (1) The Central Government shall, by notification, appoint one or more Special Directors (Appeals) to hear appeals against the orders of the Adjudicating Authorities under this Section and shall also specify in the said notification the matter and places in relation to which the Special Director (Appeals) may exercise jurisdiction.

- (2) Any person aggrieved by an order made by the Adjudicating Authority, being an Assistant Director of Enforcement or a Deputy Director of Enforcement, may prefer an appeal of the Special Director (Appeals).

- (3) Every appeal under sub-section (1) shall be filed within forty-five days from the date on which the copy of the order made by the Adjudicating Authority is received by the Aggrieved person and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed:

Provided that the Special Director (Appeals) may entertain an appeal after the expiry of the said period of forty-five days, if he is satisfied that there was sufficient cause for not filing it within that period.

- (4) On receipt of an appeal under sub-section (1), the Special Director (Appeals) may after giving the parties to the appeal an opportunity of being heard, pass such order thereon as he thinks fit confirming, modifying or setting aside the order appealed against.

- (5) The Special Director (Appeals) shall send a copy of every order made by him to the parties to appeal and to the concerned Adjudicating Authority.

- (6) The Special Director (Appeals) shall have the same powers of a civil court which are conferred on the Appellate Tribunal under sub-section (2) of Section 28 and:

(a) all proceedings before him shall be deemed to be judicial proceedings within the meaning of Sections 193 and 228 of the Indian Penal Code (45 of 1860);

(b) shall be deemed to be a civil court for the purpose of Sections 345 and 346 of the Code of Criminal Procedure, 1973 (2 of 1974).

32. (a) Every exporter of services shall furnish to the Reserve Bank or to such other authorities a declaration in such form and in such manner as may be specified, containing the true and correct material particulars in relation to payment for such services.

Section 7 read with Section 8 of FEMA, 1999 imposes on an exporter to make appropriate declaration of the value of the goods being exported and he is also required to repatriate the foreign exchange due to India in respect of such export to India in the manner and within the time as may be prescribed. Under Section 8, the exporter is under an obligation to realise and repatriate to India such foreign exchange. However, if there is a delay in the receipt of export proceeds, it will not be a violation which shall be punishable. Section 8 applies to a resident who shall take all the reasonable steps. Therefore, the word 'all reasonable steps' would depend upon facts and circumstances of each case.

- (b) The MNC being based at Tokyo would be a person resident outside India. [Section 2(w)]. Section 2(u) defines 'person'. Under clause (viii) thereof person would include any agency, office or branch owned or controlled by such 'person'. The term such 'person' appears to

refer to a person who is included in clauses (i) to (vi). Accordingly robotic unit in New Delhi, being a branch of a company, would be a 'person'.

Section 2(v) defines 'person resident in India'. Under clause (iii) thereof 'person resident in India' would include an office, branch or agency in India owned or controlled by a person resident outside India. Robotic unit in New Delhi is owned or controlled by a person 'resident outside India'. Hence, it would be 'person resident in India'. However, Colombo branch, though not 'owned' is controlled by robotic unit in New Delhi which is a person resident in India. Hence, prima facie, it may be possible to hold a view that the Colombo branch is 'person resident in India'.

33. TITLE TO DIVIDENDS (SECTION 27)

- (1) It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company with the company for being registered in his name within fifteen days of the date on which the dividend became due.

Explanation.—The period specified in this section shall be extended—

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend;
 - (ii) in case of loss of the transferee, by the actual period taken for the replacement thereof; and
 - (iii) in case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.
- (2) Nothing contained in sub-section (1) shall affect—
 - (a) the right of a company to pay any dividend which has become due to any person whose name is for the time being registered in the books of the company as the holder of the security in respect of which the dividend has become due; or
 - (b) the right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security in the name of the transferee.

34. "spot delivery contract" means a contract which provides for—

- (a) actual delivery of securities and the payment of a price therefor either on the same day as the date of the contract or on the next day, the actual period taken for the despatch of the securities or the remittance of money therefor through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;
- (b) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository;

35. Establishment of Additional Stock Exchange (Section 13A)

According to Section 13A of the Securities Contracts (Regulation) Act, 1956, a Stock Exchange may establish additional trading floor with the prior approval of the Securities Exchange Board of India in accordance with the terms and conditions stipulated by the said Board. For the purpose of this section 'Additional Trading Floor' means a trading ring or trading facility offered by a recognized stock exchange outside its area of operation to enable the investor to buy and sell securities through such trading floor under the regulatory frame work of that Stock Exchange.

36. SEBI on its own in consultation with Board of Exchange or on request of Exchange may amend any Bye-law relating to matters covered under Section 9 above after recording reasons for so doing. Amended law should be published in Gazette notification.

If an Exchange has objection to the amendments made by SEBI, it may within 2 months apply to SEBI for revision. All amendments come into effect from date of Gazette notification. However, in respect of amendments by Exchange keeping public interest in mind SEBI in its discretion may specifically waive the condition of pre publication.

Superseding of Stock Exchange (Section 11)

SEBI/Central Government are vested with power to supersede the Board of Stock Exchange after serving on governing body a notice in writing and after giving opportunity to the governing Board to be heard in the matter. SEBI may by notification in official gazette declare governing Board of an Exchange as superseded and may appoint person/s to perform and exercise all powers of Board.

Power to suspend business of Recognised Stock Exchange (Section 12)

Central Government if it deems it is vested with power to suspend business for period not exceeding 7 days by notification in gazette. Central Government also have power to extend this period by a like notification.

Power to issue directions (Section 12A)

If, after making or causing to be made an inquiry, the Securities and Exchange Board of India is satisfied that it is necessary –

- (a) in the interest of investors, or orderly development of securities market; or
- (b) to prevent the affairs of any recognised stock exchange, or, clearing corporation, or such other agency or person, providing trading or clearing or settlement facility in respect of securities, being conducted in a manner detrimental to the interests of investors or securities market; or
- (c) to secure the proper management of any such stock exchange or clearing corporation or agency or person, referred to in clause (b), it may issue such directions, -
 - (i) to any stock exchange or clearing corporation or agency or person referred to in clause (b) or any person or class of persons associated with the securities market; or
 - (ii) to any company whose securities are listed or proposed to be listed in a recognised stock exchange, as may be appropriate in the interests of investors in securities and the securities market."

37. Procedure for corporatisation and demutualisation.(Section 4B)

It provides (1) All recognised stock exchanges referred to in section 4A shall, within such time as may be specified by the Securities and Exchange Board of India, submit a scheme for corporatisation and demutualisation for its approval:

Provided that the Securities and Exchange Board of India may, by notification in the Official Gazette, specify name of the recognised stock exchange, which had already been corporatised and demutualised, and such stock exchange, shall not be required to submit the scheme under this section.

- (2) On receipt of the scheme referred to in sub-section (1), the Securities and Exchange Board of India may, after making such enquiry as may be necessary in this behalf and obtaining such further information, if any, as it may require and if it is satisfied that it would be in the interest of the trade and also in the public interest, approve the scheme with or without modification.
- (3) No scheme under sub-section (2) shall be approved by the Securities and Exchange Board of India if the issue of shares for a lawful consideration or provision of trading rights in lieu of membership card of the members of a recognised stock exchange or payment of dividends to members have been proposed out of any reserves or assets of that stock exchange.
- (4) Where the scheme is approved under sub-section (2), the scheme so approved shall be published immediately by –

- (a) the Securities and Exchange Board of India in the Official Gazette;
- (b) the recognised stock exchange in such two daily newspapers circulating in India, as may be specified by the Securities and Exchange Board of India,

and upon such publication, notwithstanding anything to the contrary contained in this Act or any other law for the time being in force or any agreement, award, judgment, decree or other instrument for the time being in force, the scheme shall have effect and be binding on all persons and authorities including all members, creditors, depositors and employees of the recognised stock exchange and on all persons having any contract, right, power, obligation or liability with, against, over, to, or in connection with, the recognised stock exchange or its members.

- (5) Where the Securities and Exchange Board of India is satisfied that it would not be in the interest of the trade and also in the public interest to approve the scheme under sub-section (2), it may, by an order, reject the scheme and such order of rejection shall be published by it in the Official Gazette:

Provided that the Securities and Exchange Board of India shall give a reasonable opportunity of being heard to all the persons concerned and the recognised stock exchange concerned before passing an order rejecting the scheme.

- (6) The Securities and Exchange Board of India may, while approving the scheme under sub-section (2), by an order in writing, restrict-
 - (a) the voting rights of the shareholders who are also stock brokers of the recognised stock exchange;
 - (b) the right of shareholders or a stock broker of the recognised stock exchange to appoint the representatives on the governing board of the stock exchange;
 - (c) the maximum number of representatives of the stock brokers of the recognised stock exchange to be appointed on the governing board of the recognised stock exchange, which shall not exceed one-fourth of the total strength of the governing board.
- (7) The order made under sub-section (6) shall be published in the Official Gazette and on the publication thereof, the order shall, notwithstanding anything to the contrary contained in the Companies Act, 1956, or any other law for the time being in force, have full effect.
- (8) Every recognised stock exchange, in respect of which the scheme for corporatisation or demutualisation has been approved under sub-section (2), shall, either by fresh issue of equity shares to the public or in any other manner as may be specified by the regulations made by the Securities and Exchange Board of India, ensure that at least fifty-one per cent. of its equity share capital is held, within twelve months from the date of publication of the order under sub-section (7), by the public other than shareholders having trading rights:

Provided that the Securities and Exchange Board of India may, on sufficient cause being shown to it and in the public interest, extend the said period by another twelve months.

38. Penalty for certain defaults in case of mutual funds (Section 15D): If any person who is:

- (a) required under this Act or any rules or regulations made thereunder to obtain a certificate' of registration from the Board for sponsoring or carrying on any collective investment scheme, including mutual funds, Sponsors or carries on any collective investment scheme, including mutual funds, without obtaining such certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme including mutual funds, or one crore rupees, whichever is less,
- (b) registered with the Board as a collective investment scheme, including mutual funds, for sponsoring or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

- (c) registered with the Board as a collective investment scheme including mutual funds, fails to make an application for listing of its schemes as provided for in the regulations governing such listing, he shall be liable to penalty not exceeding five thousand rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (d) registered as a collective investment scheme including mutual funds fails to despatch unit certificates of any scheme in the manner provided in the regulation governing such despatch shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less,
- (e) registered as a collective investment scheme, including mutual funds or fails to refund the application monies paid by the investors within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;
- (f) registered as a collective investment scheme including mutual funds fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

Penalty for non-disclosure of acquisition of shares and takeovers (Section 15H): If any person who, is required under this Act or any rules or regulations made thereunder fails to,

- (i) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or
- (ii) make a public announcement to acquire shares at a minimum price, he shall be liable to a penalty twenty-five crore rupees or three times the amount of profits made out of such failure, whichever is higher.
- (iii) make a public offer by sending letter of offer to the shareholders of the concerned company; or
- (iv) make payment of consideration to the shareholders who sold their shares pursuant to letter of offer.

39. 'May', it is well settled that enabling words are construed as compulsory, wherever the object of the power is to give effect to a legal right: the use of the word 'may' in a statutory provision would not by itself show that the provision is directory in nature. In some cases the legislature may use the word 'may' as a matter of pure conventional courtesy and yet intend a mandatory force. Therefore, in order to interpret the legal import of the word 'may' we have to consider various factors, e.g., the object and the scheme of the Act, the context or background against which the words have been used, the purpose and advantages of the Act sought to be achieved by use of this word and the like.

Where the word 'may' involves a discretion coupled with an obligation or where it confers a positive benefit to the general class of subjects, or where a remedy would be advanced and a mischief suppressed, or where giving the word a directory significance would defeat the very object of the Act then word 'may' should be interpreted to convey a mandatory force. Thus where a discretion is conferred upon a public authority coupled with an obligation, the word 'may' should be construed to mean a command. Similarly when a order of the Government or a statute confers a power on an authority in the discharge of a public duty, and though such power appears to be merely permissive, it is imperative that the authority should exercise that power in the discharge of its duties: there the word 'may' assumes mandatory force.

The, word 'may' is often read as 'shall' or 'must' when there is something in the nature of the thing to be done, which makes it the duty of the person on whom the power is conferred to exercise the power. No general rule can be laid down for deciding whether any particular provision in a statute is mandatory, meaning thereby that non-observance thereof involves the consequences of invalidity, or only directory, i.e. a discretion, non-observance of which does not entail the consequence of invalidity, whatever other consequences may occur. But in each case the Court

has to decide the legislature's intent. Did the legislature intend in making the statutory provision that non observance of this would entail invalidity or did it not? To decide this, we have to consider not only the actual words used, but the scheme of the statute, the intended benefit to the public or what is enjoined by the provisions and the material danger to the public by the contravention of the scheme. The use of the expression 'shall' or 'may' is not decisive. Having regard to the context, the expression 'may' has varying significance. In one context, it may be purely permissive, while in another context it may confer a power and make it obligatory upon the person invested with the power to exercise it as laid down. Therefore, while undoubtedly the word 'may' generally does not mean 'must' or 'shall' yet the same word 'may' is capable of meaning 'must' or 'shall' in the light of the context in which it occurs.

Coming to the word shall: the use of the word shall would not of itself make a provision of the act mandatory. It has to be construed with reference to the context in which it is used. Thus, as against the Government the word 'shall' when used in statutes is to be construed as 'may' unless a contrary intention is manifest. Hence, a provision in a criminal statute that the offender shall be punished as prescribed in the statute is not necessarily to be taken as against the Government to direct prosecution under that provision rather than under some other applicable statute.

Therefore, generally speaking when a statute uses the word 'shall' prima facie it is mandatory but it is sometimes not so interpreted if the context or intention of the legislature otherwise demands. Thus, under certain circumstances the expression 'shall' is construed as 'may'. Yet, it has to be emphasized that the term 'shall' in its ordinary significance, is mandatory and the Court shall ordinarily give that interpretation to the term, unless such an interpretation leads to some absurd or inconvenient consequence or be at variance with the intent of the legislature to be collected from other parts of the Act. For ascertaining the real intention of the legislature, the Court may consider amongst other things:

- the nature and design of the statute,
- the consequence which would flow from construing it one way or the other,
- the impact of other provisions by resorting to which the necessity of complying with the provision in question can be voided,
- whether or not the statute provides may penalty if the provision in question is not complied with,
- if the provision in question is not complied with, whether the consequences would be trivial or serious, and
- most important of all, whether the object of the legislation will be defeated or furthered.

Where a specific penalty is provided in statute itself for non compliance with the particular provision of the Act, no discretion is left to the Court to determine whether such provision is directory or mandatory – it has to be taken as mandatory.

40. CHAPTER XIII – SEBI (DIP)

GUIDELINES FOR PREFERENTIAL ISSUES - (**Updated till May 24, 2007**)

13.0 The preferential issue of equity shares/ Fully Convertible Debentures (FCDs)/ Partly Convertible Debentures (PCDs) or any other financial instruments which would be converted into or exchanged with equity shares at a later date, by listed companies whose equity share capital is listed on any stock exchange, to any select group of persons under Section 81(1A) of the Companies Act 1956 on private placement basis shall be governed by these guidelines.

13.1 Such preferential issues by listed companies by way of equity shares/ Fully Convertible Debentures (FCDs)/ Partly Convertible Debentures (PCDs) or any other financial instruments which would be converted into / exchanged with equity shares at a later date, shall be made in accordance with the pricing provisions mentioned below:

13.1.1 Pricing of the issue

13.1.1.1 ²⁹⁷(Where the equity shares of a company have been listed on a stock exchange for a period of six months or more as on the relevant date, the issue of shares on preferential basis shall be made at a price not less than higher of the following:)

- (i) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date;

OR

- (ii) The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

13.1.1.2 Where the equity shares of a company have been listed on a stock exchange for a period of less than six months as on the relevant date, the issue of shares on preferential basis can be made at a price not less than the higher of the following:

- (i) The price at which shares were issued by the company in its IPO or the value per share arrived at in a scheme of arrangement under sections
- (ii) 391 to 394 of the Companies Act, 1956, pursuant to which the shares of the company were listed, as the case may be;

OR

- (a) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the period shares have been listed preceding the relevant date;

OR

- (b) The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date. "Provided that on completing a period of six months of being listed on a stock exchange, the company shall recompute the price of the shares in accordance with the provisions mentioned in sub-clause (i) of clause 13.1.1.1 and if the price at which shares were allotted on a preferential basis under clause 13.1.1.2 was lower than the price so recomputed, the difference shall be paid by the allottees to the company.)

Explanation:

- (a) "relevant date" ²⁹⁹(for the purpose of clauses 13.1.1.1 and 13.1.1.2) means the date thirty days prior to the date on which the meeting of general body of shareholders is held, in terms of Section 81(1A) of the Companies Act, 1956 to consider the proposed issue³⁰⁰(; provided however that in respect of shares issued on preferential basis pursuant to a scheme approved under the Corporate Debt Restructuring framework of Reserve Bank of India, the date of approval of the Corporate Debt Restructuring package shall be the relevant date). b) "stock exchange" ³⁰¹(for the purpose of clauses 13.1.1.1 and 13.1.1.2) means any of the recognised stock exchanges in which the shares are listed and in which the highest trading volume in respect of the shares of the company has been recorded during the preceding six months prior to the relevant date. 13.1.2 Pricing of shares arising out of warrants, etc.13.1.2.1
- (a) Where warrants are issued on a preferential basis with an option to apply for and be allotted shares, the issuer company shall determine the price of the resultant shares in accordance with Clause 13.1.1.1 above.
- (b) The relevant date for the above purpose may, at the option of the issuer be either the one referred in explanation (a) to Clause 13.1.1.1 above or a date 30 days prior to the date on which the holder of the warrants becomes entitled to apply for the said shares. 13.1.2.2 The resolution to be passed in terms of Section 81(1A) shall clearly specify the relevant date on the basis of which price of the resultant shares shall be calculated.13.1.2.3

- (a) An amount equivalent to atleast ten percent of the price fixed in terms of Clause 13.1.1.1 above shall become payable for the warrants on the date of their allotment.
- (b) The amount referred to in sub-clause (a), shall be adjusted against the price payable subsequently for acquiring the shares by exercising an option for the purpose.
- (c) The amount referred to in sub-clause (a) shall be forfeited if the option to acquire shares is not exercised. 13.1.3 Pricing of shares on conversion 13.1.3.1 Where PCDs/ FCDs/ other convertible instruments, are issued on a preferential basis, providing for the issuer to allot shares at a future date, the issuer shall determine the price at which the shares could be allotted in the same manner as specified for pricing of shares allotted in lieu of warrants as indicated in Paras 13.1.2.1& 13.1.2.2 above. (13.1A The explanatory statement to the notice for the general meeting in terms of Section 173 of the Companies Act, 1956 shall contain:
 - i. the object/s of the issue through preferential offer,
 - ii. intention of promoters/ directors/ key management persons to subscribe to the offer,
 - iii. shareholding pattern before and after the offer,
 - iv. proposed time within which the allotment shall be complete
 - v. the identity of the proposed allottees and the percentage of post

preferential issue capital that may be held by them.)³⁰³(vi. in case of a preferential allotment to which clause 13.1.1.2 is applicable, requirements specified in proviso to clause 13.1.1.2 and proviso mentioned after sub-clause (e) of clause 13.3.1.) (13.1B) A listed company shall not make any preferential issue of equity shares, Fully Convertible Debentures, Partly Convertible Debentures or any other instrument which may be converted into or exchanged with equity shares at a latter date if the same is not in compliance with the conditions for continuous listing.) 13.2 Currency of financial instruments13.2.1 In case of Warrants/ PCDs/ FCDs/ or any other financial instruments with a provision for the allotment of equity shares at a future date, either through conversion or otherwise, the currency of the instruments shall not exceed beyond 18 months from the date of issue of the relevant instrument.13.3 Non-transferability of financial instruments13.3.1

- (a) The instruments allotted on a preferential basis to the promoter / promoter group as defined in Chapter VI in ³⁰⁶(Explanation I, II and III to clause 6.8.3.2) of these guidelines, shall be subject to lock-in of 3 years from the date of their allotment.
- (b) In any case, not more than 20% of the total capital of the company, including capital brought in by way of preferential issue, shall be subject to lock-in of three years from the date of allotment. ³⁰⁷(
- (c) In addition to the requirements for lock in of instruments allotted on preferential basis to promoters/ promoter group as per clause 13.3.1 (a) and (b), the instruments allotted on preferential basis to any person including promoters/ promoters group shall be locked-in for a period of one year from the date of their allotment.
- (d) The lock-in on shares acquired by conversion of the convertible instrument/exercise of warrants, shall be reduced to the extent the convertible instrument warrants have already been locked-in. ³¹⁰((e) the lock-in period in respect of the shares issued on preferential basis pursuant to a scheme approved under Corporate Debt Restructuring framework of Reserve Bank of India, shall commence from the date of allotment and shall continue for a period of one year and in case of allotment of partly paid up shares the lock-in period shall commence from the date of allotment and continue for a period of one year from the date when shares become fully paid up. Provided that where any amount payable by the allottee of shares under the proviso to clause 13.1.1.2 is not paid till the expiry of lock-in period mentioned in sub-clauses (a) to
- (e) above, lock-in period in respect of the shares issued to such allottee shall continue till the time the company receives such amount from such allottee.)

- (f) no listed company shall make preferential issue of equity shares / warrants / convertible instruments to any person unless the entire shareholding of such persons in the company, if any, is held by him in dematerialized form.
- (g) where the shares / warrants/ convertible instruments are issued on preferential basis, the entire pre preferential allotment shareholding of such allottees shall be under lock – in from the relevant date upto a period of six months from the date of preferential allotment.
- (h) where the shares / warrants / convertible instruments are issued on preferential basis, the shareholders who have sold their shares during the six months period prior to the relevant date shall not be eligible for allotment of shares on preferential basis.)

Explanation:

- (a) For the purpose of this clause “total capital” of the company shall mean-
 - (i) equity share capital issued by way of public/ rights issue including equity shares emerging at a later date out of any convertible securities/ exercise of warrants and
 - (ii) equity shares or any other security convertible at a later date into equity issued on a preferential basis in favour of promoter/ promoter groups.
- (b) (i) For computation of 20% of the total capital of the company, the amount of minimum promoters' contribution held and locked-in, in the past as per guidelines shall be taken into account.
- (ii) The minimum promoters' contribution shall not again be put under fresh lock-in, even though it is considered for computing the requirement of 20% of the total capital of the company, in case the said minimum promoters' contribution is free of lock-in at the time of the preferential issue. 13.3.2 These locked in shares/instruments may be transferred to and amongst promoter/ promoter group or to a new promoter(s) or person(s) in control of the company, subject to continuation of lock-in in the hands of transferee(s) for the remaining period and compliance of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 1997, as applicable.) 13.4 Currency of shareholders resolutions 13.4.1 Allotment pursuant to any resolution passed at a meeting of shareholders of a ³¹³(company) granting consent for preferential issues of any financial instrument, shall be completed within a period of ³¹⁴(fifteen days) from the date of passing of the resolution. Provided that where the allotment on preferential basis is pending on account of pendency of any approval of such allotment by any regulatory authority or the Central Government, the allotment shall be completed within 15 days from the date of such approval.) (13.4.2 The equity shares and securities convertible into equity shares at a later date, allotted in terms of the above said resolution shall be made fully paid up at the time of their allotment.) Provided that payment in case of warrants shall be made in terms of clause 13.1.2.3 above.) (13.4.2A Nothing contained in clauses 13.4.1 and 13.4.2 shall apply in case of allotment of shares and securities convertible into equity shares at a later date on preferential basis pursuant to a scheme of corporate debt restructuring as per the Corporate Debt Restructuring framework specified by the Reserve Bank of India. (13.4.3) If allotment of instruments and dispatch of certificates is not completed within ³¹⁹(fifteen days) from the date of such resolution, a fresh consent of the shareholders shall be obtained and the relevant date referred to in explanation (a) in paragraph 13.1.1.1 above will relate to the new resolution.) 13.5 (Other Requirements) 13.5.1
 - (a) In case of every issue of shares/ warrants/ FCDs/ PCDs/ or other financial instruments having conversion option, the statutory auditors of the issuer ³²¹(company) shall certify that the issue of said instruments is being made in accordance with the requirements contained in these guidelines.
 - (b) Copies of the auditors certificate shall also be laid before the meeting of the shareholders convened to consider the proposed issue. ((c) In case of preferential

allotment of shares to promoters, their relatives, associates and related entities, for consideration other than cash, valuation of the assets in consideration for which the shares are proposed to be issued shall be done by an independent qualified valuer and the valuation report shall be submitted to the exchanges on which shares of the issuer company are listed.

Explanation:

For the purpose of this clause the word valuer shall have the same meaning as assigned to the term under clause (r) of sub-regulation (1) of Regulation 2 of the SEBI (Issue of Sweat Equity) Regulations, 2002.) (13.5A The details of all monies utilised out of the preferential issue proceeds shall be disclosed under an appropriate head in the balance sheet of the company indicating the purpose for which such monies have been utilised. The details of unutilised monies shall also be disclosed under a separate head in the balance sheet of the company indicating the form in which such unutilised monies have been invested.) 13.6 Preferential allotments to FIIs 13.6.1 Preferential allotments, if any to be made in case of Foreign Institutional Investors, shall also be governed by the guidelines issued by the Government of India/ Board/ Reserve Bank of India on the subject. 13.7 Non-Applicability of the guidelines 13.7.1 Clauses 13.1 to 13.5 shall not be applicable in the following cases:

- (i) where the further shares are allotted in pursuance to the merger and amalgamation scheme approved by the High court.
- (ii) (a) where further shares are allotted to a person / group of persons in accordance with the provisions of rehabilitation packages approved by BIFR.
- (b) In case, such persons are promoters or belong to promoter group as defined in (Explanation I and II ³²⁵(to clause 6.8.3.2)) of Chapter VI of these guidelines, the lock-in provisions shall continue to apply unless otherwise stated in the BIFR order.
- (iii) where further shares are allotted to All India public financial institutions in accordance with the provision of the loan agreements signed prior to August 4, 1994. (13.7.2 Clauses 13.1 and 13.3 shall not be applicable to shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of clause (h) of section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (51 of 1993).)



The Institute of Chartered Accountants of India

FINAL (NEW) COURSE

SYLLABUS

GROUP I

- Paper – 1 : Financial Reporting
- Paper – 2 : Strategic Financial Management
- Paper – 3 : Advanced Auditing and Professional Ethics
- Paper – 4 : Corporate and Allied Laws

GROUP II

- Paper – 5 : Advanced Management Accounting
- Paper – 6 : Information Systems Control and Audit
- Paper – 7 : Direct Tax Laws
- Paper – 8 : Indirect Tax Laws

PAPER – 1 : FINANCIAL REPORTING
(One paper – Three hours – 100 marks)

Level of Knowledge: Advanced knowledge

Objectives:

- (a) To gain ability to analyze financial statements including consolidated financial statements of group companies and financial reports of various types of entities,
- (b) To gain ability to apply valuation principles,
- (c) To familiarise with recent developments in the area of financial reporting,
- (d) To gain ability to solve financial reporting and valuation cases.

Contents:

1. Accounting Standards, Accounting Standards Interpretations and Guidance Notes on various accounting aspects issued by the ICAI and their applications.
2. Overview of International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS), Interpretations by International Financial Reporting Interpretation Committee (IFRIC), Significant difference vis-a-vis Indian Accounting Standards.
Understanding of US GAAP,
Applications of IFRS and US GAAP.
3. Corporate Financial Reporting - Issues and problems with special reference to published financial statements.
4. Accounting for Corporate Restructuring (including inter-company holdings).
5. Consolidated Financial Statements of Group Companies Concept of a Group, purposes of consolidated financial statements minority interest, Goodwill, Consolidation procedures – Minority interests, Goodwill, Treatment of pre- acquisition and post-acquisition profit.
Consolidation with two or more subsidiaries, consolidation with foreign subsidiaries.
Consolidated profit and loss account, balance sheet and cash flow statement.
Treatment of investment in associates in consolidated financial statements.
Treatment of investments in joint ventures in consolidated financial statements.
6. Accounting and Reporting of Financial Instruments
Meaning, recognition, derecognition and offset, compound financial instruments
Measurement of financial instruments
Hedge accounting
Disclosures
7. Share based payments
Meaning, Equity settled transactions, Transaction with employees and non- employees
Determination of fair value of equity instruments
Vesting conditions
Modification, cancellation and settlement
Disclosures
8. Financial Reporting by Mutual funds, Non-banking finance companies, Merchant bankers, Stock and commodity market intermediaries.
9. Valuation
(a) Concept of Valuation

- (b) Valuation of Tangible Fixed Assets
- (c) Valuation of Intangibles including Brand Valuation and Valuation of Goodwill
- (d) Valuation of Liabilities
- (e) Valuation of Shares
- (f) Valuation of Business

10. Developments in Financial Reporting

- (a) Value Added Statement
- (b) Economic Value Added, Market Value Added, Shareholders' Value Added
- (c) Human Resource Reporting
- (d) Inflation Accounting

Note: If either old Accounting Standards (ASs), Accounting Standards Interpretations (ASIs), Guidance Notes (GNs), Announcements and Limited Revisions to ASs are withdrawn or new ASs, GNs, Announcements and Limited Revisions to AS are issued by the Institute of Chartered Accountants of India in place of existing ASs, ASIs, GNs, Announcements and Limited Revisions to AS, the syllabus will accordingly include/exclude such new developments in the place of the existing ones with effect from the date to be notified by the Institute.

PAPER – 2 : STRATEGIC FINANCIAL MANAGEMENT

(One paper – Three hours – 100 marks)

Level of Knowledge: Advanced knowledge

Objective:

To apply financial management theories and techniques for strategic decision making.

Contents:

1. Financial Policy and Corporate Strategy
 - Strategic decision making framework
 - Interface of Financial Policy and strategic management
 - Balancing financial goals vis-à-vis sustainable growth.
2. Project Planning and Capital Budgeting
 - Feasibility study
 - Cash flow Projections – Impact of taxation, depreciation, inflation and working capital
 - Capital Budgeting Decisions - Certainty Equivalent approach, Evaluation of Risky Investment Proposals, Risk and Return analysis, Simulation and decision tree analysis, Sensitivity analysis, Capital Rationing, Adjusted Net Present Value, Replacement decisions, Application of Real Options in capital budgeting, Impact of inflation on capital budgeting decisions
 - Preparation of Project Report
 - Social cost benefit analysis.
3. Leasing decision including cross border leasing
4. Dividend Decisions
 - Dividend theories, Determinants of dividend policies.
5. (a) Indian Capital Market including role of various primary and secondary market institutions

- (b) Capital Market Instruments
 - Financial derivatives – stock futures, stock options, index futures, index options
 - Option valuation techniques : Binomial model, Black Scholes Option Pricing Model, Greeks – Delta, Gamma, Theta, Rho and Vega
 - Pricing of Futures – Cost of carry model
 - Imbedded derivatives
- (c) Commodity derivatives
- (d) OTC derivatives -Swaps, Swaptions, Forward Rate Agreements (FRAs), Caps, Floors and Collors.
- 6. Security Analysis
 - Fundamental analysis - Economic analysis, Industry analysis and Company Analysis
 - Bond valuation, Price Yield relationship, Bond Price forecasting – application of duration and convexity, Yield curve strategies
 - Technical Analysis – market cycle model and basic trend identification, different types of charting, support and resistance, price patterns, moving averages, Bollinger Bands, momentum analysis.
- 7. Portfolio Theory and Asset Pricing
 - Efficient Market Theory – Random walk theory ; Markowitz model of risk return optimization
 - Capital Asset Pricing Model (CAPM)
 - Arbitrage Pricing Theory (APT)
 - Sharpe Index Model
 - Portfolio Management - Formulation, Monitoring and Evaluation
 - Equity Style Management
 - Principles and Management of Hedge Funds
 - International Portfolio Management.
- 8. Financial Services in India
 - Investment Banking
 - Retail Banking
 - On Line Share Trading
 - Depository Service.
- 9. (a) Mutual Funds: Regulatory framework, formulation, monitoring and evaluation of various schemes of Mutual funds, Money market mutual funds.
 - (b) Exchange Traded Funds.
- 10. Money Market operations
- 11. (a) Foreign Direct Investment, Foreign Institutional Investment.
 - (b) International Financial Management
 - Raising of capital abroad - American Depository Receipts, Global Depository Receipts, External Commercial Borrowings and Foreign Currency Convertible Bonds
 - International Capital Budgeting
 - International Working Capital Management.
- 12. Foreign Exchange Exposure and Risk Management
 - Exchange rate determination, Exchange rate forecasting

Foreign currency market

Foreign exchange derivatives – Forward, futures, options and swaps

Management of transaction, translation and economic exposures

Hedging currency risk.

13. Mergers, Acquisitions and Restructuring

Meaning of mergers and acquisition, categories, purposes

Process of mergers and acquisition – Identification and valuation of the target, acquisition through negotiation, due diligence, post – merger integration

Legal and regulatory requirements

Merger and Acquisition agreement

Reverse merger

Potential adverse competitive effects of mergers

Corporate Takeovers: Motivations, Co-insurance effect, Cross-border takeovers, Forms of takeovers, Takeover defenses

Going Private and Other Control Transactions: Leveraged Buyouts (LBOs), Management Buyouts (MBOs), Spin Offs and Asset Divestitures

Corporate Restructuring : Refinancing and rescue financing, reorganizations of debtors and creditors, Sale of assets, targeted stock offerings, downsizing and layoff programmes, negotiated wage give-backs, employee buyouts.

PAPER – 3 : ADVANCED AUDITING AND PROFESSIONAL ETHICS

(One Paper- Three hours - 100 marks)

Level of Knowledge: Advanced knowledge

Objectives:

- (a) To gain expert knowledge of current auditing practices and procedures and apply them in auditing engagements,
- (b) To develop ability to solve cases relating to audit engagements.

Contents:

1. Auditing Standards, Statements and Guidance Notes

Auditing and Assurance Standards (AASs); Statements and Guidance Notes on Auditing issued by the ICAI; Significant differences between Auditing and Assurance Standards and International Standards on Auditing.

2. Audit strategy, planning and programming

Planning the flow of audit work; audit strategy, planning programme and importance of supervision: review of audit notes and working papers; drafting of reports; principal's ultimate responsibility; extent of delegation; control over quality of audit work; reliance on the work of other auditor, internal auditor or an expert.

3. Risk Assessment and Internal Control

Evaluation of internal control procedures; techniques including questionnaire, flowchart; internal audit and external audit, coordination between the two.

4. Audit under computerized information system (CIS) environment

Special aspects of CIS Audit Environment, need for review of internal control especially procedure controls and facility controls. Approach to audit in CIS Environment, use of computers for internal

and management audit purposes: audit tools, test packs, computerized audit programmes; Special Aspects in Audit of E-Commerce Transaction.

5. Special audit techniques
 - (a) Selective verification; statistical sampling: Special audit procedures; physical verification of assets, direct confirmation of debtors and creditors
 - (b) Analytical review procedures
 - (c) Risk-based auditing.
6. Audit of limited companies

Statutory requirements under the Companies Act 1956; Audit of branches: joint audits; Dividends and divisible profits % financial, legal, and policy considerations.
7. Rights, duties, and liabilities of auditors; third party liability.
8. Audit reports; qualifications, notes on accounts, distinction between notes and qualifications, detailed observations by the statutory auditor to the management vis-a-vis obligations of reporting to the members.
9. Audit Committee and Corporate Governance
10. Audit of Consolidated Financial Statements, Audit Reports and Certificates for Special Purpose engagements; Certificates under the Payment of Bonus Act, import/export control authorities, etc.; Specific services to non-audit clients; Certificate on Corporate Governance.
11. Special features of audit of banks, insurance companies, co-operative societies and non-banking financial companies.
12. Audit under Fiscal Laws, viz, Direct and Indirect Tax Laws.
13. Cost audit
14. Special audit assignments like audit of bank borrowers, audit of stock and commodity exchange intermediaries and depositories; inspection of special entities like banks, financial institutions, mutual funds, stock brokers.
15. Special features in audit of public sector companies. Directions of Comptroller and Auditor General of India under Section 619; Concepts of propriety and efficiency audit.
16. Internal audit, management and operational audit Nature and purpose, organisation, audit programme, behavioural problems; Internal Audit Standards issued by the ICAI; Specific areas of management and operational audit involving review of internal control, purchasing operations, manufacturing operations, selling and distribution, personnel policies, systems and procedures. Aspects relating to concurrent audit.
17. Investigation and Due Diligence.
18. Concept of peer review
19. Salient features of Sarbanes – Oxley Act, 2002 with special reference to reporting on internal control.
20. Professional Ethics

Code of Ethics with special reference to the relevant provisions of The Chartered Accountants Act, 1949 and the Regulations thereunder.

PAPER – 4 : CORPORATE AND ALLIED LAWS

(One paper – Three hours – 100 marks)

Section A : Company Law (70 Marks)

Level of Knowledge: Advanced knowledge

Objective:

To be able to analyze and apply various provisions of the Companies Act in practical situations

Contents:

1. The Companies Act, 1956, Rules and Regulations thereunder in its entirety with specific reference to
 - (a) Accounts and audit
 - (b) Dividend
 - (c) Directors - powers, managerial remuneration
 - (d) Meetings, powers of the Board and related party transactions
 - (e) Inspection and Investigation
 - (f) Compromises, Arrangements and Reconstructions
 - (g) Prevention of Oppression and Mismanagement
 - (h) Revival and Rehabilitation of Sick Industrial Companies
 - (i) Corporate Winding up and Dissolution
 - (j) Producer Companies
 - (k) Companies incorporated outside India
 - (l) Offences and Penalties
 - (m) E-governance
2. Corporate Secretarial Practice – Drafting of Resolution, Minutes, Notices and Reports

Section B : Allied Laws (30 Marks)

Objective:

To develop ability to analyse the requirements of laws stated in the Section.

Contents:

3. An overview of the following laws –
 - (a) The Securities and Exchange Board of India Act, 1992, Rules, Regulations and Guidelines issued thereunder.
 - (b) The Securities Contracts (Regulation) Act, 1956
 - (c) The Foreign Exchange Management Act, 1999
 - (d) The Competition Act, 2002
 - (e) The Banking Regulation Act, 1949, The Insurance Act, 1938. The Insurance Regulatory and Development Authority Act, 1999. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
 - (f) The Prevention of Money Laundering Act, 2002
4. Interpretation of Statutes, Deeds and Documents.

PAPER – 5 : ADVANCED MANAGEMENT ACCOUNTING

(One paper – Three hours – 100 marks)

Level of Knowledge: Advanced knowledge

Objective:

To apply various management accounting techniques to all types of organizations for planning, decision making and control purposes in practical situations.

To develop ability to apply quantitative techniques to business problems

1. Cost Management

- (a) Developments in the business environment; just in time; manufacturing resources planning; (MRP); automated manufacturing; synchronous manufacturing and back flush systems to reflect the importance of accurate bills of material and routings; world class manufacturing; total quality management.
- (b) Activity based approaches to management and cost analysis
- (c) Analysis of common costs in manufacturing and service industry
- (d) Techniques for profit improvement, cost reduction, and value analysis
- (e) Throughput accounting
- (f) Target costing; cost ascertainment and pricing of products and services
- (g) Life cycle costing
- (h) Shut down and divestment.

2. Cost Volume Profit Analysis

- (a) Relevant cost
- (b) Product sales pricing and mix
- (c) Limiting factors
- (d) Multiple scarce resource problems
- (e) Decisions about alternatives such as make or buy, selection of products, etc.

3. Pricing Decisions

- (a) Pricing of a finished product
- (b) Theory of price
- (c) Pricing policy
- (d) Principles of product pricing
- (e) New product pricing
- (f) Pricing strategies
- (g) Pricing of services
- (h) Pareto analysis

4. Budgets and Budgetary Control

The budget manual, Preparation and monitoring procedures, Budget variances, Flexible budgets, Preparation of functional budget for operating and non-operating functions, Cash budgets, Capital expenditure budget, Master budget, Principal budget factors.

5. Standard Costing and Variance Analysis

Types of standards and sources of standard cost information; evolution of standards, continuous - improvement; keeping standards meaningful and relevant; variance analysis; disposal of variances.

- (a) Investigation and interpretation of variances and their inter relationship
- (b) Behavioural considerations.
- 6. Transfer pricing
 - (a) Objectives of transfer pricing
 - (b) Methods of transfer pricing
 - (c) Conflict between a division and a company
 - (d) Multi-national transfer pricing.
- 7. Cost Management in Service Sector
- 8. Uniform Costing and Inter firm comparison
- 9. Profitability analysis - Product wise / segment wise / customer wise
- 10. Financial Decision Modeling
 - (a) Linear Programming
 - (b) Network analysis - PERT/CPM, resource allocation and resource leveling
 - (c) Transportation problems
 - (d) Assignment problems
 - (e) Simulation
 - (f) Learning Curve Theory
 - (g) Time series forecasting
 - (h) Sampling and test of hypothesis

PAPER – 6 : INFORMATION SYSTEMS CONTROL AND AUDIT

(One Paper – Three hours – 100 marks)

Level of knowledge: Advanced knowledge

Objective:

To gain application ability of necessary controls, laws and standards in computerized Information system.

Contents:

1. Information Systems Concepts
 - General Systems Concepts – Nature and types of systems, nature and types of information, attributes of information.
 - Management Information System – Role of information within business
 - Business information systems –various types of information systems – TPC, MIS, DSS, EIS, ES
2. Systems Development Life Cycle Methodology
 - Introduction to SDLC/Basics of SDLC
 - Requirements analysis and systems design techniques
 - Strategic considerations : Acquisition decisions and approaches
 - Software evaluation and selection/development
 - Alternate development methodologies- RAD, Prototype etc
 - Hardware evaluation and selection
 - Systems operations and organization of systems resources

Systems documentation and operation manuals
 User procedures, training and end user computing
 System testing, assessment, conversion and start-up
 Hardware contracts and software licenses
 System implementation
 Post-implementation review
 System maintenance
 System safeguards
 Brief note on IS Organisation Structure

3. Control objectives

(a) Information Systems Controls

Need for control
 Effect of computers on Internal Audit
 Responsibility for control – Management, IT, personnel, auditors
 Cost effectiveness of control procedure
 Control Objectives for Information and related Technology (COBIT)

(b) Information Systems Control Techniques

Control Design: Preventive and detective controls, Computer-dependent control, Audit trails, User Controls (Control balancing, Manual follow up)
 Non-computer-dependent (user) controls: Error identification controls, Error investigation controls, Error correction controls, Processing recovery controls

(c) Controls over system selection, acquisition/development

Standards and controls applicable to IS development projects
 Developed / acquired systems
 Vendor evaluation
 Structured analysis and design
 Role of IS Auditor in System acquisition/selection

(d) Controls over system implementation

Acceptance testing methodologies
 System conversion methodologies
 Post implement review
 Monitoring, use and measurement

(e) Control over System and program changes

Change management controls
 Authorization controls
 Documentation controls
 Testing and quality controls
 Custody, copyright and warranties
 Role of IS Auditor in Change Management

- (f) Control over Data integrity, privacy and security
 - Classification of information
 - Logical access controls
 - Physical access controls
 - Environmental controls
 - Security concepts and techniques – Cryptosystems, Data Encryption Standards (DES), Public Key Cryptography & Firewalls
 - Data security and public networks
 - Monitoring and surveillance techniques
 - Data Privacy
 - Unauthorised intrusion, hacking, virus control
 - Role of IS Auditor in Access Control
- 4. Audit Tests of General and Automated Controls
 - (a) Introduction to basics of testing (reasons for testing);
 - (b) Various levels/types of testing such as: (i) Performance testing, (ii) Parallel testing, (iii) Concurrent Audit modules/Embedded audit modules, etc.
- 5. Risk assessment methodologies and applications: (a) Meaning of Vulnerabilities, Threats, Risks, Controls, (b) Fraud, error, vandalism, excessive costs, competitive disadvantage, business, interruption, social costs, statutory sanctions, etc. (c) Risk Assessment and Risk Management, (d) Preventive/detective/corrective strategies
- 6. Business Continuity Planning and Disaster recovery planning: (a) Fundamentals of BCP/DRP, (b) Threat and risk management, (c) Software and data backup techniques, (d) Alternative processing facility arrangements, (e) Disaster recovery procedural plan, (f) Integration with departmental plans, testing and documentation, (g) Insurance
- 7. An over view of Enterprise Resource Planning (ERP)
- 8. Information Systems Auditing Standards, guidelines, best practices (BS7799, HIPPA, CMM etc.)
- 9. Drafting of IS Security Policy, Audit Policy, IS Audit Reporting - a practical perspective
- 10. Information Technology Act, 2000

PAPER – 7: DIRECT TAX LAWS

(One paper – Three hours – 100 marks)

Level of Knowledge: Advanced knowledge

Objectives:

- (a) To gain advanced knowledge of the provisions of direct tax laws,
- (b) To acquire the ability to apply the knowledge of the provisions of direct tax laws to various situations in actual practice.

Contents:

- I. The Income-tax Act, 1961 and Rules thereunder (90 marks)
- II. The Wealth-tax Act, 1957 and Rules thereunder (10 marks)

While covering the direct tax laws, students should familiarise themselves with considerations relevant to tax management. These may include tax considerations with regard to specific management decisions, foreign collaboration agreements, international taxation, amalgamations,

tax incentives, personnel compensation plans, inter-relationship of taxation and accounting, with special reference to relevant accounting standards and other precautions to be observed to maximise tax relief. Further, they should have a basic understanding about the ethical considerations in tax management and compliance with taxation laws.

Note – If new legislations are enacted in place of the existing legislations relating to income tax and wealth tax, the syllabus will accordingly include such new legislations in the place of the existing legislations with effect from the date to be notified by the Institute.

PAPER – 8 : INDIRECT TAX LAWS
(One paper – Three hours – 100 marks)

Level of Knowledge: Advanced knowledge

Objectives:

- (a) To gain expert knowledge of the principles of the laws relating to central excise customs and service tax,
- (b) To acquire the ability to apply the knowledge of the provisions of the above-mentioned laws to various situations in actual practice.

Contents:

Section A : Central Excise (40 marks)

Central Excise Act, 1944 and the related Rules, Circulars and Notifications; Central Excise Tariff Act, 1985 and the related Rules.

Section B : Service tax & VAT (40 marks)

Law relating to service tax as contained in the Finance Act, 1994 as amended from time to time and the related Rules, Circulars and Notifications.

Issues related to Value Added Tax:

1. Backdrop for State-Level VAT in India
2. Taxonomy of VAT
3. Input tax credit, tax invoices
4. Small dealers and composition scheme
5. VAT procedures
6. VAT in relation to incentive schemes, works contract, lease transactions and hire purchase transactions.
7. VAT and Central Sales Tax

Section C : Customs (20 marks)

Customs Act, 1962 and the related Rules, Circulars and Notifications; Customs Tariff Act, 1975 and the related Rules.

While covering the above laws, students should familiarize themselves with the inter-relationship of accounting with excise, customs and service tax and also the ethical considerations involved in the compliance of these laws.

Note – If new legislations are enacted in place of the existing legislations relating to central excise, customs and service tax, the syllabus will accordingly include such new legislations in place of the existing legislations with effect from the date to be notified by the Institute. Students shall not be examined with reference to any particular State VAT Law.

TRANSITION SCHEME FOR FINAL STUDENTS

The transition scheme for the Final Course students, who have passed Professional Education (Examination-II), and are under articleship training, is as under:

- ◆ On completion of 2 years of training, such students are eligible to appear in the Final Examination, so long as the same is held under the existing syllabus i.e., upto November, 2009.

In the event of a candidate not being eligible to appear till the last Final Examination to be held in November 2009 under the existing syllabus, will be required to appear in the Final Examination under the New syllabus, but only during the last six months of articleship training (articleship training period being 3 years only).

Introduction of Final Course under New Syllabus and other related Issues

- (i) Final Course under New syllabus is introduced. Admission to the Final (New) Course under the Regulation 29B of the Chartered Accountants (Amendment) Regulations, 2006 has commenced on and from February 1, 2007.
- (ii) Existing students of Final (old) course may switch over to Final (New) course and continue with the existing scheme of articleship, if any, which they are undergoing. They will be provided a new set of study materials at a cost of Rs.1100.
- (iii) Students, who have passed the Professional Education (Examination-II) / Intermediate Examination but not yet joined Final course and also have not completed the articleship training, may join the Final (New) Course.
 - ◆ Students who have undergone Professional Education (Course-II) with articleship but not yet completed the same, will continue the articleship under the same scheme which they are undergoing presently. They will be allowed to appear in the Final Examination under the new syllabus pending last six months of articleship training on or before the last day of the month preceding the month in which the examination is held.
 - ◆ Students who have undergone Professional Education (Course-II), without articleship, will undergo three years of articleship training and they will be allowed to appear in the Final Examination under the new syllabus pending last six months of articleship training on or before the last day of the month preceding the month in which the examination is held.

They will be required to pay fees as given below:

Final Course – Without articleship Rs.8500

With articleship Rs.9000 (including articulated registration fee of Rs.500)

In addition, students have to pay Rs.500 on account of registration fee with Board of Studies and Rs.500 on account of Students' Association fee if these fees are not paid earlier.

- (iv) Students who have passed Professional Education (Examination-II) / Intermediate Examination and who have completed articleship training may join Final (New) course under Regulation 29B of the Chartered Accountants (Amendment) Regulations, 2006 and appear in the first Final (New) Course Examination to be held in November, 2008. They will be required to pay a fee of Rs.8500.
- (v) Admission to Final (old) course under Regulation 29A of the Chartered Accountants Regulations, 1988 will continue till October 31, 2007. Students who will join the same are required to pay the following fees:

Final Course	– Without articleship	Rs.4000
	– With articleship	Rs.4600
- (vi) First Final Examination (New) Course will be held in November, 2008 and Last Final Examination (Old) Course will be held in November, 2009.
- (vii) Students shall complete 100 Hours Information Technology Training or should have already completed 250 Hours Compulsory Computer Training before taking admission to Final (Old) or Final (New) Course.

APPLICABILITY OF VARIOUS PUBLICATIONS FOR FINAL EXAMINATION TO BE HELD IN NOVEMBER 2007

Paper 1 : Advanced Accounting

- I. Statements and Standards
 1. Framework for the Preparation and Presentation of Financial Statements
 2. Accounting Standards – AS 1 to AS 29 [including revised AS 15 (2005)].
- II. Guidance Notes on Accounting Aspects
 1. Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets.
 2. Guarantees and Counter-Guarantees Given by Companies.
 3. Guidance Note on Treatment of Expenditure during Construction Period.
 4. Guidance Note on Accrual Basis of Accounting.
 5. Guidance Note on Accounting Treatment for Excise Duty.
 6. Guidance Note on Accounting for Depreciation in Companies.
 7. Guidance Note on Availability of Revaluation Reserve for Issue of Bonus shares.
 8. Guidance Note on Accounting Treatment for MODVAT/CENVAT.
 9. Guidance Note on Accounting for Securitisation.
 10. Guidance Note on Accounting for Equity Index and Equity Stock Futures and Options (2003).
 11. Guidance Note on Accounting for Corporate Dividend Tax.
 12. Guidance Note on Accounting for Investments in the Financial Statements of Mutual Funds.
 13. Guidance Note on Accounting for Employee Share-based Payments.
 14. Guidance Note on Accounting for Fringe Benefits Tax.
 15. Guidance Note on Accounting for Credit Available in respect of Minimum Alternate Tax under the Income Tax Act, 1961.

Paper 3 : Advanced Auditing

- I. Professional Topics/Subjects
 1. Code of Ethics

The Chartered Accountants (Amendment) Act, 2006 is applicable for November, 2007 Final Examination. Questions on Professional Ethics may be asked in accordance with the Chartered Accountants (Amendment) Act, 2006. Chapter 17 of Advanced Auditing of Final (Old) Course study material should be accordingly read with appropriate amendments.

A supplementary study material is released covering Chapter 17 of Advanced Auditing study material. The supplementary study material can also be downloaded from the website www.icaai.org > Students > Courses (Course Curriculum) > Final > Supplementary Study Materials > Advanced Auditing.
- II. Statements and Standards
 1. Framework of Statements on Standard Auditing Practices and Guidance Notes on Related Services.
 2. Auditing and Assurance Standards AAS 1 to AAS 34
 3. Statement on Qualifications in Auditor's Report
 4. Statement on the Companies (Auditor's Report) Order, 2003 [2005 Edition].

III. Guidance Notes/Study Guide/Monograph

Guidance Notes on Auditing Aspects:

1. Guidance Note on Independence of Auditors
2. Internal Control Questionnaire.
3. Guidance Note on Accountant's Report on Profit Forecasts and / or Financial Forecasts.
4. Guidance Note on Audit Reports and Certificates for Special Purposes
5. Guidance Note on Audit of Fixed Assets.
6. Guidance Note on Audit under Section 44AB of the Income Tax Act [2005 Edition].
7. Guidance Note on Audit of Abridged Financial Statements.
8. Guidance Note on Audit of Inventories.
9. Guidance Note on Audit of Debtors, Loans and Advances.
10. Guidance Note on Audit of Investments.
11. Guidance Note on Audit of Miscellaneous Expenditure.
12. Guidance Note on Audit of Cash and Bank Balances.
13. Guidance Note on Audit of Liabilities.
14. Guidance Note on Audit of Revenue.
15. Guidance Note on Audit of Expenses.
16. Guidance Note on Section 227 (3) (e) and (f) of the Companies Act, 1956.
17. Guidance Note on Certificate of Corporate Governance [2006 Edition].
18. Guidance Note on Revision of Audit Report.
19. Guidance Note on Computer Assisted Audit Techniques (CAATs).
20. Guidance Note on Audit of Payment of Dividend.
21. Guidance Note on Audit of Capital and Reserves.

Paper 4 : Corporate Laws and Secretarial Practice

May, 2007 edition is relevant for November, 2007 Examination. Amendments in the SEBI (DIP) Guidelines 2000 as amended up to 30th April, 2007 may be made applicable.

Paper 7 : Direct Taxes

1. Study Material for Direct Taxes (as amended by Finance Act, 2006) – June 2006 edition. The relevant assessment year is A.Y.2007-08.
2. Select cases in Direct and Indirect Taxes (2006) – An Essential reading for the Final Course.[Portions relating to Direct Taxes]
3. Final Course – Supplementary Study Paper – 2006 Direct Taxes and Indirect Taxes – Amendments made by the Finance Act, 2006. [Portions relating to Direct Taxes]. This publication is relevant for those who have any earlier edition (prior to June 2006 edition) of the Direct Taxes study material.

Note – For the purposes of setting the questions in direct taxes, study material for A.Y.2007-08 containing the law as amended by the Finance Act, 2006 should be taken into account. This study material contains amendments made by notifications/circulars/other legislations up to 30.04.2006. The amendments made between 1.05.2006 and 30.4.2007 would be published in the Revision Test Papers

for November, 2007 examination. All these amendments are relevant for November, 2007 examination and hence should be taken into account for the purpose of setting questions for this exam.

Paper 8 : Indirect Taxes

1. Study Material for Indirect Taxes (as amended by Finance Act, 2006).
2. Select cases in Direct and Indirect Taxes (2006) – An Essential reading for the Final Course [Portions relating to Indirect Taxes]
3. Final Course – Supplementary Study Paper – 2006 Direct Taxes and Indirect Taxes – Amendments made by the Finance Act, 2006 [Portions relating to Indirect Taxes]. This publication is relevant for those who have any earlier Indirect Taxes Study Material (prior to the one as amended by Finance Act, 2006).

Note – For the purposes of setting the questions in indirect taxes, study material containing the law as amended by the Finance Act, 2006 should be taken into account. This study material contains amendments made by notifications/circulars/other legislations up to 30.04.2006. The amendments made between 1.05.2006 and 30.4.2007 would be published in the Revision Test Papers for November 2007 examination. All these amendments are relevant for November 2007 examination and hence should be taken into account for the purpose of setting questions for this exam.

RECENT PUBLICATIONS OF THE BOARD OF STUDIES

			Postal Charges By Registered Parcel	
	English Rs.	Hindi Rs.	English Rs.	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	<u>40</u>	<u>40</u>		
	<u>640</u>	<u>440</u>	145	145
PROFESSIONAL COMPETENCE COURSE (PCC)				
Group I				
Advanced Accounting Vol. I & Vol. II	500	500		
Auditing and Assurance Vol.I	175	175		
Auditing & Assurance Standards & Guidance Note (English) Vol. II	100			
Law, Ethics and Communication	<u>275</u>	<u>275</u>		
	<u>1050</u>	<u>950</u>	215	215
Group II				
Cost Accounting & Financial Management	300	300		
Taxation	200	200		
Information Technology	150	150		
Strategic Management	<u>100</u>	<u>100</u>		
	<u>750</u>	<u>750</u>	180	180
Both Groups	<u>1800</u>	<u>1700</u>	395	395
FINAL (NEW COURSE)				
Group I				
Financial Reporting	600			
Strategic Financial Management	260			
Advanced Auditing and Professional Ethics	520			
Corporate and Allied Laws	<u>200</u>			
	<u>1580</u>		320	
Group II				
Advanced Management Accounting	240			
Information Systems Control and Audit	150			
Direct Tax Laws	340			
Indirect Tax laws	<u>290</u>			
	<u>1020</u>		225	
Both Groups	2600		540	
Information Technology Training Course Material				
Information Technology Training Programme - Modules I & II	500		90	
II. COMPILATIONS OF SUGGESTED ANSWERS				
Professional Education (Course-II)				
Paper 1: Accounting (November, 1994 – November, 2006)	60		40	
Paper 2: Auditing (May, 2000 – November, 2006)	40		40	
Paper 3: Business and Corporate Laws (May, 2000 – November, 2006)	60		40	

Paper 4 A: Cost Accounting (May, 1981 – November, 2006)	60	40
Paper 4 B: Financial Management (May, 1996 – November, 2006)	60	40
Final		
Paper 1: Advanced Accounting (May, 1996 – November, 2006)	70	40
Paper 3: Advanced Auditing (May, 2000 – November, 2006)	60	40
IV. REVISION TEST PAPERS FOR MAY 2007		
Professional Education (Course –I)	40	40
Professional Education (Course –II) (Group I & II)	80	55
Final (Group I & II)	80	55
V. PROSPECTUS		
1. Common Proficiency Test – A Simplified Entry to the Chartered Accountancy Course	100	40
2. Professional Competence Course – First Stage of Theoretical Education of the Chartered Accountancy Course inclusive of conversion form		
– With Form Nos. 102 and 103	100	40
– Without Form Nos. 102 and 103	50	40
VI. MISCELLANEOUS		
1. Model Test paper Vol. I for CPT	250	68
2. Model Test Paper Vol. I for PCC	50	36
3. Students Guide to Accounting Standard 28: Impairment of Assets	25	36
4. Supplementary Study Paper-2006 Income tax & Central Sales Tax for PE(Course-II)	30	40
5. Supplementary Study Paper -2006 Direct tax and Indirect tax for Final Course	60	40
6. Select cases Direct and Indirect Taxes – 2006 For Final Course	40	40
7. Supplementary Study paper – 2007 Advanced Auditing for Final Course	60	40
8. Training Guide	80	40
9. Information Brochure about Common Proficiency Test – A Simplified Entry to the Chartered Accountancy Course Both in English and Hindi		Available free of cost in all Decentralised Offices and Branches of the Institute
10. Information Brochure about Professional Competence Course – First Stage of Theoretical Education of the Chartered Accountancy Both in English and Hindi		
11. Information Brochure on 100 Hours Information Technology Training		
12. Information Brochure about Chartered Accountancy - Global Career Opportunities through a premier Professional Institute Both in English and Hindi		
VII. COMPACT DISCS (CDs) New Series		
1. Membership in Company - PE-II	50	40
2. Capital Gains (Part I and Part II) - Final	50	40
3. Insurance Claims - PE-I / CPT	50	40
4. Hire Purchase and Instalment Payment - PE-II/PCC	50	40
5. Taxation of Salaries - PE-II/ PCC	50	40
6. Foreign Currency Translation-Part I - Final	50	40
7. Foreign Currency Translation-Part 2 - Final	50	40
8. Impairment of Assets - Final	50	40
9. Standard Costing – Part 1 - Final	50	40
10. Standard Costing – Part 2 - Final	50	40