Total No. of Questions : 6 **Max Marks : 100**
No. of Pages : 4 **Time Allowed : 3 Hours**

1. The Balance sheets of R Ltd and P Ltd for the year ending 31st March are as under:

Liabilities	R Ltd Rs.	P Ltd Rs.	Assets	R Ltd Rs.	P Ltd Rs.
Equity Share capital	2400000	1200000	Fixed Assets	5500000	2700000
8% Pref Share capital	800000		Current Assets	2500000	2300000
10%Pref Share capital		400000			
Reserves	3000000	2400000			
Current Liabilities	1800000	1000000			
Total	**8000000**	**5000000**	**Total**	**8000000**	**5000000**

The following information is provided

Particulars	R Ltd Rs.	P Ltd Rs.
Profit before tax	1064000	480000
Taxation	400000	200000
Preference Dividend	64000	40000
Equity Dividend	288000	192000

The Equity shares of both the companies are quoted in the market and nominal value Rs 10 each. Both the companies are carrying on similar manufacturing operations.

R Ltd proposes to absorb P Ltd as on 31st March. The terms of absorption are as under.

a) Preference shareholders of P Ltd will receive 8% Preference shares of R Ltd sufficient to increase the income of Preference shareholders of P Ltd by 10%.

b) Equity shareholders of P Ltd will receive Equity shares of R Ltd on the following basis.

i. Equity shares of P Ltd will be valued by applying to the Earnings per share of P Ltd, 75% of Price Earnings ratio of R Ltd based on the results of the immediately preceding year of both the companies.

ii. Market price of Equity shares of R Ltd is Rs 40 per share

iii. The number of shares to be issued to the Equity Shareholders of P Ltd will be based on the above market value.

iv. In addition to Equity shares, 8% Preference shares of R Ltd will be issued to the Equity shareholders of P Ltd to make up for the loss in income arising from the above exchange of shares based on the dividends for the year ending on the Balance Sheet date given above.

Note: (1) For the next two years, no increase in the rate of equity dividend is expected.

(2) Assets and liabilities of P Ltd as on the Balance Sheet date are revalued by professional valuer as under.

Particulars	Increased by Rs.	Decreased by Rs.
Fixed Assets	100000	
Current Assets		200000
Current Liabilities		40000

Required:
1. Calculate Purchase Consideration
2. Prepare the Balance Sheet as on 31st March after absorption. (16 Marks)

2. The following is the Balance Sheet of P Ltd and B Ltd as on 31st March 2005:

Liabilities	**P Ltd Rs.**	**B Ltd Rs.**	**Assets**	**P Ltd Rs.**	**B Ltd Rs.**
Equity Capital	4800000	2000000	Goodwill	450000	300000
10%Preference capital	700000	380000	Plant and machinery	1200000	500000
General Reserve	550000	420000	Motor Vehicles	950000	750000
Profit and loss A/c	1000000	600000	Furniture and fittings	650000	400000
Bank Overdraft	120000	70000	Investments	2600000	450000
Sundry creditors	430000	480000	Stock	450000	720000
Bills payable		160000	Cash at Bank	225000	210000
			Debtors	930000	780000
			Bills receivable	145000	
Total	**7600000**	**4110000**	**Total**	**7600000**	**4110000**

Details of acquisition of shares by P Ltd are as under:

Nature of Shares	Nos. acquired	Date of acquisition	Cost of acquisition Rs.
Preference Shares	14250	1.4.2002	310000
Equity Shares	80000	1.4.2003	950000
Equity Shares	70000	1.4.2004	800000

Other Information:

1. On 1.4.2004 Profit and loss account and General Reserve of B Ltd had credit balances of Rs 300000 and Rs 200000 respectively

2. Dividend @ 10% was paid by B Ltd for the year 2003-04 out of its profit and loss account balance as on 1.4.2004. P Ltd credited its share of dividend to its profit and loss account.

3. B Ltd allotted bonus shares out of general reserve at the rate of 1 share for every 10 shares held. Accounting thereof has not yet been made.

4. Bills receivable of P Ltd were drawn upon B Ltd.

5. During the year 2004-05 P Ltd purchased goods from B Ltd for Rs 100000 at a sale price of Rs 120000. 40% of these goods remained unsold at close of the year.

6. On 1.4.2004 Motor Vehicles of B Ltd were overvalued by Rs 100000. Applicable depreciation rate is 20%

7. Dividends recommended for the year 2004-05 in the holding and the subsidiary companies are 15% and 10% respectively.

Prepare consolidated Balance Sheet as on 31st March 2005. (16 Marks)

3. The following is the profit and loss account of E Ltd from which you are required to prepare a Gross Value Added Statement and reconcile the same with profit before taxation.

Particulars	Rs in 000s
Sales	28500
Other Income	750
Total	29250
Expenditure	
Operating cost	25600
Excise duty	1700
Interest on Bank overdraft	100
Interest on 12% Debentures	1150
Total Operating Costs	28550
Profit before depreciation	700
Less: Depreciation	250
Profit before tax	250
Less: Provision for tax	270
Profit after tax	180
Less: Transfer to Replacement reserve	30
Balance profit	150
Less: Dividend	50
Retained profit	100

Note: Sales are net after deducting discounts, returns and sales tax. Operating cost includes Rs 10200000 as Wages, Salaries and other benefits to employees. Bank overdraft is a temporary source of finance. Provision for Tax includes Rs 70000 for deferred tax.

(16 Marks)

4. From the following information in respect of J Ltd, calculate the total value of Human Capital by using Lev and Schwartz Model.

	Unskilled		Semi-skilled		Skilled	
Age	No.	Average annual earnings	No.	Average annual earnings	No.	Average annual earnings
30-39	100	Rs 18000	60	Rs 36000	40	Rs 84000
40-49	50	Rs 30000	30	Rs 48000	20	Rs 120000
50-54	30	Rs 36000	20	Rs 60000	10	Rs 180000

Retirement age is 55 years. Use 10% discount factor. In calculations of total value of human factor, lowest value of each class should be taken. Annuity factors at 10% are as follows:

5 years	10 years	15 years	20 years	25 years
3.7908	6.1446	7.6061	8.5136	9.0770

(16 Marks)

5. The following information has been extracted from the books of account of J ltd as at 31.03.05.

Particulars	**Rs. 000s**	**Particulars**	**Rs. 000s**
Factory closure costs	30	Cash received on sale of fittings	5
Distribution costs	51	Long term loan	35
Purchase of Equipment	60	Depreciation on assets (1.4.2004)	130
Stock (1.4.2004)	70	Profit and loss account (1.4.2004)	40
Investments	100	Sales (Net of Excise duty)	1500
Cash and bank	114	Equity Share capital (50000 shares of Rs 10 each)	500
Administration expenses	240	Trade creditors	40
Fixtures, fittings, tools at cost	340		
Trade debtors	390		
Purchase of goods for resale	855		
Total	**2250**	**Total**	**2250**

Additional Information:

1. The stock at 31.3.2005 (valued at the lower of cost or realizable value) was estimated to be worth Rs 100000.

2. Fixtures, fittings, tools and equipment all related to administration. Depreciation is charged at a rate of 20% per annum on cost. A full year's depreciation is charged in the year of acquisition, but no depreciation is charged in the year of disposal.

3. During the year, the company purchased Rs 60000 equipment. It also sold some fittings (which had originally cost Rs 30000) for Rs 5000 and for which depreciation of Rs 15000 had been set aside.

4. The average income tax for the company is 30%. Factory closure cost is to be presumed as an allowable expenditure for income tax purpose. Income tax depreciation is Rs 94000.

5. The company proposes to pay a dividend of 20% per equity share. Transfer to reserves is proposed at Rs 30000.

Prepare the Final Accounts of J Ltd along with Notes on Accounts containing significant accounting policies. (16 Marks)

6. (a) P Ltd had the following borrowings during a year in respect of capital expansion.

Plant	Cost of Asset	Remarks
Plant P	Rs 100 lakhs	No specific borrowings
Plant Q	Rs 125 lakhs	Bank loan of Rs 65 lakhs at 10%
Plant R	Rs 175 lakhs	9% Debentures of Rs 125 lakhs were issued

In addition to the specific borrowings stated above, the company had obtained Term loans from two banks (1) Rs 100 lakhs at 10% from Corporation Bank and (2) Rs 110 lakhs at 11.50% from SBI, to meet its capital expansion requirements. Determine the amount of borrowing cost to be capitalized in each of the above Plants, as per AS 16.

(8 Marks)

(b) A Ltd acquired 12% voting power in G Ltd. A Ltd being the single largest shareholder of G Ltd, appoints the chairman and one other member of the Board of Directors of G Ltd (out of total of 12 directors). These nominees of A Ltd are not directors of A Ltd. By virtue of its representation on the Board (through two nominees) of G Ltd, A Ltd participates in the financial and operating policy decisions of the enterprise taken at the Board meetings. Would A Ltd be considered as exercising control over G Ltd ? Explain.

(6 Marks)

(c) K Ltd has taken an asset on lease from V Ltd for a period of 3 years. Annual lease rentals are Rs 6 lakhs payable at the end of every year. The residual value guaranteed by K Ltd is Rs 2 lakhs whereas V Ltd expects the estimated salvage value to be Rs 5 lakhs at the end of the lease term. If the fair value of the asset at the lease inception is Rs 15 lakhs and the interest rate implicit in the lease is 12%. Compute the net investment in the lease from the viewpoint of V Ltd and the annual finance income.

(6 Marks)

1.

1. Computation of Purchase Consideration

Particulars	Rs.
(a) Consideration to Preference Shareholders:	
Current Income of Preference Shareholders of Pasupathi Ltd. = 4,00,000 x 10%	40,000
Add: 10% increase thereof	4,000
Revised Expected Income of Preference Shareholders	44,000
Hence, Preference shares to be issued = Rs. 44,00 ÷ 8% **(A)**	**5,50,000**

(b) Consideration to Equity Shareholders:	
(1) BY Issue of Equity shares	
Step 1: PE Ratio of R Ltd:	10,64,000
Profit Before Tax in R Ltd	4,00,000
Less: Tax	6,64,000
Profit After Tax in R Ltd	64,000
Less: Preference Dividend in R Ltd	6,00,000
Profit available for Equity Shareholders of R Ltd	2.50
Earnings Per Share (EPS) = Rs. 6,00,000 ÷ 2,40,000 Shares PE Radio of R Ltd = Market Price per share ÷ EPS = Rs. 40 ÷ Rs. 2,50	**16.00**
Step 2: AEPS of P Ltd	4,80,000
Profit After Tax of P Ltd	2,00,000
Less: Tax	2,80,000
Profit After Tax of P Ltd	40,000
Less: Preference Dividend of P Ltd	2,40,000
Profit available for Equity Shareholders in P Ltd Earnings Per Share (EPS) = Rs. 2,40,000 ÷ 1,20,000 Shares	**2.00**
Step 3: Issue of Equity Shares	
Valuation of Equity Shares of P Ltd: 1,20,000 Shares x Rs.24 [i.e. Rs.2x 15x75%]	**28,80,000**
Number of Equity Shares to be issued: Rs. 28,80,000 ÷ Rs.40	72,000
Equity Shares Capital (72,000 Shares of Rs.10 each)	7,20,000
Securities Premium (72,000 Shares at Rs.30 each)	21,60,000
Total Consideration discharged **(B)**	**28,80,000**
(2) By Issue of Preference Shares	
Current Equity Dividend	1,92,000
Less: Expected Equity Dividend from R Ltd.(Rs.7,20,000 x 2,88,000 / 24,00,000)	86,400
Loss in Income	1,05,600
8% Preference Shares to be issued to make good this loss= Rs.1,05,600 ÷ 8% **(C)**	**13,20,000**
Total Purchase Consideration: (A) + (B) + (C)	**47,50,000**

2. Balance Sheet of R Ltd as at 31st March (after absorption)

Liabilities	Rs.	Assets	Rs.
SHARE CAPITAL: **Equity Share Capital:** 3,12,000 Shares of Rs.10 each (of the above shares, 72,000 Shares are fully paid-up for consideration other than cash) **Preference Share Capital**: 2,67,000 8% Preference Shares of Rs.10 each (of the above, 1,87,000 are allotted as fully paid-up for consideration other than cash) **RESERVES AND SURPLUS**: Securities Premium Other Reserves (as per last B/S)	31,20,000 26,70,000 21,60,000 30,00,000	**FIXED ASSETS** Goodwill (as per WN below) Other Assets (55,00,000 + 28,00,000) **NET CURRENT ASSETS:** Total Current Assets (25,00,000+21,00,000) = 46,00,000 **Less:** Current Liabilities (18,00,000+9,60,000) 27,60,000	 8,10,000 83,00,000 18,40,000
Total	**1,09,50,000**	**Total**	**1,09,50,000**

Note: Goodwill = Purchase Consideration – Value of Net Assets taken over
= 47,50,000 – (28,00,000 + 21,00,000 – 9,60,0000 = **Rs. 8,10,000**

2.

1. Basic Information:

Company Status	Date of Acquisition	Holding Status
Holding Company = Popeye Subsidiary = Bluto	Lot 1 = 8,000 Shares = 01.04.2003 Lot 2 = 7,000 Shares = 01.04.2004	Holding Company = 70% Minority Interest = 30%

Date of Consolidation = 31.03.2005

2. Analysis of Reserves & Surplus of B Ltd

(a) General Reserve

			Rs.
Balance as per Balance Sheet		=	4,20,000
Less: Bonus issue 1/10 x Rs. 20,00,000		=	(2,00,000)
Corrected balance on Balance Sheet date		=	2,20,000
As on 1.4.2004 (date of controlling acqn.)		=	2,00,000
From 01.04.2004 to B/s Date (upto Consolidation)			
Less: Bonus Issue out of this Balance	(2,00,000)		**Rs. 2,20,000**
Capital Profit			**NIL**
Revenue Reserves			

(b) Profit & Loss Account

		Rs.
Balance as per Balance Sheet		6,00,000
Less: Pref. Dividend (10% x RS. 3,80,000)		(38,000)
Less: Equity Dividend (10% x Rs.20 Lakhs)		(2,00,000)
Corrected balance on Balance Sheet date		3,62,000
As on 1.4.2004 (date of controlling acqn.)		3,00,000
From 01.04.2004 to B/s Date (upto Consolidation)(balancing figure)		
Less: Dividend for FY03-04 (20,00,000 x 10%)	(2,00,000)	**Rs. 2,62,000**
Balance **Capital Profit**		1,00,000
Revenue Profit		

(c) Gain / Loss on Revaluation of Assets:

- Loss on Revaluation of Machinery = (Rs. 1,00,000)
  Capital Profit
- Depreciation Gain Revaluation Loss = Rs. 1,00,000x 20% = Rs. 20,000
  Revenue Profit

3. Analysis of Net Worth of B Ltd

Particulars		Total 100%	P Ltd 75%	Minority 25%
(a) Equity Share Capital (20,00,000 + Bonus 2,00,000)		**22,00,000**	16,50,000	5,50,000
(b) Preference share Capital		**3,80,000**	1,42,500	2,37,500
(c) Capital Profits:	General Reserve	NIL		
	Profit & Loss Account	1,00,000		
	Loss on Revaluation of Assets	(1,00,000)		
		NIL	-	-
(d) Revenue Reserves:	General Reserve	**2,20,000**	1,65,000	55,000
(e) Revenue Profits:	Profit & Loss Account	2,62,000		
	Depreciation Gain on Revaluation	20,000		
		2,82,000	2,11,500	70,500
(f) Proposed Equity Dividend		2,00,000	1,50,000	50,000
(g) Proposed Preference Dividend		38,000	14,250	23,750
Minority Interest Before Stock Reserve Adjustment				9,86,750
Less: Stock Res.-Share of Minority Interest in Unrealized Profits On Clg. Stock (Price 120000 – Cost 100000) x 40% x 75%				(2,000)
Minority Interest after Stock Reserve Adjustment				**9,84,750**

4. Cost of Control

Particulars	Rs.	Rs.
Cost of Investment in B Ltd		17,50,000
Equity Shares (Rs. 9,50,000+Rs.8,00,000) Preference Shares		3,10,000
Total Cost of Investment		20,60,000
Less: Dividend out of Pre-acquisition profits (Only for Lot 2 – 70,000 Shares Rs. 70,000 Shares x Rs.10 x 10%)		(70,000)
Corrected Cost of Investment		1990,000
Less: (1) Nominal Value of Equity Capital	16,50,000	
(2) Nominal Value of Preference Share Capital	1,42,500	
(3) Share in Capital Profit	NIL	17,92,500
Goodwill on Consolidation		**1,97,500**

5. Consolidation of reserves & Surplus

Particulars	Gen. Res Rs.	P&L A/c Rs.
Balance as per Balance Sheet	5,50,000	10,00,000
Less: Dividend out of Pre-acquisition Profits (Rs. 7,00,000 x 10%)	-	(70,000)
Less: proposed Equity Dividend (Rs.48,00,000 x 15%)	-	(7,20,000)
Less: Proposed Preference Dividend (Rs. 7,00,000 x 10%)		(70,000)
Add: Share of Proposed Dividend from Bluto (Equity 1,50,000 + Pref.14,250)	-	1,64,250
Corrected Balance	5,50,000	3,04,250
Add: Share of Revenue Profits / Reserves of B Ltd	1,65,000	2,11,500
Consolidated Balance	7,15,000	5,15,750
Less: Unrealised Profits on Clg. Stock (Price 120000 – Cost 100000) x 40% x 75%	-	(6,000)

	Corrected Consolidated balance	7,15,000	5,09,750

6. Consolidated Balance Sheet of P Ltd and its subsidiary B Ltd as at 31.03.2005

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
Equity share Capital	48,00,000	Goodwill on consolidation	1,97,500
10% Preference share Capital	7,00,000	Goodwill (450 + 300)	7,50,000
Reserves and Surplus:		Plant and Mey. (1200 + 500)	17,00,000
General Reserve	7,15,000	Motor Vehicles (950+750–100 + 20)	16,20,000
Profit and Loss Account	5,09,750	Furniture (650 + 400)	10,50,000
Minority Interest	9,84,750	Investments: (2600 + 450 – 2060)	9,90,000
Current Liabilities:		Current Assets:	
Bank Overdraft (120+70)	1,90,000	Stock [450 + 720 – 8(Stock Reserve)]	11,62,000
Sundry Creditors (430 + 480)	9,10,000	Bills Receivable [145 – 145 (Mutual)]	-
Bills payable 9160 – 145 (Mutual))	15,000	Cash at Bank [225 + 210]	4,35,000
Proposed Dvnd. (720 + 70)	7,90,000	Debtors [930 + 780]	17,10,000
Total	**96,14,500**	**Total**	**96,14,500**

3. Value Added Statement of E Ltd.

Particulars	Rs.000s	Rs. 000s	%
Sales		28,500	
Less: Cost of Materials and Services	15,400		
Operating Cost (25,600 – 10,000)	1,700		
Excise Duty	100		
Interest on Overdraft (See Note 1)		17,200	
Value Added by manufacturing and trading activities		11,300	
Add: Other Income		750	
TOTAL VALUE ADDED		12,050	
Application of Total Value Added:			
1. To pay Employees: Wages, Salaries and other benefits		10,200	84,65
2. To pay Government: Corporation Tax		200	1.65
3. To Pay Providers of Capital: Interest on 12%	1,150		

Debentures Dividend	50	1,200	9.95
4. To Provide for maintenance and expansion of Company:	250		
Depreciation	30		
Replacement Reserve	70		
Deferred Tax (See Note 2)	100	450	3.75
Retained Profit			
TOTAL APPLICATION		12,050	100.00

Note:

1. Bank Overdraft is a temporary source of finance. It has been considered as provision of a banking service rather than provision of Capital. Hence, Interest on bank OD has been shown as deduction from Sales and as part of "Cost of bought in Materials & Services".

2. Deferred Taxation can also be shown as "To Pay Government".

4. Value of Human Capital is Rs. 13,71,93,780 with the following break-up-

Category	30 – 39 years	40 – 49 years	50 – 54 years	Total
Unskilled	Rs.2,01,85,520	Rs.1,18,47,600	Rs.40,94,064	Rs.3,61,37,184
Semi-Skilled	Rs.2,21,23,296	Rs.1,14,78,924	Rs.45,48,960	Rs.3,81,51,180
Skilled	Rs.3,60,73,536	Rs.2,00,08,440	Rs.68,23,440	Rs.6,29,05,416

5.

1. Profit and Loss Account of J Ltd for the year ending 31st March 2005

Particulars	Rs.000	Rs.00
A.INCOME Sales (net of Excise Duty)	1,500	
Increase in Stocks (Closing Rs.100-70)	30	1,530
B. EXPENDITURE Purchase of Goods for Resale	855	
Administration Expenses	240	
Distribution costs	51	
Loss on sale of asset	10	
Depreciation	74	(1,230)
C.PROFIT/LOSS		
Profit Before Extraordinary Items		300
Less: Factory Closure Costs		(30)
Profit Before Taxation		**270**
Less: Tax Expense Current Tax	(78)	
Deferred Tax	(6)	84
Profit After Tax for the year		**186**
D. APPROPRIATIONS		
Balance brought forward from previous year		40
Add: Profit After Tax for the year		186

Total profits Available for Appropriation		**226**
Less: Appropriations Proposed Equity Dividend	100	
Amount transferred to General Reserve	30	(130)

Working Notes:-

(a) **Fixed Assets and Depreciation**

Asset	Gross Block				Depreciation Block			
	Opg.Bal	Addn	Sale	Clg. Bal.	Opg.Bal	Dedn. for Sale	Depn for the year	Clg.Bal
Equipments	340	60	(30)	370	130	(15)	74 20%x370)	189

(b) **Computation of Current Tax**

Particulars	Rs.000s
Profit as Profit and Loss Account	**270**
Add: Loss Sale of Assets	10
Add: Depreciation as per Books	74
Profit before Income Tax Depreciation	354
Less: Depreciation under Income Tax Act	(94**)**
Taxable Profit	**260**
Provision for Taxation (Rs.260x30%)	**78**

(c) **Computation if Deferred Tax**

Particulars	Rs.00s
Profit as per profit and loss Account	270
Less: Profit as per Income Tax Act	260
Difference	10
Permanent Difference Loss on Sale of Asset	(10)
Timing Difference (IT Depreciation **Less** Book Depreciation =94-74)	**20**
Deferred Tax Liability on Timing Difference (20x30%)	**6**

2. Balance Sheet of J Ltd as at 31.03.2005

Liabilities	Rs.000s	Assets	Rs.000s
Share Capital	500	**Fixed Assest:** Gross Block	
Reserves and Surplus General	30	370	**181**
Reserve	96	**Less**: Depreciation	100
Profit &	35	**189**	
Loss A/c	6	**Investments**	100
Secured Loans		**Current Assest, Loans and**	390
Deferred Tax Liability	40	**Advances**	114
Current Liabilities and	78	Inventories	
Provisions	100	Sundry Debtors	
(a) Liabilities Sunday Creditors		Cash and Bank	
(b) Provisions Taxation			
Proposed Divided			
Total	**885**	**Total**	**885**

3. Significant Accounting Policies

1. **Historical Cost Convention:** Financial Statements are Prepared under Historical Cost Convention, in ACCORDANCE with the Generally Accepted Accounting Principles and the provisions of the Companies Act, 1956 as adopted consistently by the company.

2. **Depreciation:** Depreciation fixed assets is provided using the straight-line method, based on the period of five years. Depreciation on additions additions is provided for the year but no depreciation is providing on assets sold in the year of their disposal.

3. **Investments:** Investment are valued at lower of cost or net realizable value.

4. **Inventories:** Inventories are valued at the lower of historical cost or the net realizable value.

6:-(a).

1. computation of Actual Borrowing Costs incurred during the year-

Source	Loan Amount	Interest Rate	Interest Amount
Bank Loan 9% Debentures Term Loan from Corporation Bank	Rs.65.00 lakhs Rs.125.00 lakhs Rs100.00 lakhs Rs.110.00 lakhs	10.00% 9 .00% 10.00% 11.50%	Rs.6.50 lakhs Rs.6.50 lakhs Rs.6.50 lakhs Rs.6.50 lakhs
Total	**Rs.400.00 lakhs**		**Rs.40.40 lakhs**
Specific Borrowings included in above	**Rs.190.00 lakhs**		**Rs.17.75 lakhs**

2. weighted Average Capitalisation Rate <u>**Total Interest Less Interest on Specific borrowing**</u>
For General Borrowings **= Total Borrowings Less Specific Borrowings**

$= \frac{(40.40 - 17.75)}{(400 - 190)} = 22.65 \div 210 =$ **10.79%**

3. Capitalisation of Borrowing Cots under As -16 will be as under-

Plant	Borrowing	Loan Amount	Interest Rate	Interest Amt	Cost of Asset
p	General	Rs.100lakhs	10.79%	Rs.10.79lakhs	Rs.110.79 lakhs
Q	Specific General	Rs.65 lakhs Rs.60 lakhs	10.00% 10.79%	Rs.6.50 lakhs Rs.6.47 lakhs	Rs.137.97lakhs
R	Specific General	Rs.125 lakhs Rs.50 lakhs	9.00% 10.79%	Rs.11.25lakhs Rs.5.39 lakhs	Rs.191.64 lakhs
Total		Rs.400 lakhs		Rs.40.40lakhs	Rs.440.40 lakhs

Note: The amount of borrowing costs capitalized should not exceed the actual interest cost.

(b).

1. **Coverage:** Para 3(a) of AS – 18 includes “enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes Holding Companies, Subsidiaries and Fellow Subsidiaries)”.

2. **No Control Relationship:** A Ltd relationship with G is not one of control as per 10 of AS – 18 as it does not – (a) own, directly or indirectly, more than one half of the voting power of G Ltd, or (b) control the composition of the Board of Directors of G Ltd, or (c) hold a substantial interest in voting power in G Ltd (over 20%) and the power to direct the financial and / or operating policies of that Company. Hence, A would not be classified as a party that exercises control over G Ltd.

3. **Significant Influence Relationship**: Para 3(b) of AS – 18 refers to "Associates and Joint Ventures of the reporting enterprise and the investing or venturer of the reporting enterprise is an Associate or a Joint Venture" as a Related Party relationship. Also as per Para 10, an Associate is "an enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of that party".

4. **Means of influence:** Significant Influcant refers to "participation in the financial and / or operating policy decisions of an enterprise, but not control of those policies". As per Para 13, Significant Influence may be gained by share ownership, agreement or statute.

5. **Analysis:** In case of share ownership, there is a rebuttable presumption that is the investing party holds les than 20% of the voting power of the enterprise; it does not have significant influence. In this case, there is no agreement or statute, which gives Achyuta any power to exert significant influence.

6. **Conclusion:** However, by virtue of its ownership of voting power to the extent of 12% and being the single largest shareholder, A participates in the financial and operating policy decisions of Govinda Ltd. So, in the given case, it is clearly demonstrated that A has significant influence over G Ltd.

Accordingly, G Ltd is a related party of A Ltd.

(C).

1. Minimum Lease Payments (MLP)	Rs.6lakhs x 3 years=	Rs. 18,00,000
2. Guaranteed Residual Value (GRV)	Given =	Rs. 2,00,000
3. MLP from the viewpoint of the Lessor (Kasyapa)	MLP as above + GRV	Rs.20,00,000
4. Unguaranteed Residual Value (URV)	Total Residual Value – GRV=	Rs.3,00,000
5. Gross Investment in the Lease	MLP for Lessor = URV	Rs.23,00,000
6. PV of MLP, GRV and URV	As per computation below	Rs.17,97,040
7. Unearned Finance Income	(5) – (6)	Rs. 5,02,960
8. Net Investment in the Lease	(5) – (7)	Rs. 17,97,040

Note: PV of Gross Investment = PV of MLP + PV of (GRV + URV) = Rs.17,97,040, computed as under: = (Rs. 6,00,000 x PVF at 12% for 3 years) [i.e. Rs. 6,00,000 x (0.7972+ 0.7118)] = Rs. 14,41,140 + Rs. 5,00,000 x 0.7118 = Rs. 3,55,900

Recognition of Finance Income:

Year	Net Investment in the Lease	Finance Income at 12% on NI	Total Lease Payment	Balance Reduction in Receivable
1.	Rs. 17,97,040	Rs. 17,97,040 x12% = Rs.2,15,645	Rs. 6,00,000	Rs.6,00,000-Rs. 2,15,645 = Rs. 3,84,355
2.	Rs.17,12,685 = Rs. 3,84,355 =Rs.14,12,685	Rs.14,12,685 x 12% =Rs.1,69,522	Rs.6,00,000	Rs.6,00,000-Rs.1,69,522 =Rs.4,30,478
3.	Rs.14,12,685 – Rs.4,30,478 = Rs.9,82,207	Rs.9,82,207 x 12% =Rs.1,17,865	Rs.6,00,000	Rs.6,00,000-Rs.1,17,865 =Rs.4,82,135
3	Rs.9,82,207 – Rs.4,82,135 = Rs.5,00,072	Nil	Rs.5,00,000 (GRV + URV)	Nil(difference of Rs.72 due to R/Off]

SM

Total No. of Questions : 6 **Max Marks : 100**
No.of Pages : 3 **Time Allowed : 3 Hours**

Answer any 5 Questions
Question No. 6 is Compulsory

1. **(a)** XYZ Ltd is interested in developing a new project. The company decided that the project would require an initial investment of Rs.20 million. XYZ expects that the project will produce positive cash flows of Rs.3 million at the end of each year for the next 20 years. The project's cost of capital is 12 %. What is the project's net present value? **(4 marks)**

(b) While XYZ expects the cash flows to be Rs.3 million a year it also recognizes that the flows could in fact be much higher or lower depending on whether the government imposes a large tax for the sector. One year from now, XYZ will know whether the tax will be imposed or not. XYZ estimates that there is a 25% chance that the tax will be imposed in which case the yearly cash flows will be only 2.4 million. Conversely, if the tax is not imposed, the yearly cash flows will be 3.2 million. XYZ now has to decide whether to proceed with the project today or to wait one year till clarity is available on the tax imposition issue. I f XYZ waits for a year the initial investment will remain at Rs.20 million. Assuming that all cash flows are discounted at 12%, should XYZ proceed with the project today or should it wait a year before deciding? Use the decision tree approach **(12 marks)**

(c) Write short notes on a) Net asset value b) Closed ended Scheme **(2x2 = 4 marks**)

2 **(a)** **.**You are given the following information regarding a portfolio consisting of four securities. The market return is expected to be 12.5% and the risk free rate is 5.5%.

Portfolio A			
Security invested in	**Beta**	**Expected return (%)**	**Market Value of invst.(Rs.million)**
P	1.4	16	3.8
Q	0	6	5.2
R	0.7	10	6.1
S	1.1	13	2.9

a) Ascertain the Beta of the portfolio and the required return on the portfolio
b) Find if the portfolio is correctly valued
c) Explain whether the individual shares in the portfolio appear to be over / under valued and what action this would imply for the portfolio manager

d) Explain why the actual return on each security is often different from that predicted by using its beta (14 marks)

(b)

(i) The direct quote for Sterling in New York is 1.6944. Give the direct quote in London.

(ii) Consider the following Rupee / SG$ direct quote of a bank 26.5 – 75. What is the cost of buying SG$ 7,450

(iii)Consider the following rates and suggest which currency is quoting at premium and which at a discount – Spot Rs. / HK$ is 6.02 One month forward is Rs.6.04

(3x2 = 6 marks)

3 **(a)**. An initial expenditure of Rs.21,000 for acquisition of a new plant, would result in running costs of Rs.6,000 and Rs.7,500 in the first and second years. During these two years, the expected cost savings are Rs.18, 000 and Rs.21,000 respectively. If the cost of capital is 9%, (a) you are required to advise whether the plant can be acquired, and (b) measure in percentage terms the sensitivity of the project NPV to changes in purchase price, running costs, cost savings and cost of capital**.** **(12 marks)**

(b) The interest rate on pounds is 7% in the US and 12% in the UK. The spot rate for the pound is 1.75 in the U.S. and the one year forward rate is 1.68. Confirm whether arbitrage exists**.** **(8 marks)**

4. **(a)** Consider the following information with regard to a call option on the stock of a company

Particulars	
Current share price	Rs.120
Exercise price	Rs.115
Time period	3
Standard deviation of CCRFI	0.6
CCRFI	10%

a) Compute the value of the call option using Black Scholes Model
b) What would be the value of the put option?
c) If the value of the call option is Rs.16 in the market, what action would follow?
d) If the value of the put option is Rs.60 in the market, what action would follow?

(12 marks)

(b) The shares of A Ltd are selling for Rs.104/- per share. Mr.S buys a three months call option at a premium of Rs.5/- . The exercise price is Rs.105/- . State whether he will exercise his option and find his net payoffs at each of the following possible prices on expiration date – (i) Rs.105 (ii) Rs.120

(4 marks)

(c) The current market price of X ltd is at Rs.28 per share. Mr.A buys a three months put option at a premium of Rs.5/-. The exercise price is Rs.30/-. What is the possible net pay off for the option writer at the expiration date at each of the following prices – (i) Rs.18 (ii) Rs.50 **(4 marks)**

5. (a) You are presented the following information pertaining to two companies

Particulars	A ltd	B ltd
Total earnings(000)	9000	1800
Number of shares(000)	3000	1500
PE ratio	6	4

A ltd wants to take over B ltd and form a merged entity AB ltd. A is confident that by managing more efficiently they could achieve a permanent savings in administration and marketing costs to the tune of Rs.5, 00,000 annually. A Ltd is evaluating the following two alternative forms of purchase considerations (I) a cash offer of Rs 5.75 per share of B Ltd or (II) 25% holding in the merged company. Assume tax rate is 40% and cost of capital is 12%

a) What would be the gain from merger (i) if the savings is pretax (ii)if the savings is post tax

b) What is the cost of merger if cash offer materializes? Will the cost be different if the purchase consideration is discharged by issuing shares of the merged entity?

c) Will the NPV differ under the two alternatives mentioned above? **(12 marks)**

(b). A Company has a book value per share of Rs.137.80 today. Its return on equity is 15% and it follows a policy of retaining 60% of its earnings. If the opportunity cost of capital is 18% what is the price of the share today. Use Gordon's model **(4 marks)**

(c) Explain Modigliani Millers' view on the effect of dividends on a firm's value. **(4 marks)**

6. (a) The following information are available about Securities A & C

	Expected return	Standard deviation	Corr coeff A,C
Security A	15%	20%	As between A and C 0.36
Security C	20%	40%	

a) What is the expected value of return and standard deviation of a portfolio that would comprise A and C in the ratio 40:60 **(4 marks)**

b) At what proportion will risk of the portfolio be the least **(4 marks)**.

(b) Compare and contrast the following option strategies: bull spread, bear spread and butterfly spread

(6 marks)

(c) Briefly explain how Monte Carlo simulation is helpful in a capital budgeting decision

(6 marks)

PRIME ACADAMY

27 -Session Final

MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS

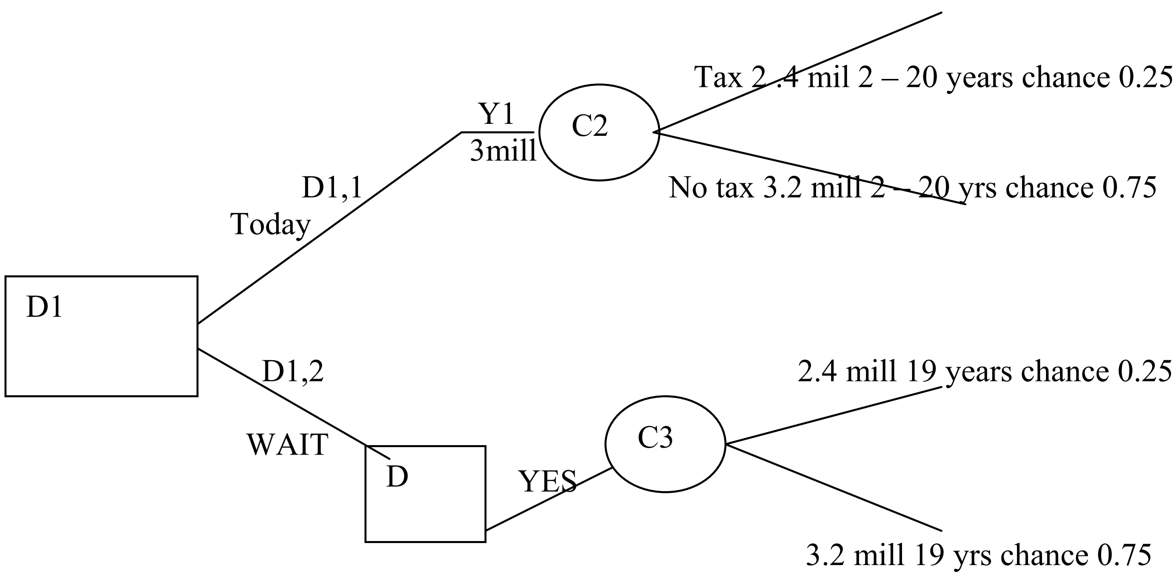
Suggested Answers

1a.

Year	Cash flows	DF	DCFs
0	(200)	1	(200)
1 – 20	30	7.469	224.07
			24.07 lacs (2.407 mill)

The project has +ve NPV and should therefore be selected.

1b. DECISION TREE



C2 ----- (2.4 million x PVAF(19 yrs , 12%) x 0.25) +
(3.2 million x PVAF(19 yrs, 12%) x 0.75)
= (2.4 x 7.366 x 0.25) + (3.2 x 7.366 x 0.75)
= 22.098
We also get 3 mill – end of Y1 if we start project at time 0.
Value at year 1 = 25.098
Discounting to time 0 = 25.098/1.12 = 22.41
Deducting initial investment of 20 mill at beginning we get PV of benefits **at 2.41 mill**

C3 ------ 22.098 at Time1 **(C2)**

Deduct 20 mill – initial investment at year1 end
Benefits accruing at end of year1 = 2.098 mill
Discounting to time 0 = 2.098 / 1.12 **= 1.873 mill**

Comparing between the two decision is that the project should be started today

1c. (a)NAV is the net value of all assets and liabilities : market value of total assets of the fund (i.e a specific scheme of the fund) minus total liabilities attributable to those assets. NAV changes daily and is computed per unit of holding in the scheme of the mutual fund.

(b) Close ended scheme: - Subscription period for investors is kept open only for a specific period called redemption period. At the end of the period entire corpus is disinvested and the proceeds distributed to unit holders.

2a. **(**a) To find β of portfolio we compute market value weights

Security	Mkt value of invst	Weight
P	3.8	0.21
Q	5.2	0.29
R	6.1	0.34
S	2.9	0.16
TOTAL	18	1

Security	Weight	Beta	Weight * β
P	0.21	1.4	0.294
Q	0.29	0	0
R	0.34	0.7	0.238
S	0.16	1.1	0.176
			0.708

Portfolio β is 0.708 < 1 and hence the portfolio is defensive.

a) K_e (based on CAPM)
$= R_f + \beta\ (R_m – R_f)$
$=0.055+0.708(0.125-0.055)$
$=0.10456 = 10.456\%$

(b) Return as per CAPM = 10.46%

Expected return based on current market price
(Weighted average return of securities constituting the portfolio)

Security	Expectd return	Wt	Wt * expected return
P	16	0.21	3.36

Q	6	0.29	1.74
R	10	0.34	3.4
S	13	0.16	2.08
			10.58

Return (CAPM) < Return (DVM)
10.46 < 10.58
Hence portfolio is undervalued and therefore an investor should buy into this portfolio.

C)

	Ke = Rf + β(Rm – Rf)	Exp return	Inference
P	0.055+1.4(0.125-0.055)=0.153	0.16	BUY(Undervalued)
Q	0.055	0.06	BUY(Undervalued)
R	0.104	0.10	SELL(overvalued)
S	0.132	0.13	SELL(overvalued)

In this portfolio Security Q has beta = 0 Therefore it's return is the Risk free rate of return

Conclusion : The portfolio manager should buy the undervalued stocks – A and B and sell the overvalued stocks – C and D.

(d) Beta is computed on the basis of historical market prices which in turn are based on past performance. The company's future performance can be different based on changes that may take place in the industry. Therefore market prices and consequently returns in the future can be different from that predicted by Beta of the stock.

2b. (a)The quote is a direct quote for Sterling in New York(USA). Hence, the home country is USA. Hence the quote is $ per pound. The corresponding indirect quote in USA will be 1 / DQ = 0.5901 ponds per dollar. In UK this 0.5901 pounds per dollar is a direct quote.
(b)We want to buy SG$. Hence the bank has to sell SG$. Hence the relevant rate is the ask rate. Cost of buying SG$7,450 = 7,450 * 26.75 = Rs.1,99,287.50.
© Spot – Rs.6.02 = 1HK$
Forward – 1 month = 6.04
Explanation and Conclusion – This is a direct quote. Forward > Spot. Hence foreign currency, HK$, is at a premium and home currency, Re, is at a discount.

3a. Computation of NPV

	Amount Rs.000				
Year	Disc.9%	Outlay	PV of costs	PV of savings	PV-Net
0	1	(21000)	0	0	(21,000)
1	0.917		(5,502)	16,506	11,004
2	0.842		(6,315)	17,682	11,367
	Total	(21000)	(11,817)	34,188	1,371

The NPV of the project is positive. Hence the project can be accepted.

SENSITIVITY

(i) INITIAL OUTLAY

Wn1 If the project outlay goes up by Rs.1371 NPV will become zero.

Wn2 SENSITIVITY (%) OUTLAY

$= \frac{\text{change}}{\text{Base}} \times 100$

$= \frac{1371}{21000} \times 100 = 6.53\%$

(ii) RUNNING COSTS

PV of running costs should go up by Rs.1,371 for the project to become unviable.

Step 1 : PV of running cost : Rs.11,817.

Step 2: Change in PV leading to change in investment decision Rs.1,371

Step 3(a): In PV terms this represents

$$11.6\% \text{ of } \frac{1371}{11817} \times 100$$

Step 3(b) : In nominal terms the running costs for two years is Rs.13,500, which occurs in the ration of 4 : 5 in years 1 and 2 respectively.

	Amount / Rs		
	Year 1	Year 2	Total
Current costs (nominal terms)	6,000	7,500	13,500
Ratio	4	5	9
Resilience level in PV terms in the same ratio	609	762	1371
Nominal value of resilience	609 x 1.09 = 664	762 x 1.09 x 1.09 = 905	1569
In % terms 1569 / 13500	11.62%		
Resilience for Year 1 alone 646/6000	11.07%		
Resilience for Year 2 (905/7500)	12.07%		

(iii) CASH SAVINGS

Step 1 : PV of cash savings should come down by Rs.1,371 fro the project to become unviable.

Step 2: In PV terms sensitivity = C/B x 100 = 1371 / 34188 x 100 = 4.0%

Step 3: In nominal terms the position is as under

	Amount / Rs		
	Year 1	Year 2	Total
Current savings (nominal terms)	18000	21000	39000
Ratio	6	7	13
Resilience level in PV terms in the same ratio	633	738	1371
Nominal value of resilience	633 x 1.09 = 690	877	1567
In percentage terms 1567 / 39000			4.02%
Resilience for Year 1 alone 690 / 18000	3.83%		
Resilience for Year 2 (877 / 21000)		4.18%	

3b. WN1 : Exchange rate : S_0 = 1.75 \$ / £
F_1 = 1.68 \$ / £

WN2 : Home – US
Foreign – UK

WN3 : Compute theoretical R_h

$$\frac{1 + R_h}{1 + R_f} = \frac{F_1}{E_0}$$

$$\frac{1 + R_h}{1.12} = \frac{1.68}{1.75}$$

R_h = 1.0752 – 1
= 0 .0752 * 100
= 7.52%

WN4 : Since theoretical R_h > actual R_h(7%) money will flow out of US as an arbitrage opportunity

TO VERIFY :

Stage I : a) Borrow 1 lac \$ in US @ 7% ; liability = 107000 US\$
b) Convert to £ @ spot rate
i.e. $\frac{100000}{1.75}$ = 57143

Stage II : c) Invest 57143 @ 12%
d) Take forward cover to sell @ 1.68 / £

Stage III : e) Realise
Principal 57143

Interest 12%   6857

64000

f) Convert to \$ = 64000 * 1.68
= 107520

Stage IV : g) Repay
III f) Realisation   107520
I a) (-) to be paid   107000

GAIN   520

There is an arbitrage gain of 520 for every 1 lac borrowed

4a. Call price $= (S_0 \text{ x } Nd_1) - (E \text{ x } e^{-rt} \text{ x } Nd_2)$

Term	Calculation	Result
S_0	Given	120
E	Given	115
PV of EP	$E \text{ x } e^{-rt} = 11.5 \text{ x } e^{-0.10x0.25} = 11.5 \text{ x } e^{-0.025} = 11.5 \text{ x } 0.97533$	112.16
$NL(S_0/E)$	NL(120/115)	0.03922
d_1	$\frac{NL(S_0/E) + (r + 0.5\sigma^2) \text{ x } t}{\sigma\sqrt{t}} = \frac{(0.03922+(0.1+0.18)0.25)}{0.3}$	0.3641
d_2	$\frac{NL(S_0/E) + (r - 0.5\sigma^2) \text{ x } t}{\sigma\sqrt{t}} = \frac{(0.03922+(0.1 - 0.18)0.25)}{0.3}$	0.064

Nd_1
d1 is positive and hence the value falls on the right tail.
Table value for 0.364 is 0.1406
Cumulative value = 0.5 + 0.1406 = 0.6406 = Nd_1

Nd_2
Cumulative value = 0.5 + 0.0239 = 0.5239

Call price
$= (S_0 \text{ x } Nd_1) - (E \text{ x } e^{-rt} \text{ x } Nd_2)$
= (120 x 0.6406) – (112.16 x 0.5239)
= 76.872 – 58.76 = 18.112

Put price

$= Cp + PV \text{ of } EP - S_0$
$= 18.112 + 112.16 - 120 = 10.272$

Strategy –

Option	Actual option price	Fair option price	Valuation	Decision
Call	16	18.112	Under	Buy call option
Put	18	10.272	Over	Sell put option

4b. (a)(i)Action – lapse option
Gross pay off - 0
Premium – Rs.5
Net pay off :- (-) Rs.5
(ii) Action – Exercise option
Gross pay off – Rs.15
Premium – Rs.5
Net pay off :- Rs.10

(b)(i)Action of put holder – Exercise
Gross pay off of put writer – (-)Rs.12
Premium : Rs.5
Net payoff : (-)Rs.7
(ii) Action of put holder - Lapse
Gross pay off of put writer : 0
Premium : Rs.5
Net payoff of writer : Rs.5

5a.

a) Present value of savings

	Annual savings	
	If pre tax	If after tax
Present savings(perpetuity)	500,000	5,00,000
Tax rate	40%	-----
Net after tax savings(1-t)	300,000	500,000
Capitalisation rate	0.12	0.12
Present value of savings	25,00,000	41,67,000

b) Cost of cash offer and stock offer

	Cash offer
Present market value of B(4.8 x 1500) (y)	7200
Cash payment (5.75 x 1500) (x)	8625
Cost of merger (x – y)	1425

	Share offer

	If savings are pre tax	If savings are post tax
Present market value of B(4.8 x 1500) (Y)	7200	7200
Stock offer 25% holding (X)	15925	16342
Difference (X minus Y) Cost of merger	8725	9142

	If savings are pre tax	If savings are post tax
a) Combined value of A + B without any synergy (54000+7200)	61,200	61,200
b) Savings because of synergy	2,500	4,167
c) Post merger value with synergy (a + b)	63,700	65,367
d) Value for 25% holding (X) (25% of above)	15,925	16,342

c) NPV of merger

	Cash offer		Shares	
If savings were	Pre tax	Post tax	Pre tax	Post tax
a) PV of outflows	(1425)	(1425)	(8725)	9142
b) PV of synergies	2500	4167	2500	4167
c) NPV of merger(b-a)	575	2742	(6225)	4975

Note : For computing the NPV we compare the present value of cash outflows with the PV of gains. In the case of share offer post merger value of shares held by shareholders of B is compared with PV of gains on the logic that these shareholders can in any case convert the shares into cash by selling in the market at the post merger price.

5b. WN1 :- Calculation of earnings
Earnings = 137.8 * 15% = Rs.20.67.(This earnings will take place a year later)

WN2:- Dividends
Retention Ratio is 60%
Hence payment is 40%
Dividends = 20.67 * 40% = Rs.8.268
(This dividend will take place a year later)

WN3:- Growth rate
G = B * R = 0.06 * 0.15 = 0.09 = 9%

WN4:- $P_0 = \frac{D_1}{Ke - g}$

$\frac{8.268}{18\% - 9\%}$ = Rs.91.87

Note : If the earnings are assumed to take place today, the dividend of 8.268 is of today. A year later dividend will then be 8.268(1.09) = 9.012. Consequently, the current market price would be :

$$\frac{9.012}{18\% - 9\%} = \text{Rs.}100$$

5c. Modigilani- Miller argue that what a firm pays in dividends is irrelevant and that stockholders are indifferent about receiving dividends. The basic theory of MM is that a company can compensate for the cash-outflow in the form of dividend by raising equivalent cash though issue of equity shares at fair value. This said, they further postulate that if the operating cash flows are unaffected by dividend policy, then the firm value will be unaffected by dividend policy and that the average stockholder will be indifferent to dividend policy since he or she receives the same total value (price + dividends) under any dividend payment. However, for MM theory to hold good, the following assumptions need to hold true:

- The issue of new stock is assumed to be costless and can therefore cover the cash shortfall created by paying excess
- It is assumed that firms that face a cash shortfall do not respond by cutting back on projects and thereby affecting future
- Stockholders are assumed to be indifferent between receiving dividends and price appreciation.
- Any cash remaining in the firm is invested in projects that have zero net present value (such as financial investments) rather than used to take on poor projects.

6a. (a)Return of the portfolio 40:60

Weighted average return of the securities constituting the portfolio

WN1

	Weight	Return
A	40	15
C	60	20

ER = (0.4 * 15) + (0.6 * 20)

= 18%

WN2:- Risk of the portfolio 40:60

	Return	σ
A	15	20
C	20	40

$SD = \sqrt{(WA)^2 * (\sigma A)^2 + (WC)^2 * (\sigma C)^2 + 2 * WA * WC * \sigma A * \sigma C * \text{Corr coeff A,C}}$

$= \sqrt{(0.4)^2 * (0.2)^2 + (0.6)^2 * (0.4)^2 + 2 * 0.4 * 0.6 * 0.20 * 0.4 * 0.36}$

$= \sqrt{0.0064 + 0.0576 + 0.13824}$

$= \sqrt{0.077824}$

$= 28\%$

(b) Proportion at which risk will be minimum

$$\text{Weight of A} = \frac{(\sigma C)^2 - \text{Covariance A,C}}{(\sigma A)^2 + (\sigma C)^2 - 2 * \text{Covariance A,C}}$$

Correlation * σA * σC = Covariance A,C
= 0.36 * 0.2 * 0.4 = 0.0288

$$\text{Weight of A} = \frac{(0.4)^2 - 0.0288}{(\mathbf{0.2})^2 + (\mathbf{0.4})^2 - 2 * 0.0288}$$

$$= 0.1312 / 0.1424 = 0.92 = 92\%$$

Risk is minimum at the portfolio combination of A and C in the ratio of 92 : 8

.

6b. Bull Spread :
Buying a call of lower strike price and selling a call of higher strike Price (or)
Buying a put of lower strike price and selling a put of higher strike Price

Bear Spread :
Buying a call of higher strike price and selling a call of lower strike Price
Buying a Put of higher strike price and selling a Put of lower strike price

Butterfly Spread: This is created by buying two call options, one with low strike price and the other with comparatively high strike price, and selling two call options having the strike price which lies in the middle of above two strike prices and which is close to the current prevailing market price

6c. Monte Carlo methods are a class of computational algorithms that rely on repeated random sampling to compute their results.
There is no single Monte Carlo method; instead, the term describes a large and widely-used class of approaches. However, these approaches tend to follow a particular pattern:

- Define a domain of possible inputs.
- Generate inputs randomly from the domain, and perform a deterministic computation on them
- Aggregate the results of the individual computations into the final result

Monte-Carlo simulation is useful in the context of capital budgeting in the sense that one can run various possible scenarios and find out the possible outcome under each scenario.

AA

Total No. of Questions : 8
Max Marks : 100
No. of Pages : 2
Time Allowed: 3 Hours

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

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

a) X Ltd. entered into a contract with Y Ltd. to despatch goods valuing Rs. One lakh every month for six months upon receipt of entire payment. Y Ltd. accordingly made the payment.In 3rd month due to a natural calamity, Y Ltd. requested X Ltd. not to despatch until further notice. X Ltd. accounted Rs. two lakhs as sales and transferred the balance to Advance Receipt against sales.

(**5 Marks)**

b) The accountant of C Ltd. has requested you, not to send balance confirmations to a particular group of debtors since the said balances are under dispute and the matter is pending in the Court.
(**4 marks)**

c) P Ltd. of whom you are the Statutory Auditor appoints M/s XYZ as Branch Auditors for one of its branches. M/s XYZ conducted the audit of the branch without visiting the branch and instead getting the books at the H.O. M/s XYZ has submitted their Branch Audit Report to you.

(**5 Marks)**

d) T Pvt. Ltd. is an unlisted closely held company with turnover less than Rs.50 crores. While finalizing the accounts, Mr. M the Director (finance) disputed the applicability of AS 20 to the company.

(**4 Marks)**

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

(a) L, a chartered accountant did not maintain books of account for his professional earnings on the ground that his income is less than the limits prescribed u/s 44AA of the Income Tax Act, 1961.

(5 marks)

(b) M/s. ABC, a firm of Chartered Accountants has taken a loan for acquiring computers, from a company whose Managing Directors' son is an Articled Trainee with A, a partner of M/s ABC.

(4 marks)

(c) Mr. S, a Chartered Accountant published a book and gave his personal details as the author. These details also mentioned his professional experience and his present association as partner with M/s RST, a firm.

(5 Marks)

(d) B, a Chartered Accountant in practice is a partner in 3 firms. While printing his personal letter heads, B gave the names of all the firms in which he is a partner.

(4 Marks)

3. Answer the following:

a) Enumerate, in brief, the important aspects to be evaluated by the external auditor in determining the efficiency and extent of reliance to be placed on the work and function of an Internal Auditor.

(6 marks)

b) Enumerate (in brief) the basic principles governing an audit. **(5 Marks)**

c) Enumerate some of the areas of concern in an audit of indirect taxes. **(5 Marks)**

4

a) What are the steps to be taken by an auditor for the audit of re-insurance ceded?

(8 Marks)

b) Designing an Audit Strategy is the backbone of the "Audit Planning" process. Discuss.

(8 Marks)

5. Answer the following:

(a) A Company gets its accounting data processed by a third party to achieve cost reduction. As a Statutory Auditor of such a company, what are the additional precautions/checks that you would consider for conduct of the audit?

(8 Marks)

(b) As a tax auditor, how would you report on the following:

(i) Labour charges paid on which tax is deducted at source at an inappropriate rate.

(**4 Marks)**

(ii) Capital expenditure incurred for Scientific Research Assets.

(4 Marks)

6.

a) State the special features of Co-operative Societies Audit.

(8 Marks)

b) Explain the Constitution and functions of Audit Committee under Section 292A of the Companies Act, 1956.

(8 Marks)

7.

(a) The method of collecting Audit evidence and evaluating the same changes drastically under EDP Auditing". Comment on the above.

(8 Marks)

(b) What are the features of a qualified Audit Report?

(8 Marks)

8. Write short notes on (any four):

(4 X4 = 16 Marks)

- **a)** Record of Audit Assignments (as required by ICAI regulations)
- b) Broad objectives of operational audit.
- c) Peer review
- d) Circuit Filters (as specified by SEBI)
- e) Sampling Risk
- f) Test Packs

PRIME ACADAMY

27 -Session Final

ADVANCED AUDITING - Suggested Answers

1.

a. Treatment of Advance Received Against Sales:

(i) AS-9 on "Revenue Recognition" specifies that revenue from sales should be recognised when the following conditions have been fulfilled:
he seller of the goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and

(ii) No significant uncertainty exists regarding the amount of consideration that will be derived from the sale of the goods.

In this case, X Ltd. had transferred the property in the goods at an agreed price and all significant risks and rewards. As such sale has been fully completed because upon receipt of the entire payment, X Ltd. was required to despatch goods valuing Rs.100,000 for six months out of its inventory. However, in the third month, Y Ltd requested to stop dispatch until further intimation due to a natural calamity. X Ltd. recognised revenue to the extent the goods were despatched and transferred the balance payment received to Advance Receipt against Sales. X Ltd. had transferred the property in the goods at an agreed price and all significant risks and rewards. The delivery was to be effected as per the schedule indicated by Y Ltd. As per AS-9, "Revenue Recognition", mere postponement of delivery at buyer's request does not alter the period in which revenue should be recognised. Accordingly, X Ltd. should recognise the entire Rs.6,00,000 as Sales and pass necessary corrective entries.

b. External Confirmation Requests:

AAS 30, "External Confirmations", establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. It requires that the auditor should employ external confirmation procedures in consultation with the management. The auditor may come across certain situations in which the management may request him not to seek external confirmation from certain parties because of dispute with the debtors, etc. The management, for example, might make such a request on the grounds that due to a dispute with the particular debtor, the request for confirmation might aggravate the sensitive negotiations between the entity and the debtor. In such cases, when an auditor agrees to management's request not to seek external confirmation regarding a particular debtor, the auditor should consider validity of grounds for such a request and assess management's integrity and obtain evidence to support the same. The auditor should also ask the management to submit its request in a written form, detailing therein the reasons for such a request. The auditor agrees to management's request not to seek external confirmation regarding a particular matter, the auditor should document the reasons for acceding to the management's request and should apply alternative procedures to obtain sufficient appropriate evidence regarding that matter. While considering the validity of request, in case the auditor reaches at a conclusion that the same was not valid, he may appropriately modify the report.

c. Branch Auditor's Report:

As per provisions of the Companies Act, 1956, the accounts of a branch office of a company are required to be audited either by the company's auditor or by any other person qualified for appointment as auditor of the company. It is not necessary for branch auditor M/s XYZ to visit the branch and conduct the audit only at branch's premises. It is a matter of professional judgment for the branch auditor to decide as to whether he needs to visit the branch. At the same time, the statutory auditor has the right to visit branch offices and to have access to the books of accounts and vouchers maintained at the branch office in this case.

In any case, the principal auditor i.e. the statutory auditor of Head Office P Ltd. Is entitled to rely on the work of branch auditor unless there are special circumstances to make it essential for him to visit the branch and examine the books of account and voucher records. As per basic principles governing an audit, the principal auditor is entitled to rely upon the work performed by others provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. As per AAS10, "Using the work of another auditor", the principal auditor is not required to evaluate professional competence because branch auditor happens to be member of ICAI. The statutory auditor is also required to deal with the Branch Auditor's report in the manner, he considers necessary. Therefore, the statutory auditor is required to deal with M/s XYZ's report in the manner it considers fit under the circumstances.

d. Applicability of Accounting Standard:

AS 20, "Earning Per Share", came into effect inrespect of accounting periods commencing on or after 1-4-2001 and is mandatory innature, from that date, in respect of enterprises whose equity shares or potential equity shares are listed on a recognised stock exchange in India. As such AS 20 does not mandate an enterprise, which has neither equity shares nor potential equity shares which are so listed, to calculate and disclose earnings per share, but, if that enterprise discloses earnings per share for complying with the requirements of any statute or otherwise, it should calculate and disclose earnings per share in accordance with AS 20.Part IV of Schedule VI to the Companies, Act, 1956, requires, among other things, disclosure of earnings per share. Accordingly, every company, which is required to giveinformation under Part IV of Schedule VI to the Companies Act, 1956, should calculate and disclose earnings per share in accordance with AS 20, whether or not its equity shares or potential equity shares are listed on a recognised stock exchange in India.

Accordingly the company, T Pvt. Ltd should compute and disclose EPS according to AS20. Therefore, the contention of Director (Finance) is incorrect. The auditor will have to ensure that EPS is disclosed as per AS 20 or else the auditor should appropriately

2.

a. Maintenance of Books of Account:

Under Clause (ii) of Part II of Second Schedule to the Chartered Accountants Act, 1949, the Institute has specified that if a chartered accountant in practice or the firm of Chartered Accountants of which he is a partner fails to maintain and keep in respect of his/its professional practice, proper books of account including the Cash Book and Ledger, he is deemed to be guilty of professional misconduct. Accordingly, it does not matter whether section 44AA of the Income Tax Act, 1961 applies or not. Hence, Mr. L is guilty of professional misconduct.

b. Loan from a Company:

As per Clause (i) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant is deemed to be guilty of professional misconduct if he contravenes any of the provisions of Chartered Accountants Act, 1949 or Regulations made thereunder. Regulation 47 of the Chartered Accountant's Regulations, 1988 prohibits a member from accepting any premiums or loans or any deposit in any form from an articled clerk directly or indirectly. However, M/s ABC has taken loan from a company whose Managing Director happens to be father of articled clerk with Mr. A, a partner of M/s ABC. In this case, the articled trainee has no direct interest in that company. There has been a case wherein a chartered accountant was held guility of professional misconduct because he took a loan from a firm in which the articled clerk and his father were both interested. But, in this case as per the facts, the articled trainee has no direct interest in the company. However, if relationship, direct or indirect, can be established in view of relationship of articled trainee with MD of the company, Mr. A of M/s ABC would be held liable for professional misconduct. Thus, M/s ABC would be guilty of professional misconduct under this clause if it is proved that the loan was related to the engagement of the articled clerk.

c. Soliciting Professional Work:

Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 refers to professional misconduct of a member in practice if he solicits client or professional work either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means. Therefore, members should not adopt any indirect methods to advertise their professional practice with a view to gain publicity and thereby solicit clients or professional work. Such a restraint must be practised so that members may maintain their independence of judgement and may be able to command the respect of their prospective clients. While elaborating forms of soliciting work, the Council has specified that a member is not permitted to indicate in a book or an article, published by him, the association with any firm of chartered accountants. In this case, Mr S a chartered accountant published the book and mentioned his professional experience and his association as a partner with M/s RST, a firm of chartered accountants. Mr. S being a chartered accountant in practice has committed the professional misconduct by mentioning that at present he is a partner in M/s. RST, a chartered accountants firm.

d. Advertisement of Professional Attainments:

Clause 7 of Part I of the First Schedule to the Chartered Accountants Act, 1949 prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a Chartered Accountant in documents through which the professional attainments of the member would come to the notice of the public. Even a member is not permitted to specify the date of setting up of practice or establishment of firm. However, there is no prohibition for printing names of all the three firms on the personal letterheads in which a member holding Certificate of Practice is a partner. Thus B is not guilty of any misconduct under the Chartered Accountants Act, 1949.

3

a. AAS 1, "Basic Principles Governing an Audit", describes the basic principles which govern the auditor's professional responsibilities and which should be complied with whenever an audit is carried out. Basic principles are:

(i) **Integrity, Objectivity and Independence:** The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being compatible with integrity and objectivity.

(ii) **Confidentiality:** The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

(iii) **Skills and Competence:** The audit should be performed and the report prepared with due professional care by persons who have adequate training, experience and competence in auditing.

(iv) **Work performed by others:** When the auditor delegates work to assistants or uses work performed by other auditor and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. The auditor should carefully direct, supervise and review work delegated to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose.

(v) **Documentation:** The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles.

(vi) **Planning:** The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on a knowledge of the client's business.

(vii) **Audit evidence:** The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information.

(viii) **Accounting System and Internal Control:** The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal controls normally contribute to such assurance.

(ix) **Audit conclusions and reporting**: The auditor should review and assess the conclusions drawn from the audit evidence obtain and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information.

b. Audit of Indirect Taxes: Same areas of concern in an audit of indirect taxes would be:

(i) Non availment or short / excess availment of control or expert incentives.
(ii) Goods imported duty free or payment at concessional rates without properly complying with conditions.
(iii) Valuation Issues – valuation not in line with customs rules.
(iv) Applicability of the relevant control excise exemptions.
(v) Valuation of goods not removed in normal course using valuation methods not in line with Central Excise Valuation Rules.
(vi) Ignoring Liability under Service Tax on services provided or availed.
(vii) Procedural non-compliance.
(viii) Passing on of duty suffered on imported goods and of locally manufactured goods

4.

a. Steps in Audit of Reinsurance ceded:

(i) Evaluate internal control system in the area of reinsurance ceded to ensure determination of correct amount for reinsurance ceded, proper valuation of assets and liabilities arising out of reinsurance transaction and adherence to legal provisions and regulations.

(ii) Ascertain whether adequate guidelines and procedures are established with respect to obtaining reinsurance.

(iii) Reconcile reinsurance underwriting returns received from various units with the figures of premium, claims paid and outstanding claims for the company as a whole.

(iv) Examine whether commission on reinsurance ceded is as per the terms of the agreement with the re-insurers.

(v) Examine the computation of profit commission for automatic treaty arrangements in the light of the periodic accounts rendered and in relation to outstanding loss pertaining to the treaty.

(vi) Examine whether loss recoveries have been claimed and accounted on a regular basis.

(vii) Examine whether outstanding losses recoverable have been confirmed by reinsurers.

(viii) Examine whether remittances to foreign re-insurers are as per foreign exchange regulations.

(ix) Examine whether confirmations have been obtained regarding balances with reinsurers.

(ix) Review individual accounts of re-insurers to evaluate whether any provision/write off or write back is required.

b. Audit strategy is concerned with designing optimised audit approaches, that seeks to achieve the necessary audit assurance at the lowest cost within the constraints of the information available. The formulation of audit strategy as shall be evident from the process as explained in the following paragraphs in fact shall form the basis of audit planning to achieve the audit objectives in the most efficient and effective manner. Audit strategy generally involves the following steps:

(i) Obtaining Knowledge of Business: AAS 20, "Knowledge of Business", states that in performing an audit of financial statements, the auditor should have or obtain knowledge of the business sufficient to enable the auditor to identify and understand the events, transactions and practices that, in the auditor's judgment, may have a significant effect on the financial statements or on the examination or audit report. Knowledge of the business is a frame of reference within which the auditor exercises professional judgment. Understanding the business and using this information appropriately assists the auditor in assessing risks and identifying problems, planning and performing the audit effectively and efficiently. It also ensures that the audit staff assigned to an audit engagement obtains sufficient knowledge of the business to enable them to carry out the audit work delegated to them. This would also ensure that the audit staff understands the need to be alert for additional information and the need to share that information with the auditor and the other audit staff.

(ii) Performing Analytical Procedures: The purpose of analytical procedures at the planning stage is attention-directing; corroboration is not normally necessary at this stage. The use of the analytical procedures during the planning stage requires the extensive use of accounting and business knowledge and experience to assess the potential for material misstatement in the financial statements as a whole, because the key aspect of the task is to identify the relevant risk indicators and to interpret them properly. Furthermore, analytical techniques applied during the planning stage are not generally as precise as the analytical techniques at the substantive stage.

(iii) Evaluating Inherent Risk: To assess inherent risk, the auditor would use professional judgement to evaluate numerous factors such as quality of accounting system, unusual pressure on management, etc. having regard to his experience of the entity from previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which, might have taken place since his last assessment.

(iv) *Evaluating Internal Control*: The auditor's assessment of the control environment is crucial to the decision on whether to make an extended assessment of controls.This is because a good control environment is conducive to the maintenance of a reliable system of accounting and control procedures. For strategy purposes, the auditor should obtain a sufficient understanding of the control environment. The auditor needs an understanding of the accounting systems, regardless of whether the audit strategy will involve an extended assessment of internal accounting controls. This is done by:

(a) Considering the results of gathering or updating information about the client; and

(b) Making preliminary judgements about materiality, inherent risk and control effectiveness. These will include identification of the system(s) the auditor proposes to subject to an extended assessment of controls.

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

5.

a. Precaution to be taken by auditor in case Accounting Data Processed by Third Party:

Processing of accounting data may be given to a third party on account of various considerations such as economy, own computer working to full capacity, an interim measures restricting accessibility to sensitive information, etc. A client may use a service organisation such as one that executes transactions and maintains related accountability or records transactions and processes related data (e.g., a computer systems service organisation). If a client uses a service organisation, certain policies, procedures and records maintained by the service organisation might be relevant to the audit of the financial statements of the client. Consequently, the auditor would consider the nature and extent of activities undertaken by service organisations so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk. AAS 24, "Audit Considerations Relating to Entities Using Service Organisations", while planning the audit, the auditor of the client should determine the significance of the activities of the service organisation to the client and their relevance to the audit. In doing so, the auditor of the client would need to consider the following, as appropriate:

- Nature of the services provided by the service organization.
- Terms of contract and relationship between the client and the service organization.
- The material financial statement assertions that are affected by the use of the service organization.
- Inherent risk associated with those assertions.
- Extent to which the client's accounting and internal control systems interact with the systems at the service organization.
- Client's internal controls that are applied to the transactions processed by the service organization.
- Service organization's capability and financial strength, including the possible effect of the failure of the service organization on the client.
- Information about the service organization such as that reflected in user and technical manuals, if any.
- Information available on general controls and computer systems controls relevant to the client's applications.
- The auditor of the client would also consider the availability of third-party reports from service organization's auditors, internal auditors, or regulatory agencies as a means of providing information about the accounting and internal control systems of the service organization and about its operation and effectiveness.

b.

i. Section 40(a) of the Income-tax Act, 1961 specifies that amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply or labour for carrying out any work) on which tax is deductible under Chapter XVII-B and such tax has not been deducted or after deduction has not been paid during the previous year or in the subsequent year before the expiry of the time prescribed under sub-section (1) of section 200, shall not be deducted in computing the income. Therefore, if tax is deducted at an inappropriate rate, the amount is disallowable u/s 40(a) (ia) of the Income-tax Act. This fact needs to be reported in Clause 17(f) of Form 3CD where all amounts inadmissible u/s 40(a) are to be reported. In case, the assessee submits that the rate is proper, though in the auditor's view it is improper, the tax auditor should exercise his judgment and accordingly report in Clause 17(f) of Form 3CD.

ii. Clause 15(a) and (b) of Form 3CD requires that expenditure on Scientific Research (capital as well as revenue) covered u/s 35 of the Income-tax Act, 1961 reported of the amount debited to the profit and loss account (showing the amount debited and deduction allowable and not debited to the profit and loss account. Accordingly, the auditor should exercise his judgment and accordingly report in Clause 15(b) the amount of capital expenditure not debited to the Profit and Loss Account which is eligible for deduction u/s 25 as Scientific Research Expenditure.

6. Special features of Co-operative Societies Audit:

The special features of co-operative society's audit, to be borne in mind while conducting the audit are as follows:

I **Examination of overdue debts:** Overdue debts for a period from six months to five years and more than five years will have to be classified and shall have to be reported by an auditor. Overdue debts have far reaching consequences on the working of a credit society. It affects its working capital position. A further analysis of these overdue debts from the viewpoint of chances of recovery will have to be made, and they will have to be classified as good or bad. The auditor will have to ascertain whether proper provisions for doubtful debts is made and whether the same is satisfactory. The percentage of overdue debts to the working, capital and loans advanced will have to be compared with last year, so as to see whether the trend is increasing or decreasing whether due and proper actions for recovery are taken, the position regarding cases in co-operative courts, District Courts etc. and the results thereof.

ii. **Overdue Interest:** Overdue interest should be excluded from interest outstanding and accrued due while calculating profit. Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue.

iii. **Certification of Bad Debts:** A peculiar feature regarding the writing off of the bad debts as per Maharashtra State Co-operative Rules, 1961, is very interesting to note. As per Rule No. 49, bad debts can be written off only when they are certified as bad by the Auditor. Bad debts and irrecoverable losses before being written off against Bad Debts Funds, Reserve Fund etc. should be certified as bad debts or irrecoverable losses by the auditor where the law so requires. Where no such requirement exists, the managing Committee of the society must authorize the write-off.

iv. **Valuation of Assets and Liabilities:** Regarding valuation of assets there are no specific provisions or instructions under the Act and Rules and as such due regard shall be had to the general principles of accounting and auditing conventions and standards adopted. The auditor will have to ascertain existence, ownership and valuation of assets. Fixed assets should be valued at cost less adequate provision for depreciation.

The incidental expenses incurred in the acquisition and the installation expenses of assets should be properly capitalised. If the difference in the original cost of acquisition and the present market price is of far reaching significance, a note regarding the present market value may be appended; so as to have a proper disclosure in the light of present inflatory conditions. The current assets be valued at cost or market price, whichever is lower. Regarding the liabilities, the auditor should see that all the known liabilities are brought into the account, and the contingent liabilities are stated by way of a note.

v. Adherence to Co-operative Principles: The auditor will have to ascertain in general, how far the objects, for which the co-operative organisation is set up, have been achieved in the course of its working. While auditing the expenses, the auditor should see that they are economically incurred and there is no wastage of funds. Middlemen commissions are, as far as possible, avoided and the purchases are made by the committee members directly from the wholesalers. The principles of propriety audit should be followed for the purpose.

vi. Observations of the Provisions of the Act and Rules:

An auditor of a co-operative society is required to point out the infringement with the provisions of Co-operative Societies Act and Rules and bye-laws. The financial implications of such infringements should be properly assessed by the auditor and they should be reported. Some of the State Acts contain restrictions on payment of dividends, which should be noted by the auditor.

vii. Verification of Members' Register and examination of their pass books:

Examination of entries in members, pass books regarding the loan given and its repayments, and confirmation of loan balances in person is very much important in a co-operative organization to assure that the entries in the books of accounts are free from manipulation.

viii. Special report to the Registrar:

During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society, he may report these special matters to the Registrar, drawing his specific attention such irregularities. The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance a special report may become necessary:

(i) Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.

(ii) Detection of fraud relating to expenses, purchases, property and stores of the society.

(iii) Specific examples of mis-management including decisions of management against co-operative principles.

(iv) In the case of urban co-operative banks, disproportionate advances to vested interest groups, such as relatives of management, and deliberate negligence about the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.

ix. **Audit classification of society:** After a judgment of an overall performance of the society, the auditor has to award a class to the society. This judgment is to be based on the criteria specified by the Registrar. It may be noted here that if the management of the society is not satisfied about the award of audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification. The auditor should be very careful, while making a decision about the class of society.

e) Constitution and Functions of Audit Committee:

Section 292A of the Companies Act,1956 requires that every public company having not less than Rs. 5 crores of paid up capital shall constitute a committee of Board known as Audit Committee. It shall consist of not less than three directors and such number of other Directors as the Board may determine of which two-third shall be directors other than the Managing Director and whole time director. They shall elect one such member amongst them as Chairman. The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

Every audit committee constituted as above shall act in accordance with the terms of reference specified in writing by a Board. The function of the audit committee as specified in the Companies Act, 1956 are as under:

(i) The audit committee should have discussions with the auditors periodically about the internal control systems, the scope of audit, the audit observations and review the periodical financial statements before submission to the board and also ensure compliance with the internal control systems.

(ii) It shall have the authority to investigate any matter in relation to the items specified in this section or reference to it by the Board and shall have access to the information contained in the records of the company and external professional advice, if necessary.

(iii) Its recommendations on all financial matters including audit report shall be binding on the board.

(iv) The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote.

(v) To advise and check the compliance of the organization for policy and regulation aspects.

While performing the aforesaid key functions, the energy auditor is required to carry out the following activities:

(i) To analyse the historical energy consumption and cost data.

(ii) To conduct preliminary energy audit with the objectives to identify:

  (a) Major energy consuming equipment and process;

  (b) Obvious inefficiencies and energy wastes; and

  (c) Priority areas for further detailed investigation.

(iii) To conduct detailed technical and economic analysis of energy efficiency measures involving large efficiency measures involving large capital investment or long payback periods.

7.

(a) Effects of EDP Auditing: Auditor must provide a competent, independent opinion as to whether the financial statements records and report a true and fair view of the state of affairs of an entity. However, computer systems have affected how auditors need to collect and evaluate evidence. These aspects are discussed below:

(1) Changes to Evidence Collection - Collecting evidence on the reliability of a computer system is often more complex than collecting evidence on the reliability of a manual system. Auditors have to face a diverse and complex range of internal control technology that did not exist in manual system, like:

(a) accurate and complete operations of a disk drive may require a set of hardware controls not required in manual system,

(b) system development control include procedures for testing programs that again are not necessary in manual control.
Since, Hardware and Software develop quite rapidly, understanding the control technology is not easy. With increasing use of data communication for data transfer, research is focussed an cryptographic controls to project the privacy of data. Unless auditor's keep up with these developments, it will become difficult to evaluate the reliability of communication network competently. The continuing and rapid development of control technology also makes it more difficult for auditors to collect evidence on the reliability of controls. Even collectionof audit evidence through manual means is not possible. Hence, auditors have to run through computer system themselves if they are to collect the necessary evidence. Though generalized audit softwares are available the development of these tools cannot be relied upon due to lack of information. Often auditors are forced to compromise in some way when performing the evidence collection.

(2) Changes to Evidence Evaluation - With increasing complexity of computer systems and control technology, it is becoming more and more difficult for the auditors to evaluate the consequences of strength and weaknesses of control mechanism for placing overall reliability on the system.

Auditors need to understand:

(a) Whether a control is functioning reliably or multi functioning,

(b) Traceability of control strength and weakness through the system. In a shared data environment a single input transaction may update multiple data itemused by diverse, physically disparate user, which may be difficult to understand. Consequence of errors in a computer system is a serious matter as errors in computer system tend to be deterministic, i.e., an erroneous program will always execute data incorrectly. Moreover, the errors are generated at high speed and the cost and effort to correct and rerun program may be high. Errors in computer program can involve extensive redesign and reprogramming. Thus, internal controls that ensure high quality computer systems should be designed implemented and operated upon. The auditors must ensure that these control are sufficient to maintain assets safeguarding, data integrity, system effectiveness and system efficiency and that they are in position and functioning.

b. The features of a qualified report are:

1 *Clarity:* The Auditor must express the nature of qualification, in a clear and unambiguous manner.

2 *Explanation:* Where the Auditor answers any of the statutory affirmations in the negative or with a qualification his report shall state the reasons for such answer.

3 *Placement:* All qualifications should be contained in the Auditor's Report. When there are notes which are subject matter of a qualification, the same should preferably be annexed to the Auditors' Report. However a reference to the notes to Accounts in the Auditors' Report does not automatically become a qualification.

4. *Subject to:* The words' subject to are essential to state any qualification. The qualification should be preceded by words such as 'subject to' or except that' to make it clear that he is making an exception.

5. *Quantification:* It is also necessary that the auditor should quantify, wherever possible, the effect of individual as well as the total effect of all qualifications on profit or loss and/or state of affairs these qualifications on the financial statements in a clear and unambiguous manner. In circumstances where it is not possible to quantify the effect of the qualifications accurately the auditor may do so on the estimates made by the management after carrying out such audit tests as are possible and clearly indicate that the figures given are based on the estimate s of the management.

6. *Nature of qualification:* Vague statements the effect of which on accounts cannot be ascertained like 'the debtors balances are subject to confirmation', 'no provision for taxation has been made in view of the loss during the year' etc., should be avoided.

7. *Violation of law:* Where the company has committed an irregularity resulting in a breach of law, the Auditor should bring the same to the notice of the shareholders by properly qualifying his report.

8. Notes – Report Relationship – Where notes of a qualificatory nature appear in the accounts the Auditors should state all qualifications independently in their report so that the user can assess the significance of these qualifications.

9. *Draft Report:* The auditor may discuss matters of qualification with the management of the company to acquire their views. It is not necessary that the Auditor should accept the managements view and modify his opinion. But it would enable the Auditor to accurately draft the qualifications in his Final Report.

8.

a. Record of Audit assignments:

In exercise of the powers conferred by clause (ii) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, the Council of the Institute of Chartered Accountants of India issued a notification which specifies that a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he holds at any time appointment of more than the "specified number of audit assignments of the companies under Section 224 and /or Section 228 of the Companies Act, 1956. As a part of this notification, to meet its requirements, a CA in practice as well as a firm in practice shall maintain a record of the audit assignments accepted as laid out in notification issued by the Council of the ICAI under Part II of Second Schedule to the Chartered Accountants Act, 1949 in respect of ceiling on audits

Containing following particulars:

(i) Name of Company Audit/ Assignment.

(ii) Regn. No.

(iii) Date of appointment with Registrar of Companies.

(iv) Date of acceptance.

(v) Date on which form 23B filed.

b. Broad objectives of operational audit:

(i) Appraisal of controls: Operations and the results in which management is interested are largely a matter of control. If controls are effective in design and are faithfully adhered to, the result that can be attained will be subject to the other limiting constraints in the organization.

(ii) Evaluation of performance: In the task of performance evaluation, an operational auditor is heavily dependent upon availability of acceptable standards. The operational auditor cannot be expected to possess technical background in so many diverse technical fields obtaining even in one enterprise. Even when examining or appraising performance or reports of performance, the operational auditor's mind is invariably fixed on control aspects.

(iii) Appraisal of objectives and plans: In performance appraisal, the operational auditor is basically concerned not so much with how well technically the operations are going on, but with accumulating information and evidence to measure the effectiveness, efficiency and economy with which the operations are being carried on.

(iv) Appraisal of organisational structure: Organisational structure provides the line of relationships and delegation of authority and tasks. This is an important element of the internal control design. In evaluating organisational structure, the operational auditor should consider whether the structure is in conformity with the management objectives and it is drawn up on the basis of matching of responsibility and authority. He should also analyse whether line of responsibility has been fixed, whether delegation of responsibility or authority is clear and there is no overlapping area.

c. **Peer Review:** The term "peer" means a person of similar standing. The term "review" means conduct of re-examination or retrospective evaluation of the subject matter. In general, for a professional, the term "peer review" would mean review of work done by a professional, by another professional of similar standing. 'Peer Review' is defined as, a regulatory mechanism for monitoring the performances of professionals for maintaining quality of service expected of them for enhancing the reliance placed by the users of financial statements for economic decision-making.

As per the Statement of Peer Review (ICAI, 2002) "Peer Review" means an examination and review of the systems and procedures to determine whether they have been put in place by the practice unit for ensuring the quality of attestation services as envisaged and implied/mandated by the Technical Standards and whether these were effective or not during the period under review". The examination and review of a practice unit would be carried out by a "reviewer", i.e. amember, selected from a panel of reviewers maintained by the Board. The term "practice unit" means members in practice, whether practising individually or as a firm of Chartered Accountants.

d. **Circuit Filters:** Circuit breakers or filters are the price bonds that set the upper and lower limit within which a stock can fluctuate on any particular day. A price band for a day is a function of previous trading days' closing. SEBI has directed exchanges to apply circuit filters on scrips traded in rolling settlement if their price fluctuates more than 20% of the closing price of scrips on the previous day in any direction. However for scrips forming part of sensex or in which derivatives and futures are available, the fluctuation is restricted to 10%.

e. **Sampling Risk:** Sampling Risk arises from the possibility that the auditor's conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same audit procedure. The auditor is faced with sampling risk in both tests of control and substantive procedures as follows:

(a) Tests of Control:

(i) ***Risk of Under Reliance***: The risk that, although the sample result does not support the auditor's assessment of control risk, the actual compliance rate would support such an assessment.

(ii) ***Risk of Over Reliance***: The risk that, although the sample result supports the auditor's assessment to control risk, the actual compliance rate would not support such an assessment.

(b) Substantive Procedures:

(i) *Risk of Incorrect Rejection*: The risk that, although the sample result supports the conclusion that a recorded amount balance or class of transactions is materially mis-stated, in fact it is not material mis-stated.

(ii) Risk of Incorrect Acceptance: The risk that, although the sample result supports the conclusion that a recorded amount balance or class of transactions is no materially mis-stated, in fact it is materially mis-stated.

The risk of under reliance and the risk of incorrect rejection affect audit efficiency as they would ordinarily lead to additional work being performed by the auditor, or the entity, which would establish that the initial conclusions were incorrect. The risk of over reliance and the risk of incorrect acceptance affect audit effectiveness and are more likely to lead to an erroneous opinion on the financial statements then either the risk of under reliance or the risk of incorrect rejection.

Sample size is affected by the level of sampling risk the auditor is willing to accept from the results of the sample. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

f. *Test Packs:*

Test pack is a technique to determine the correctness of the computer programming used to record transactions through the computer. Preparation of test pack requires a great deal of expertise. It may be prepared by the auditor himself with the help of the entity's staff or by the Internal Control department of the entity. Normally test packs are used where:

(i) A significant part of the control system is embodied in the programme;

(ii) There are gaps in audit trail making it difficult to trace output from input and to verify intermediate calculation; and

(iii) The volume of records is large, so that it may be more economical and more effective to use test packs rather than to trace the transactions manually.

EC

Total No. of Questions : 9 | **Max Marks : 100**
No. of Pages : 4 | **Time Allowed: 3 Hours**

Question No s 1,2, and 3 are compulsory.
Answer any four from the rest

1. Answer any two of the following:

(a) M holds the office of managing director of a private Ltd company for life. The company's Articles of Association empower him to appoint a person to be the managing director in succession to him. M, therefore, in the exercise of his power appoints,by will, S as the managing director to hold office after the former's death.Some members of the company challenge the provisions of the Articles of Association and question the validity of appointment of S on the ground that M's action amounts to assignment of office. Examine the validity of the contention of the members.

(b) Securities and Exchange Board of India received serious complaints against the Affairs of a member of a stock exchange. Explain the powers of SEBI under Securities Contracts (Regulation) Act, 1956 to make enquiries and to take action, if necessary, against the member of a stock exchange.

(c) Salem Stock Exchange wants to get itself recognises. Explain.
(i) Who enjoys the power to recognise Stock Exchange
(ii) What information will have to be provided with the application for recognition?

(10 Marks)

2. Answer any two of the following:

(a) Examine with reference to the provisions of the Foreign Exchange Management Act, 1999,the residential status of the branches mentioned below:

(i) Sk Ltd an Indian Company having its Registered office at Mumbai, India established a branch at Newyork USA on 1 st April 2007
(ii) TCP Ltd a company incorporated and registered in London established a branch at Chennai in India on 1 st April 2007
(iii) RCP Ltd's Singapore Branch which is controlled by its Chennai Branch.

(b) Mr.B, an Indian National desires to obtain foreign exchange for the following purposes.

(i) Payment of US $ 10,000 AS commission on exports under Rupees State Credit Route
(ii) US $ 25000 for a business trip to U K
(iii) Remittance of US Dollar 50,000 out of winnings on a lottery ticket.

(c) XYZ Ltd Computers is having directors. Out of these directors 4 directors are nominee directors of financial institution. The Board meeting of the company was held on 1-1-2008 in which 4 nominee directors were absent and the remaining directors were interested in the resolution to be passed by the Board. State whether quorum is adequate for the Board meeting.

(14 Marks)

3. Answer any two of the following:

(a) The last year's Balance sheet of PQR Ltd contains the following information and figures.

	As at 31.3.2006	As at 31.3.2007	As at 31.3.2008
Paid up capital	50,00,000	50,00,000	75,00,000
General Reserve	45,00,000	50,00,000	60,00,000
Debenture Redemption Reserve	15,00,000	20,00,000	25,00,000
Secured Loan	10,00,000	15,00,000	30,00,000
Net profit for the year	12,50,000	19,00,000	34,50,000

In the ensuring Board meeting scheduled to be held on 15 th November 2008, among other items of agenda, following item is also appearing.

"To decide about borrowing from financial institutions on long term basis.

Based on the above information, you are required to find out as per the provisions of the companies Act, 1956, the amount up to which the Board can borrow from financial institutions without seeking the approval in general meeting.

(b)

(i) Explain the composition of competition commission- What is the term of office of chairperson of competition commission?

(ii) Explain briefly the power of SEBI under securities board of India Act 1992 to seize the records of stock broker or other intermediacies associated with securities market

(c)

(i) What are the External aid available for interpretation/construction of status.

(ii) Explain whether the following contracts require previous approval of central Government in accordance with provisions of section 297 of the companies Act, 1956.

(d) Contracts for purchase of goods from a public company having a paid up share capital by a firm in which a director of the public company is a partner. The purchase is for cash at prevailing market prices.

(e) Contracts entered by a public company with another public company, the paid up capital of both the companies are more than Rs one crore.

(16 Marks)

4

(a) MR. REDDY is a Director of ABC and BCM ltd ABC Ltd was regular in filing annual returns but did not file annual accounts for the year ended 31st march 2006. Further ABC Ltd failed to pay interest on loans taken from financial institution from 1st January 2006. Mr. REDDY is proposed to be appointed as additional director MSS Ltd. On 5th April 2008. MSS Ltd has bought a declaration from Mr. REDDY to the effect that the disqualification specified in section 274(1) (a) of the Companies Act,1956 is not applicable in his case. MR. REDDY seeks. Your advice on the following

(i) Whether it is in order for him to give declaration

(ii) Whether he can continue as a Director in BCM Ltd and also to seek reappointment? When he retires by rotation at the annual general meeting of BCM Ltd.

b) A Private Ltd Company having a paid up capital of Rs-6 crore has been converted into Public Ltd Company. The Company proposes to constitute an audit committee Draft a Board Resolution for Constitution of audit Committee specifying any four functions of the committee.

(15 Marks)

5

(a) The Board of Directors of M/S Geethanjali Ltd a company whose shares are listed on the Madras Stock Exchange Ltd. Proposes to give loans to sister concern in excess of the limits prescribed under section 372A(1) of the Companies Act, 1956. The next annual general meeting of the Company is due only after 9 months. Since the Board is anxious to complete the formalities quickly without waiting for the date of the next annual General meeting, advise the Board about the steps to be taken to comply with the legal requirements under the Companies Act, 1956.

(b) (i) The Articles of Association of KAP Limited incorporated with an Authorized Share Capital of Rs-50 corers divided into 5 crore equity share of Rs-10 each contained the following clause. “The qualification of a director shall be the holding of at least 1000 equity shares in the company and such a director, if not already so qualified shall have to obtain his qualification within a period of 30 days from the date of appointment as a director” Examine the validity of the above clause in the high of the provisions Of the Companies Act, 1956. (ii)Redraft the above clause which would conform in the light of the Provisions of the Companies Act, 1956.

(15 Marks)

6 (a) what is the provisions regarding appointment of Directors for producer Companies

(b) There are eight Shareholders in Super Private Ltd. MR. Ramesh who is holding less than one tenth of the share capital of the Company seeks Your advise whether he can apply to the Company Law Board for relief against oppression and mismanagement Advise.

(15 Marks)

7 (a) Advise Sunbeam Ltd in respect of the following proposals under consideration of its Board of Directors.

(i) appointment of Managing Director who is more than 70 years of age;

(ii) Payment of commission of 4% of net profits per annum to the ordinary directors of the company.

(iii) Appointment of both Managing Director and Manager in the Company.

(iv) Payment of remuneration of Rs 40,000 per month to the whole time director of the company running in loss and having an effective capital of Rs-98.00 lakhs.

(8 Marks)

(b) Mr. BCM Ltd, a private Ltd Company is having a paid up share capital of Rs-2.80 corers. Whether it is obligatory for the company to have a whole-time secretary? Will it make any difference if the Capital of BCM Ltd is 1.75 corers if yes, what other formality would have to be complied by it under the provisions of the Companies Act, 1956.

(7 Marks)

8 (a) What do you understand by corporate Governance? Explain the meaning of independent directors with reference to "Corporate Governance".

(8 Marks)

(b) State procedure for the following, explaining the relevant provisions of the Companies Act, 1956.

(i) Appointment of first Auditor, when the Board of Directors did not appoint the First Auditor with in one month from the date of registration of the company.

(ii) Removal of Statutory Auditor (Appointed in last Annual General Meeting) before the expiry of his term.

What difference it would make, if the Auditor was first Auditor appointed by the Board of Directors?

(7 Marks)

9

(a) The Board of Directors of M/S AYZ Limited, an unlisted Company having a paid up capital of Rs-6 crores consisting of equity share capital of Rs-5 crores and preference share capital of Rs-1 crore and also 1100 "small Shareholders" holding equity shares seek your advice on the following;

(i) Is it necessary for the Company to appoint a Director to represent the 'small share holders'?

(ii) In case the Company decides to appoint such a Director, the procedure to be followed by the company for such appointment and the period for which such appointment can be made.

(iii) Can such a director be removed by the company before the expiry of his period of appointment without the consent of the "small Shareholders"

Advise explaining the relevant provisions of the Companies Act and the Rules.

(8 Marks)

(b) (i) Board of Directors of BCM Limited held a Board Meeting on 2nd May 2008 at Registered Office. You are required to state the salient points to be taken into account while drafting the minutes of the said board meeting.

(i) Draft a Board Resolution for appointment of Mr. James as the Managing Director of BCM Limited passed in the above stated Board Meeting.

(7 Marks)

PRIME ACADAMY

27 -Session Final

CORPORATE LAWS AND SECRETARIAL PRACTICE - Suggested Answers

1(a) section 312 of the Companies Act, 1956 prohibits assignment of office by a Director. However in Oriental Metal pressing versus Bhasker Kashinath Thakoor [196] 31 company cases 143 [sc] on which the facts of the given problem are based, the Supreme court made distinction between 'assignment' and 'appointment' and held appointment by will as valid if the articles contained such a provision.
Thus the appointment of S as the Managing Director is valid.

1(b) SEBI has power under the provision of section 11 G, to conduct enquiries and to take action against the members of the Stock Exchange, if necessary.

1(c) (i)As per section 4 of Securities Contracts (Regulation) Act, 1956, SEBI will give the recognisiton for the stock exchange. Central Government has delegated the power to SEBI.
(ii)Application must be accompanied with Bye-laws, Rules, Regulations which must contain specific details on

1. The governing body of Stock Exchange, its constitution and powers of management and manner in which its business is transacted.
2. Powers and duties of office bearers of the Stock Exchange.
3. Various classes of members, qualification for membership and the exclusion, suspension, expulsion and re-admission, suspension, expulsion and readmission of members.
4. The procedure for registration of Partnerships as members to stock exchange and rules to nomination of authorized representatives.

2(a) (i) An office or branch outside India owned and controlled by a person resident in India is person resident in India.
(ii) an office or branch in India owned or controlled by a person resident outside India is treated as resident in India.
(iii)Chennai Branch is treated as resident in India. Section 2(v) defines 'person resident in India' Under Clause (III) thereof 'person resident in India' Branch in Chennai is owned or controlled by a person' resident in India.

2(b) (i) Not permissible.
(ii) Permissible.
(iii) Not permissible.

2(c) The quorum for a Public Limited Company should be disinterested quorum. In the problem given all the Directors are interested in the subject and therefore quorum for the Board Meeting is not present. In the Circumstance, approval of the Shareholder has to be obtained.

3(a)

	Rs.
Paid-up capital	75, 00,000
Free Reserves	60, 00,000

	135, 00,000
Loan already taken	30,00,000

	105, 00,000

The company can borrow up to Rs.105,00,000 from the Financial Institutions without seeking approval in general meeting.

3(b) (i) Composition of Competition Commission.-

The Commission shall consist of the Chairperson and not less then than two and not more than ten other Members. As may be specified by the Central Government. However, the Central government shall appoint the Chairperson and a member during first year of the establishment of the Commission. Further, this section also provides, the Chairperson and other Members shall be whole-time members and persons of ability, integrity and standing. A person who is or has been or is qualified to be a judge of a High Court or is having special knowledge of, and professional experience in, not less than fifteen years in international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs. Administration or in any other matter which in the opinion of the central Government, may be useful to the commission.

(ii) Where in the course of investigation under section 11c the investing Authority has reasonable ground to believe that the books, registers, other documents and record of relating to, any intermediary or any person associated with securities market in any manner may be destroyed, mutilated, altered, falsified or secreted, the investing Authority may make an application to the judicial Magistrate of the first class having jurisdiction for an order for the seizure such books, registers other documents and record.

After considering the application and hearing the investigating Authority. If necessary, the magistrate, may by order, authorized the investing Authority-

To seize books, registers, other documents and record, it considers necessary for the proposes of the Investigation.

(c) (i) The following are the External aid

(a) Historical setting
(b) Consolidating statues and previous law
(c) Usage
(d) (i) Earlier and later Acts and Analogous Acts
  (ii) Earlier Act explained by the later Act
  (iii)Reference to Repeated Act
(e) Dictionary definitions
(f) Use of foreign decisions

3(c) (ii)

(a) As per section 297(2) of the companies Act 1956, is the transaction is for cash and prevailing market price, previous approval of the central government is not required.
(b) Contracts entered by a public company with another public company is not coming under the par view of Section 297 of the Companies Act, 1956 and hence previous approval of the Central Govt is not required in this case.

4(a) (i) it is not in order for Mr.REDDY to give declaration as required by MSS LTD
Because in terms of section 274(1) (a) of the companies Act, 1956, a public company

1.has not filed the annual accounts and annual returns for any continuous three financial years commencing on or after the first day of April 1999 or

2.has failed to repay its deposit or interest thereon on due date or redeem its debenture on due date or pay dividend and such failure continues for one year or more.
Since ABC Ltd has not paid interest on fixed deposit for more than one year, Mr.REDDY cannot give declaration under section 274(1)(G)

(ii) Mr. REDDY cannot be reappointed as Director in BCM Ltd, since he is disqualified to be appointed as director in terms of section 274(1) (G) of the Companies Act,1956

4(b) Resolution:

Resolved that pursuant to Section 292A of the Companies Act, 1956, Audit committee be and is hereby constituted with the following members.

1. Mr. S
2. Mr. R
3. Mr. B

RESOLVED Further that the functions of the Audit committee are as follows:

(a) Oversee company's financial reporting process and disclosure to ensure that they are correct, sufficient and credible.
(b) Recommend appointment and removal of external auditors and fixation of their fees and approval for payment for any other services.
(c) Review annual financial statements before submission to Board.
(d) Review related party transactions.
(e) Review adequacy of internal control audit systems.
(f) Discussions with internal auditors and follow up action on irregularities noticed.
(g) Discussions with external auditors pre-audit as well as post-audit.
(h) Review company's financial and risk management policy.
(i) Defaults in payments to depositors, debenture holders, creditors, dividend, etc.

5(a) As per Section 372A, a company may have loan, give any guarantee or provide security and/or make investment in aggregate exceeding the aforesaid limit of 60% or 100% if the same is previously authorized by a special resolution passed in a general meeting.

A. Notice of such resolution shall indicate:

(i) the specific limits.
(ii) the particulars of body corporate in which the investment is proposed to be made or loan or security or guarantee to be given.
(iii) the purpose of the investment, loan or security or guarantee.
(iv) Specific source of funding: and
(v) any other detail which is material.

B. No loan or investment shall be made or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting.

C. The company has to obtain prior approval of the public financial institution referred to see.4A, where any term loan is subsisting if the loan or investments or guarantee given does not exceed 60% no approval of the public financial institution is required.

Hence as per see-372A, previous approval of the shareholder is required for the company to invest in excess of limits prescribed in the section. Accordingly the special resolution has to be passed at the Extraordinary General Meeting.

5(b) (i) Section 270 of the companies Act, if there is Qualification shares as per articles association the value should not exceed Rs.5000 and Qualification shares should be obtained within 2 months from the date of appointment.

(ii) In view of the above, the articles should be redrafted as follows:
The Qualification of a director shall be the holding of atleast 500 equity shares in the company and such a director, if not already qualified shall have to obtain his qualification shares within a period of 30 days from the date of appointment as a director.

6(a) Appointment of Directors (section 581P)

The members who sign the memorandum and the articles are designated as first directors and shall govern the affairs of the company until the directors are appointed at the Annual General Meeting. The Election of Directors shall be conducted within 90 days from the date of registration of the producer company. In the case of Inter-State Co-operative Society the election shall be held within a period of 360 days. The period of office of a director shall be not less than one year and not exceeding 5 years as may be specified in the articles. The directors retiring by rotation in accordance with the articles shall be eligible for re-appointment as a director. Normally, the Directors of the Board shall be elected are appointed by the member in the Annual General Meeting. The Board may also co-opt one or more expert directors or an additional director. Such directors cannot exceed 1/5th of the total number of directors. The expert directors shall not have the right to vote in the election of chairman but shall be eligible to be elected as chairman if it is provided by the articles. The maximum period for which such directors shall hold, shall not exceed such period as may be prescribed in the articles.

6(b) The application can be made only by

(a) Incase of a company having a share capital.
(i) Not less than one hundred members or not less than one tenth of the total number of members whichever is less.
(ii) A member or members holding not less than one-tenth of the issued share capital of company provided that the applicants have paid all calls and others sums due on their respective share [section 399(1)(a)]. It may be noted that joint members are counted as one member.
Hence in the given problem eight shareholders cannot apply for oppression and mismanagement.

7(a) Appointment of Managing Director who is more than 70 years of age.

(1) As per schedule XIII, where age of a person is more than 70 years his appointment has be approved by a special resolution passed by the company in general meeting.
(2) Payment of commission of 4% of net profits to the ordinary directors of the company.

In accordance with Section 309 of the Companies Act, 1956, the remuneration paid to such director shall not exceed.

(i) one per cent of the net profits of the company, if the company has a managing or wholetime Director or a Manager.
(ii)Three percent of the net profits of the company in any other case.

In view of this, the remuneration payable shall be restricted to 3% of the net profits of the company.

(iii)Appointment of both Managing Director and Manager in the company.

A company cannot appoint both Managing Director and Manager at the same time.

(iv)Payment of remuneration of Rs.40,000 per month to the wholetime director of the company running in loss and having a effective capital of Rs.98 lakhs.

As per schedule XIII, where the effective capital is less than rupees one crore, monthly remuneration shall not exceed Rs.75,000. Hence payment of remuneration of Rs.40,000 per month to the wholetime director of the company is permissible provided it is approved by the shareholders in the general meeting.

7(b) Companies whose paid up capital is more than Rs.2 crore shall appoint a company secretary who is a member of the Institute of Company Secretaries of India.

If the capital of the company is Rs.1.75 crores, no need for appointment of qualified company secretary. Only compliance certificate is required to be obtained from a Company Secretary who is in wholetime practice.

8(a) Corporate Governance means more transperency in disclosures and abiding the law.

Corporate Governance is applicable to listed companies.

As per Corporate Governance, the composition of Board of Directors should contain independent directors. Independent director means who is not having any pecuniary interest in the company.

8(b) Appointment of First Auditors.

(i) If the Board of Directors did not appoint the First Auditor within the month from the date of registration of the company, the vacancy shall only be filled by the company in general meeting.

(ii) Auditor appointed in general meeting shall be removed from office before the expiry of his term only by the company in general meeting, after obtaining the previous approval of the Central Government.

The Auditor was first Auditor appointed by the Board of Directors, shall be removed by the shareholders in the general meeting special notice of 14 days is required for removal of the first auditor.

9(a) a.(i) Manner of election of small shareholders' director; (1) It is not not necessary to appoint a director .A company may act suo moto to elect a small shareholders director from amongst small shareholders or upon the notice of small (2001) 22 TCR…(st) Appt of Small

Shareholders' Rules shareholders, who are not less than 1/10th of total small shareholders and have proposed name of person who shall also be a small shareholder of the company.

ii) A Small Shareholders intending to propose a person shall leave a notice of their intention with the company at least 14 days before the meeting under the signature of tat least 100small shareholders specifying name, address, shares held and folio number and particulars of share with differential rights as to divided and voting, if any, of the person whose name is being proposed for the post of director and of other small shareholders proposing such person as a candidate for the post of director or small shareholders.

b.A person whose name has been proposed for the post of small shareholders' director shall sign, and file with the company, his consent in writing to act as a director.

c. The listed public company shall elect small shareholders nominee subject to sub-rules(1),(2) and (3) above through the postal ballot.

The unlisted company may appoint such small shareholders' nominee subject to above conditions if majority of small shareholders recommend his candidates for the post of director in their meeting.

d. Tenure of such small shareholders' director shall be for a maximum period of 3 years subject to meeting the requirement of provisions of Companies Act except that he need not have to retire by rotation.

e. On expiry of his tenure the same person if so desired by small shareholders, may be elected for another period of 3 years.

f. Such director shall be treated as director for all other purposes except for appointment as whole time director or managing director.

(i) Such director cannot be removed by the company before the expiry of his period of appointment without the consent of the "small Shareholders".

9(b) (i) In the case of minutes of Board meetings, besides the names of those present, the names of directors who retrained who retrained from voting on matters in which they were interested, should also be given.

Apart from these general considerations, Section 193 provides that;

1. The minutes of each meeting must contain a fair and correct summary of the proceedings;
(a)The pages of the minute books must be consecutively numbered.
(b)all appointments of officers made at the meeting must be included in the minutes;
(b)in the case of a meeting of the board of directors or a committee thereof, the minutes must also state;

- the names of the directors present at the meeting; and
- in the case of a resolution passed at the meeting, the names of those directors who did not concur in the resolution.

It is also provided that certain details will not be included in the minutes if, in the opinion of the chairman of the meeting, any of them;
(a) is, or could reasonably be regarded as , defamatory of any person; or
(b) is irrelevant or immaterial to the proceedings; or
(c) is detrimental to the interests of the company.

9(c) "RESOLVED that Shri ABC who fulfills the conditions specified in parts I and ii of Schedule xii to the Companies Act, 1956 be and is hereby appointed as the Managing Director/Whole-time Director/ manager of the company for a period of five years effective from 2-5-2008 and that he may be paid remuneration by way of salary, commission and perquisites in accordance with part ii of schedule xiii of the Act.

Resolved further that in the event of loss or inadequacy of profit the salary payable ti him shall be subject to the limits specified in schedule xiii"

Resolved that Shri ABC be and is hereby appointed as Managing Director/Whole-time Director/Manager of the company subject to the approval of the Central Government for a period of five years effective from 2-5-2008 and that he may be paid remuneration as follows;

I Salary

II Commission

III Prerequisites;

Housing, Medical Reimbursement, Leave Travel Concession, Club fee Personal Accident Insurance, Gratuity, and Provident Fund etc.

Resolved further that the secretary of the company be and is hereby authorized to make an application to the Central Government seeking their approval to the above appointment.