

MOCK TEST PAPER – 1
FINAL COURSE: GROUP – I
PAPER – 1: FINANCIAL REPORTING

Question No. 1 is compulsory.

*Attempt any **five** questions from the remaining **six** questions.*

Working notes should form part of the answer.

Wherever necessary, suitable assumption(s) may be made by the candidates.

1. (a) During the course of the last three years, a company owning and operating Helicopters lost four Helicopters. The company's accountant felt that after the crash, the maintenance provision created in respect of the respective helicopters was no longer required, and proposed to write back to the Profit and Loss account as a prior period item. Is the company's proposed accounting treatment correct? Discuss.
- (b) Supertech Ltd. began construction of a new building on 1st January, 2015. It obtained Rs. 10 lakh special loan to finance the construction of the building on 1st January, 2015 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
Rs. 50,00,000	11%
Rs. 90,00,000	13%

The expenditures that were made on the building project were as follows:

		Rs.
January	2015	20,00,000
April	2015	25,00,000
July	2015	45,00,000
December	2015	12,00,000

Building was completed by 31st December, 2015. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one journal entry for capitalizing the cost and borrowing cost in respect of the building.

- (c) From the following information of Brave Ltd. calculate Earnings Per Share (EPS) in accordance with AS 20:

		(Rs.) Year 31.3.16	(Rs.) Year 31.3.15
1.	Net profit before tax	1,50,000	50,000
2.	Less: Current tax	(20,000)	(15,000)
	Tax relating to earlier years	(12,000)	6,500
	Deferred tax	(15,000)	(5,000)
3.	Profit after tax	1,03,000	36,500
4.	Other information:		
	(a) Profit includes compensation from Central Government towards loss on account of earthquake in 2013 (non-taxable)	1,00,000	NIL
	(b) Outstanding convertible 6% Preference shares 1,000 issued and paid on 30.9.2014. Face value Rs. 100, conversion ratio 15 equity shares for every preference share.		
	(c) 15% convertible debentures of Rs. 1,000 each total face value Rs. 50,000 to be converted into 10 Equity shares per debenture issued and paid on 30.6.2014.		
	(d) Total number of equity shares outstanding as on 31.3.2016, 10,000 including 5,000 bonus shares issued on 1.1.2016, face value Rs. 100.		

- (d) Shortfall Ltd. is the owner of a CGU (Cash Generating Unit) block of assets whose current carrying cost is Rs. 999 lakhs. The company, after a detailed study by its technical team, has assessed the present recoverable amount of this CGU block of assets at Rs. 555 lakhs. The value of the block of assets as per the Income-tax Records is Rs. 777 lakhs. The Approving Authority of the company have issued a signed statement confirming that the impairment in the value of the CGU is only a temporary phenomenon which is reversible in subsequent periods and also assuring virtual certainty of taxable incomes in the foreseeable future. You are required to show Deferred Tax workings as per Accounting Standards in force, given the tax rate of 30% plus 10% surcharge thereon. The depreciation rate for tax purposes is 15% and that per books is 13.91%.

Assume that current carrying cost of the CGU block of asset as per Accounting and Tax Records are after charging depreciation of the current year.

(4 x 5 = 20 Marks)

2. The following is the summarized Balance Sheet of Authentic Ltd. as on 31st March, 2016:

Balance Sheet

Liabilities	Rs.	Assets	Rs.
4,00,000 Equity shares of Rs. 10 each fully paid	40,00,000	Goodwill	6,00,000
13.5% Redeemable preference shares of Rs. 100 each fully paid	20,00,000	Building	24,00,000
General Reserve	16,00,000	Machinery	22,00,000
Profit and Loss Account	3,20,000	Furniture	10,00,000
Bank Loan (Secured against fixed assets)	12,00,000	Vehicles	18,00,000
Trade Payables	37,00,000	Investments	16,00,000
		Inventory	11,00,000
		Trade Receivables	18,00,000
		Bank Balance	<u>3,20,000</u>
	<u>1,28,20,000</u>		<u>1,28,20,000</u>

Further information:

- (i) Return on capital employed is 20% in similar businesses.
- (ii) Fixed assets are worth 30% more than book value. Inventory is overvalued by Rs. 1,00,000, Trade Receivables are to be reduced by Rs. 20,000. Trade investments, which constitute 10% of the total investment are to be valued at 10% below cost.
- (iii) Trade investments were purchased on 1.4.2015. 50% of Non-trade Investments were purchased on 1.4.2013 and the rest on 1.4.2014. Non-trade Investments yielded 15% return on cost.
- (iv) In 2013-2014 new machinery costing Rs. 2,00,000 was purchased, but wrongly charged to revenue. This amount should be adjusted taking depreciation at 10% on reducing value method.
- (v) In 2014-2015, furniture with a book value of Rs. 1,00,000 was sold for Rs. 60,000.
- (vi) For calculating goodwill two years purchase of super profits based on simple average profits of last four years are to be considered. Profits of last four years are as under:
2012-2013 Rs. 16,00,000, 2013-2014 Rs. 18,00,000, 2014-2015 Rs. 21,00,000, 2015-2016 Rs. 22,00,000.
- (vii) Additional depreciation provision at the rate of 10% on the additional value of Plant and Machinery alone may be considered for arriving at average profit.

Find out the intrinsic value of the equity share. Income-tax and Dividend tax are not to be considered. (16 Marks)

3. A Limited is a holding company and B Limited and C Limited are subsidiaries of A Limited. Their summarized Balance Sheets as on 31.3.2016 are given below:

	<i>A Ltd.</i> <i>Rs.</i>	<i>B Ltd.</i> <i>Rs.</i>	<i>C Ltd.</i> <i>Rs.</i>		<i>A Ltd.</i> <i>Rs.</i>	<i>B Ltd.</i> <i>Rs.</i>	<i>C Ltd.</i> <i>Rs.</i>
Share Capital	2,00,000	2,00,000	1,20,000	Fixed Assets	40,000	1,20,000	86,000
Reserves	96,000	20,000	18,000	Investments			
Profit & Loss Account	32,000	24,000	18,000	Shares in B Ltd.	1,90,000		
Trade payables	14,000	10,000		Shares in C Ltd.	26,000	1,06,000	
A Ltd. Balance		14,000		Inventory in Trade	24,000		
C Ltd. Balance	6,000			B Ltd. Balance	16,000		
				Trade receivables	52,000	42,000	64,000
				A Ltd. Balance			<u>6,000</u>
	<u>3,48,000</u>	<u>2,68,000</u>	<u>1,56,000</u>		<u>3,48,000</u>	<u>2,68,000</u>	<u>1,56,000</u>

The following particulars are given:

- The Share Capital of all companies is divided into shares of Rs. 10 each.
- A Ltd. held 16,000 shares of B Ltd. and 1,000 shares of C Ltd.
- B Ltd. held 8,000 shares of C Ltd.
- All these investments were made on 30.9.2015.
- On 31.3.2015, the position was as shown below:

	<i>B Ltd.</i> <i>Rs.</i>	<i>C Ltd.</i> <i>Rs.</i>
Reserve	16,000	15,000
Profit & Loss Account	8,000	6,000
Trade payables	10,000	2,000
Fixed Assets	1,20,000	86,000
Inventory in Trade	8,000	71,000
Trade receivables	96,000	66,000

- (vi) 10% dividend is proposed by each company.
- (vii) The whole of inventory in trade of B Ltd. as on 30.9.2015 (Rs. 8,000) was later sold to A Ltd. for Rs. 8,800 and remained unsold by A Ltd. as on 31.3.2016.
- (viii) Cash-in-transit from B Ltd. to A Ltd. was Rs. 2,000 as at the close of business.

You are required to prepare the Consolidated Balance Sheet of the group as on 31.3.2016. (16 Marks)

4. (a) Saransh Ltd. granted 500 options to each of its 2,500 employees in 2011 at an exercise price of Rs. 50 when the market price was the same. The contractual life (vesting and exercise period) of the options granted is 6 years with the vesting period and exercise period being 3 years each. The expected life is 5 years and the expected annual forfeitures are estimated at 3 per cent. The fair value per option is arrived at Rs. 15. Actual forfeitures in 2011 were 5 per cent. However at the end of 2011 the management of Saransh Ltd. still expects that the actual forfeitures would average only 3 per cent over the entire vesting period. During 2012 the management revises its estimated average forfeiture rate to 10 per cent per annum over the entire vesting period. Of the 2,500 employees 1,900 employees have completed the 3 year vesting period. 1,000 employees exercise their right to obtain shares vested in them in pursuance of ESOP at the end of 2015 and 500 employees exercise their right at the end of 2016. The rights of the remaining employees expire unexercised at the end of 2016. The face value per share is Rs. 10. Show the necessary journal entries with suitable narrations. Workings should form part of the answer.
- (b) Kingship Fortunes is a SEBI Registered Mutual Fund which made its maiden N.F.O (New Fund Offer) on 10th April, 2015 Rs. 10 face value per unit. Subscription was received for 90 lakhs units. An underwriting arrangement was also entered into with Fellow feeling Capital Markets Ltd. that agreed to underwrite the entire NFO of 100 lakh units on a commission of 1.5%.

Out of the monies received Rs. 892.50 lakhs was invested in various capital market instruments. The marketing expenses for the N.F.O amounted to Rs. 11.25 lakhs. During the financial year ended March 2016 the Fund sold securities having cost of Rs.127.25 lakh (FV Rs. 54.36 lakhs) for Rs. 141.25 lakhs. The fund in turn purchased securities for Rs. 130 lakhs. The management expenses of the fund are regulated by SEBI stipulations which state that the same shall not exceed 0.25% of the average funds invested during the year. The actual amount spent towards management expenses was Rs. 2.47 lakhs of which Rs. 47,000 was in arrear. The dividends earned on the investments held amounted to Rs. 2.51 lakhs of which a sum of Rs. 25,000 is yet to be collected. The fund distributed 80% of realized earnings. The closing market value of the portfolio was Rs. 1120.23 lakhs

You are required to determine the closing per unit NAV of the fund. (8+8 = 16 Marks)

5. (a) Plus Ltd. has provided the following information:

	(Rs. in thousands)
Equity Share Capital (Rs. 10 each)	400
15% Preference Share Capital (Rs. 10 each)	200
Reserves and Surplus	220
15% Debentures	1600
10% Non-trade Investments (Nominal Value Rs. 100 thousands)	140
Land and Building held as Investment	20
Advance given for Purchase of Plant	10
Capital Work in Progress	30
Underwriting Commission (not written off)	20
Earnings per share	16
Tax rate	30%
Beta factor	1.65
Market rate of return	16.25%
Risk free rate	9.85%

Calculate Economic Value Added by the company.

- (b) ABC Ltd. is covered under Ind AS roadmap and required to prepare its financial statements as per Ind AS from financial year 2016-17 with comparatives for financial year 2015-16. The date of transition to Ind AS is April 1, 2015. The Company has chosen to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition to Ind AS, measured as per the previous GAAP. The Company has recorded capital spares in its previous GAAP financial statements as a part of inventory.

How should the capital spares be accounted under Ind AS on the date of transition to Ind AS if the Company chooses to apply the previous GAAP as deemed cost exemption?
(8 + 8 = 16 Marks)

6. The following was the abridged Balance Sheet of Atharv Ltd, as at 31st March, 2016:

Liabilities	Rs.	Assets	Rs.
Capital:		Plant and machinery at depreciated value	8,60,000
Authorized:		Land	7,00,000
10,000 Equity shares of Rs. 100 each	10,00,000	Current assets	
<u>Issued and paid up:</u>			

8,000 Equity shares of Rs. 100 each, fully paid up	8,00,000	Trade receivables	8,00,000
		Patents, trademarks and copyrights	6,00,000
<u>Reserves and surplus:</u>			
General reserve 5,00,000			
Securities premium 4,00,000			
Profit and loss <u>3,60,000</u>	12,60,000		
11% Debentures secured against the assets of the Co.	5,00,000		
Trade payables	<u>4,00,000</u>		
	<u>29,60,000</u>		<u>29,60,000</u>

The company ran two distinct departments utilizing the trademarks and copyrights owned and generated by it. The assets and liabilities of one of the departments as on the date of Balance Sheet were:

	Rs.
Plant and machinery	4,00,000
Land (used for business)	2,00,000
Current assets	2,00,000
Trademarks and copyrights	<u>3,50,000</u>
	11,50,000
Trade payables	<u>2,50,000</u>
	<u>9,00,000</u>

Due to managerial constraints, Atharv is unable to develop this department. An overseas buyer is interested to acquire this department and after due diligence, offers a consideration of Rs. 20,00,000 to the company for transfer of business. The buyer offered to discharge the purchase consideration immediately after 31st March, 2016, in the following manner:

- (i) Issue of equity shares of the buyer's company for Rs. 10,00,000 nominal value at a premium of 20% over the face value; and
- (ii) Payment of the balance consideration in £ Sterling. The exchange rate agreed upon is Rs. 80 per £ Sterling. This amount will be retained in London, till the actual takeover of the business is done by the buyer.
 - (a) expenses to put through the transaction come to Rs. 8,00,000 initially to be incurred by Atharv but to be shared equally by the parties.
 - (b) the balance value of trademarks, copyrights and patents left with Atharv does

not enjoy any market value and has to be written off.

- (c) the value of the balance of land in Atharv's possession will be taken at its market value in the books of account. Such a value, determined by an approved valuer, is 200 percent of the book value.
- (d) the parties agree that the date of legal ownership of the transferred business shall be 31st March, 2016 though certain formalities may have to be gone through and agree that the actual transfer to the buyer will be effected before 30th April, 2016.

Atharv Ltd to carry on the business in the normal course and account for the profits of the transferred department to the foreign buyer. Atharv made a net profit of Rs. 2,40,000 from the whole business for April, 2016; 40 percent of the net profit related to the business of the transferred department.

- (e) the shares of the overseas buyer's company were quoted on the London Stock Exchange and on 30th April, 2016 were quoted at 95 percent of their face value.
- (f) the cash received by Atharv at London was remitted by it to its Indian banking account on 30th April 2016 when the rupee sterling rate was Rs. 75 per UK sterling pound.

Draw the Balance Sheet of Atharv Ltd. as at 30th April, 2016, after the transfer of the business to the overseas buyer. (16 Marks)

7. Answer any **four** of the following:

- (a) Tasty Ltd. sells beer to customers. Some of the customers consume the beer in the bars run by Tasty Limited. While leaving the bars, the consumers leave the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling for tenders. Keeping this in view:
 - (i) Decide whether the inventory of empty bottles is an asset of the company;
 - (ii) If so, whether the inventory of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'?
- (b) On 1st January, 2016, Allen Ltd. sold equipment for Rs. 6,14,460. The carrying amount of the equipment on that date was Rs. 1,00,000. The sale was a part of the package under which Solley Ltd. leased the asset to Allen Ltd. for ten years term. The economic life of the asset is estimated as 10 years. The minimum lease rents payable by the lessee has been fixed at Rs. 1,00,000 payable annually beginning from 31st December, 2016. The incremental borrowing interest rate of Allen Ltd. is

estimated at 10% p.a. Calculate the net effect on the Statement of Profit and Loss in the books of Allen Ltd.

- (c) An enterprise reports quarterly, estimates an annual income of Rs. 50 lakhs. Assume tax rates on 1st Rs. 25,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are Rs. 3,75,000, Rs. 12,50,000, Rs. 18,75,000 and Rs. 15,00,000.

Calculate the tax expense to be recognized in each quarter.

- (d) X Ltd. purchased a fixed asset four years ago for Rs. 150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at Rs. 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is Rs. 67.50 lakhs and expected disposal costs are Rs. 3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at Rs. 60 lakhs?
- (e) The capital structure of W Ltd. whose shares are quoted on the NSE is as under:

Equity Shares of Rs. 100 each fully paid	Rs. 505 lakhs
9% Convertible Pref. Shares of Rs. 10 each	Rs. 150 lakhs
12% Secured Debentures of Rs. 10 each	5,00,000
Reserves	Rs. 101 lakhs
Statutory Fund	Rs. 50,50,000

The Statutory Fund is compulsorily required to be invested in Government Securities. The ordinary shares are quoted at a premium of 500%; Preference Shares at Rs. 30 per share and debentures at par value.

You are required to ascertain the Market Value added of the company and also give your assessment on the market value added as calculated by you.

(4 x 4 = 16 Marks)

MOCK TEST PAPER – 1
FINAL COURSE: GROUP – I
PAPER – 1: FINANCIAL REPORTING
SUGGESTED ANSWERS/HINTS

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

(b) (i) **Computation of average accumulated expenses**

		Rs.
Rs. 20,00,000 x 12 / 12	=	20,00,000
Rs. 25,00,000 x 9 / 12	=	18,75, 00
Rs. 45,00,000 x 6 / 12	=	22,50,000
Rs. 12,00,000 x 1 / 12	=	<u>1,00,000</u>
		<u>62,25,000</u>

(ii) **Calculation of average interest rate other than for specific borrowings**

Amount of loan (Rs.)	Rate of interest	Amount of interest (Rs.)
50,00,000	11%	= 5,50,000
90,00,000	13%	= <u>11,70,000</u>
1,40,00,000		<u>17,20,000</u>
Weighted average rate of interest $\left(\frac{17,20,000}{1,40,00,000} \times 100 \right)$		= 12.285% (approx)

(iii) Interest on average accumulated expenses

		Rs.
Specific borrowings (Rs. 10,00,000 x 10%)	=	1,00,000
Non-specific borrowings (Rs. 52,25,000* x 12.285%)	=	<u>6,41,890</u>
Amount of interest to be capitalized	=	<u>7,41,890</u>

(iv) Total expenses to be capitalized for building

	Rs.
Cost of building Rs. (20,00,000 + 25,00,000 + 45,00,000 + 12,00,000)	1,02,00,000
Add: Amount of interest to be capitalised	<u>7,41,890</u>
	<u>1,09,41,890</u>

(v) Journal Entry

Date	Particulars		Dr. (Rs.)	Cr. (Rs.)
31.12.2015	Building account To Bank account (Being amount of cost of building and borrowing cost thereon capitalized)	Dr.	1,09,41,890	1,09,41,890

(c) Calculation of Earnings Per Share (EPS) of Brave Ltd.

		Rs. Year ended 31.3.16	Rs. Year ended 31.3.15
1.	A Earning after extra ordinary items for equity shareholders (Rs. 1,03,000 – Rs. 3,000) (Rs. 36,500 – Rs. 1,500)	1,00,000	35,000
	B. No. of Equity Shares	10,000	10,000
	C. Basic Earnings Per share [A/B]	10.00	3.50
	A. Earnings before extraordinary items	50,000	35,000
	B. No. of Equity Shares	10,000	10,000**

* (Rs. 62,25,000 – Rs. 10,00,000)

	C. Basic Earnings Per share [A/B]	5.00	3.50
2.	Tax rate applicable		
	Rs. 20,000 + Rs. 15,000/ Rs. 1,00,000×100	35%	
	Rs. 15,000 + Rs. 5,000/Rs. 50,000×100		40%
3.	A. Dividend on Weighted Average Preference Shares	3,000	1,500
	B. Incremental shares	7,500	3,750
	C. EPS on Incremental Shares [A/B]	0.40	0.40
		(dilutive)	(dilutive)
4.	Convertible Debentures		
	A. Increase in earnings		
	$(50,000 \times \frac{15}{100} \times .65)$	4,875	
	$50,000 \times \frac{15}{100} \times .60 \times \frac{9}{12}$		3,375
	B. Increase in shares	1,000	750
	C. Increase in EPS [A/B]	9.75	9.00
		(Anti dilutive)	(Anti dilutive)

It is anti-dilutive as it increases the EPS from continuing ordinary operations (Para 39, AS 20)

Calculation of Diluted EPS		Year ended 31.3.16 (Rs.)	Year ended 31.3.15 (Rs.)
A.	Profit from continuing ordinary activities before Preference Dividend	53,000	36,500
	No. of ordinary equity shares	10,000	10,000
	Adjustment for dilutive potential of 6% convertible preference shares	7,500	3,750
B.	Total no. of shares	17,500	13,750
C.	Diluted EPS from continuing ordinary operations [A/B]	3.02	2.65

** Since the bonus issue is without consideration, the issue is treated as if it had occurred prior to the beginning of the year 2015.

D. Profit including extra ordinary items	1,03,000	36,500
E. Adjusted No. of shares	17,500	13,750
F. Diluted EPS including extra ordinary items [D/E]	5.88	2.65

Disclosure of EPS in accordance with AS 20 in the Profit and Loss Account

Earnings per share (Face value Rs. 100)	31.3.16 (Rs.)	31.3.15 (Rs.)
Basic EPS from continuing ordinary operations	5.00	3.50
Diluted EPS from continuing ordinary operations	3.02	2.65

(d) Statement showing Deferred Tax workings for the current year

	<i>Rs. in lakhs</i>
Depreciation as per Accounting books for the current year $\frac{999}{(1-.1391)} \times .1391$	161.41
Depreciation as per Income Tax Records for the current year $\frac{777}{(1-.15)} \times .15$	<u>137.12</u>
Timing difference	<u>24.29</u>
Tax effect of the above timing difference at 33%* (deferred tax asset) (A)	<u>8.02</u>
Impairment Loss recognised in the profit and loss account (999- 555)	444
Impairment Loss allowed for tax purposes	<u>Nil</u>
Timing difference	<u>444</u>
Tax effect of the above timing difference at 33% (deferred tax asset) (B)	<u>146.52</u>
Total deferred tax asset (A+B)	<u>154.54</u>

Note:

- Deferred tax asset should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax asset can be realised. The Approving Authority of Shortfall Ltd. have issued signed statement confirming

*Tax rate = 30%x 110%= 33%.

virtual certainty of taxable incomes in the foreseeable future. Therefore, the company can recognize deferred tax asset during the current year.

2. The deferred tax asset calculated on account of difference of depreciation as per accounting and tax records is actually a reversal of deferred tax liability created in the previous years.

2. Calculation of intrinsic value of equity shares of Authentic Ltd.

1. Calculation of Goodwill

- (i) Capital employed

Fixed Assets	Rs.	Rs.
Building	24,00,000	
Machinery (Rs. 22,00,000 + Rs. 1,45,800)	23,45,800	
Furniture	10,00,000	
Vehicles	<u>18,00,000</u>	
	75,45,800	
Add: 30% increase	<u>22,63,740</u>	
	98,09,540	
Trade investments (Rs. 16,00,000 × 10% × 90%)	1,44,000	
Trade Receivables (Rs. 18,00,000 – Rs. 20,000)	17,80,000	
Inventory (Rs. 11,00,000 – Rs. 1,00,000)	10,00,000	
Bank balance	<u>3,20,000</u>	1,30,53,540
Less: Outside liabilities		
Bank Loan	12,00,000	
Trade Payables	<u>37,00,000</u>	<u>(49,00,000)</u>
Capital employed		<u>81,53,540</u>

- (ii) Future maintainable profit

Calculation of average profit

	2012-2013 Rs.	2013-2014 Rs.	2014-2015 Rs.	2015-2016 Rs.
Profit given	16,00,000	18,00,000	21,00,000	22,00,000
Add: Capital expenditure of machinery charged to revenue		2,00,000		
Loss on sale of furniture			<u>40,000</u>	
	<u>16,00,000</u>	<u>20,00,000</u>	<u>21,40,000</u>	<u>22,00,000</u>

Less: Depreciation on machinery		(20,000)	(18,000)	(16,200)
Income from non-trade investments		(1,08,000)	(2,16,000)	(2,16,000)
Reduction in value of inventory				(1,00,000)
Bad debts				<u>(20,000)</u>
Adjusted profit	<u>16,00,000</u>	<u>18,72,000</u>	<u>19,06,000</u>	<u>18,47,800</u>
				Rs.
Total adjusted profit for four years (2012-2013 to 2015-2016)				<u>72,25,800</u>
Average profit (Rs. 72,25,800/4)				18,06,450
Less: Depreciation at 10% on additional value of machinery (22,00,000 + 1,45,800) × 30/100 i.e. Rs. 7,03,740				<u>(70,374)</u>
Adjusted average profit				<u>17,36,076</u>

(iii) Normal Profit: 20% on capital employed i.e. 20% on Rs. 81,53,540 = Rs. 16,30,708

(iv) Super profit: Expected profit – normal profit
Rs. 17,36,076 – Rs. 16,30,708 = Rs. 1,05,368

(v) Goodwill: 2 years' purchase of super profit
Rs. 1,05,368 × 2 = Rs. 2,10,736

2. Net assets available to equity shareholders

	Rs.	Rs.
Goodwill as calculated in 1(v) above		2,10,736
Sundry fixed assets		98,09,540
Trade and Non-trade investments		15,84,000
Trade Receivables		17,80,000
Inventory		10,00,000
Bank balance		<u>3,20,000</u>
		1,47,04,276
Less: Outside liabilities		
Bank loan	12,00,000	
Trade Payables	<u>37,00,000</u>	
		(49,00,000)
Preference share capital		<u>(20,00,000)</u>
Net assets for equity shareholders		<u>78,04,276</u>

3. Valuation of equity shares

$$\begin{aligned}\text{Value of equity share} &= \frac{\text{Net assets available to equity shareholder}}{\text{Number of equity shares}} \\ &= \frac{\text{₹ 78,04,276}}{4,00,000} = \text{Rs. 19.51}\end{aligned}$$

Note:

1. Depreciation on the overall increased value of assets (worth 30% more than book value) has not been considered. Depreciation on the additional value of only plant and machinery has been considered taking depreciation at 10% on reducing value method while calculating average adjusted profit.
2. Loss on sale of furniture has been taken as non-recurring or extraordinary item.
3. It has been assumed that preference dividend has been paid till date.

3. Consolidated Balance Sheet of A Ltd. and its subsidiaries B Ltd. and C Ltd. as on 31st March, 2016

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital		2,00,000
(b) Reserves and Surplus	1	1,20,610
(2) Minority Interest (W.N 5)		75,640
(3) Current Liabilities		
(a) Trade payables		24,000
(b) Short term provisions	2	20,000
Total		4,40,250
II. Assets		
(1) Non-current assets		
Fixed assets		
i. Tangible assets		2,46,000
ii. Intangible assets	3	11,050
(2) Current assets		
(a) Inventories	4	23,200
(b) Trade receivables		1,58,000

(c) Cash and cash equivalents	5	2,000
Total		4,40,250

Notes to Accounts

		(Rs.)	(Rs.)
1.	Reserves and surplus		
	Reserves - Balance as on 31.3.2016 (given)	96,000	
	Share in		
	B Ltd. [WN 3]	2,400	
	C Ltd. [WN 2]	<u>250</u>	98,650
	Profit & Loss Account		
	Balance as on 31.3.2015 (given)	32,000	
	Share in		
	B Ltd. [WN 3]	9,600	
	C Ltd. [WN 2]	<u>1,000</u>	
		42,600	
	Less: Proposed dividend (10% of Rs. 2,00,000)	(20,000)	
	Provision for unrealised profit on inventory [80% of (Rs. 8,800 – Rs. 8,000)]	<u>(640)</u>	<u>21,960</u>
			<u>1,20,610</u>
2.	Short term provisions		
	Proposed Dividend		20,000
3.	Intangible Assets		
	Goodwill (W.N 4)		11,050
4.	Inventories		
	Inventory in Trade	24,000	
	Less: Provision for unrealised profit	<u>(800)</u>	23,200
5.	Cash and cash equivalents		
	Cash in Transit (16,000 – 14,000)		2,000

Working Notes:

Shareholding Pattern

	B Ltd.	C Ltd.
Total Shares	20,000	12,000

Held by A Ltd.	16,000 [80%]	2,000 [1/6 th]
Held by B Ltd.	NA	8,000 [4/6 th]
Minority Holding	20%	1/6 th

(1) Position on 30.09.2015 i.e. date of investment

	<i>Reserves</i>	<i>Profit and Loss Account</i>
B Ltd.	<i>Rs.</i>	<i>Rs.</i>
Balance on 31.3.2016	20,000	24,000
Less: Balance on 31.3.2015	<u>(16,000)</u>	<u>(8,000)</u>
Increase during the year	<u>4,000</u>	<u>16,000</u>
Estimated increase for half year	2,000	8,000
Balance on 30.9.2015	18,000 (16,000 + 2,000)	16,000 (8,000 + 8,000)
C Ltd.		
Balance on 31.3.2016	18,000	18,000
Balance on 31.3.2015	<u>15,000</u>	<u>6,000</u>
Increase during the year	<u>3,000</u>	<u>12,000</u>
Estimated increase for half year	1,500	6,000
Balance on 30.9.2015	16,500 (15,000 + 1,500)	12,000 (6,000 + 6,000)

(2) Analysis of Profits of C Ltd.

	<i>Capital Profit</i> <i>Rs.</i>	<i>Revenue Reserve</i> <i>Rs.</i>	<i>Revenue profit</i> <i>Rs.</i>
Reserves on 30.9.2015 [WN 1]	16,500		
Profit and Loss A/c on 30.9.2015	12,000		
Increase in reserves		1,500	
Increase in profit			<u>6,000</u>
	28,500	1,500	6,000
Less: Minority interest (1/6)	<u>(4,750)</u>	<u>(250)</u>	<u>(1,000)</u>
	<u>23,750</u>	<u>1,250</u>	<u>5,000</u>
Share of A Ltd. (1/6)	4,750	250	1,000
Share of B Ltd. (4/6)	19,000	1,000	4,000

(3) Analysis of Profits of B Ltd.

	<i>Capital Profit Rs.</i>	<i>Revenue Reserve Rs.</i>	<i>Revenue profit Rs.</i>
Reserves on 30.9.2015	18,000		
Profit and Loss A/c on 30.9.2015	16,000		
Increase in reserves		2,000	
Increase in profit			8,000
Share in C Ltd. [WN 1]	<u> </u>	<u>1,000</u>	<u>4,000</u>
	34,000	3,000	12,000
Less: Minority interest (2/10)	<u>(6,800)</u>	<u>(600)</u>	<u>(2,400)</u>
Share of A Ltd. (8/10)	<u>27,200</u>	<u>2,400</u>	<u>9,600</u>

(4) Cost of control

	<i>Rs.</i>	<i>Rs.</i>
Investments in		
B Ltd.	1,90,000	
C Ltd. [26,000 + 1,06,000]	<u>1,32,000</u>	3,22,000
Less : Paid up value of investments in		
B Ltd.	1,60,000	
C Ltd.	<u>1,00,000</u>	(2,60,000)
Capital profits in		
B Ltd. [WN 3]	27,200	
C Ltd. [WN 2]	<u>23,750</u>	<u>(50,950)</u>
Goodwill		<u>11,050</u>

(5) Minority Interest

	<i>Rs.</i>	<i>Rs.</i>
Share Capital:		
B Ltd. [20 %]	40,000	
C Ltd. [1/6 th]	<u>20,000</u>	60,000
Share in profits and reserves (Pre and Post-Acquisitions)		
B Ltd. [WN 3]	9,800	

C Ltd. [WN 2]	<u>6,000</u>	<u>15,800</u>
		75,800
Less: Provision for unrealized profit (20% of Rs. 800)		<u>(160)</u>
		<u>75,640</u>

Note: The above solution has been done by direct method. Alternatively, students may follow indirect method. In indirect method, the share in pre-acquisition profits of B Ltd. in C Ltd. amounting Rs. 19,000 will be included as capital profit while analysing the profits of B Ltd. and will not be considered for the purpose of cost of control. Thus, in this case, the amounts of goodwill and minority interest will increase by Rs. 3,800 (2/10 of Rs. 19,000). Goodwill and minority interest will be shown at Rs. 14,850 and Rs. 79,440 respectively in the consolidated balance sheet. Therefore, the total of the assets and liabilities side of the consolidated balance sheet will be Rs. 4,44,050.

4. (a) **Journal Entries**

Year 2011		Rs.	Rs.
Employee Compensation Expense A/c	Dr.	57,04,205	
To Employee Stock Options Outstanding A/c			57,04,205
(Being the compensation expenses recognized in respect of the ESOP)			
Profit and Loss A/c	Dr.	57,04,205	
To Employee Compensation Expense A/c			57,04,205
(Being Expenses of the year transferred to P&L A/c)			
Year 2012			
Employee Compensation Expense A/c	Dr.	34,08,295	
To Employee Stock Options Outstanding A/c			34,08,295
(Being the compensation expenses recognized in respect of the ESOP)			
Profit and Loss A/c	Dr.	34,08,295	
To Employee Compensation Expense A/c			34,08,295
(Being Expenses of the year transferred to P&L A/c)			
Year 2013			
Employee Compensation Expense A/c	Dr.	51,37,500	
To Employee Stock Options Outstanding A/c			51,37,500

(Being the compensation expenses recognized in respect of the ESOP)		
Profit and Loss A/c	Dr.	51,37,500
To Employee Compensation Expense A/c		51,37,500
(Being Expenses of the year transferred to P&L A/c)		
<i>Year 2015</i>		
Bank A/c	Dr.	250,00,000
Employee Stock Options Outstanding A/c	Dr.	75,00,000
To Share Capital A/c		50,00,000
To Securities Premium		275,00,000
(Being shares issued to employees against options vested in them in pursuance of the ESOP)		
<i>Year 2016</i>		
Bank A/c	Dr.	125,00,000
Employee Stock Options Outstanding A/c	Dr.	37,50,000
To Share Capital A/c		25,00,000
To Securities Premium A/c		137,50,000
(Being shares issued to employees against options vested in them in pursuance of the ESOP)		
Employee Stock Options Outstanding A/c	Dr.	30,00,000
To General Reserve A/c		30,00,000
(Being the balance standing to the credit of stock options outstanding account, in respect of vested options expired unexercised, transferred to general reserve account)		

Working Notes:

1. Fair value of options recognized as expense in the year 2011

Number of options expected to vest = $500 \times 2,500 \times .97 \times .97 \times .97 = 11,40,841$ options

Fair value of options expected to vest = $11,40,841 \times \text{Rs. } 15 = \text{Rs. } 171,12,615$

One third of fair value recognized as expense = $\text{Rs. } 171,12,615 / 3 = \text{Rs. } 57,04,205$

Year 2012	
Fair Value of options revised in the year = $500 \times 2500 \times 0.90 \times 0.90 \times 0.90 \times \text{Rs.}15$	Rs. 136,68,750
Revised cumulative expenses in year 2012 = $136,68,750 \times \frac{2}{3}$	Rs. 91,12,500
Less: Already recognized in year 2011	<u>Rs. (57,04,205)</u>
Expenses to be recognized in year 2012	<u>Rs. 34,08,295</u>
Year 2013	
Number of options actually vested = $1900 \times 500 = 9,50,000$	
Fair Value of options actually vested = $9,50,000 \times \text{Rs.} 15$	Rs. 1,42,50,000
Less: Expense recognized till year 2013	<u>Rs. (91,12,500)</u>
Balance amount to be recognized	<u>Rs. 51,37,500</u>

2. Amount recorded in share capital account and securities premium account upon issue of shares

Particulars	Year 2015	Year 2016
Number of employees exercising option	1,000	500
Number of shares issued upon exercise of option @ 500 per employee	5,00,000	2,50,000
Exercise price received @ Rs. 50 per share	2,50,00,000	1,25,00,000
Corresponding amount recognized in the 'Employee stock options outstanding A/c' @ Rs. 15 per option	<u>75,00,000</u>	<u>37,50,000</u>
Total consideration	<u>3,25,00,000</u>	<u>1,62,50,000</u>
Amount to be recorded in 'Share capital A/c' @ Rs. 10 per share	50,00,000	25,00,000
Amount to be recorded in 'Securities premium A/c' @ Rs. 55 (i.e. 65 –10) per share	<u>2,75,00,000</u>	<u>1,37,50,000</u>
	<u>3,25,00,000</u>	<u>1,62,50,000</u>

(b) Calculation of Closing per unit of NAV of the fund

	<i>Rs. in lakhs</i>
Net Assets of Sparrow holding	
Closing cash balance (W.N.2)	79.99
Closing Market Value of Investments	1,120.23
Accrued Dividends (collectable)	<u>0.25</u>
	1,200.47
Less: Current Liabilities	
Outstanding Management Fee (payable)	<u>(0.47)</u>
Closing Net Assets (A)	<u>1,200.00</u>
Units outstanding (in lakhs) (B)	100.00
NAV per unit (A/B)	12.00

Working Notes:

		<i>Rs. in lakhs</i>
1. Computation of opening cash balance		
Proceeds of NFO in full including underwriters commitment		1000.00
Less: Initial purchase of securities		<u>(892.50)</u>
		107.50
Less: Underwriting commission	15.00	
Marketing expenses	11.25	<u>(26.25)</u>
Opening cash balance		81.25
2. Computation of closing cash balance		
Opening bank balance (W.N.1)		81.25
Add: Proceeds from sale of securities	141.25	
Dividends received on investment	<u>2.26</u>	<u>143.51</u>
		224.76
Less: Cost of securities purchased	130.00	
Management expenses (W.N.3)	1.76	
Capital gains distributed Rs. (141.25 - 127.25) x 80%	11.20	
Dividends distributed Rs. (2.26 x 80%)	<u>1.81</u>	<u>(144.77)</u>
Closing cash balance		<u>79.99</u>

3. Computation of Management Expenses Chargeable		
Actual expense incurred [A]		2.47
Opening investment made	892.50	
Closing funds invested (892.50 - 127.25 + 130)	<u>895.25</u>	
Total	<u>1,787.75</u>	
Average funds invested (1,787.75/2)	<u>893.875</u>	
0.25% of Average funds invested [B]		2.23
Lower of A or B		2.23
Less: Amount unpaid		(0.47)
Management expenses paid		<u>1.76</u>

5. (a) Computation of Economic Value Added (EVA)

<i>Particulars</i>	<i>(Rs. in thousands)</i>
Net Operating Profit after Tax (NOPAT)	831.00
Less: Weighted average cost of operating capital employed (13.35% of 2,200) (See W.N.7)	<u>(293.70)</u>
Economic Value Added (EVA)	<u>537.30</u>

Working Notes:

1. Net Operating Profit after Tax (NOPAT)

Earnings per share	Rs. 16
No. of equity shares	40 thousands
	Rs. in thousands
Profit after Interest, Tax & Preference Dividend [40 thousands x Rs. 16]	640.00
Add: Preference Dividend (15% of Rs. 200 thousands)	<u>30.00</u>
Profit after Tax	670.00
Add: Tax @ 30% [670/70 x 30]	<u>287.14</u>
Profit before Tax	957.14
Add: Interest on Debentures [15% of Rs. 1,600 thousands]	<u>240.00</u>
Profit before Interest & Tax	1,197.14
Less: Income from Non-trade Investment [10% of Rs. 100 thousands]	<u>(10.00)</u>

Net Operating Profit before Tax	1,187.14
Less: Tax @ 30%	<u>(356.14)</u>
Net Operating Profit after Tax [NOPAT]	<u>831.00</u>

2. Cost of Equity = Risk Free Rate + Beta Factor x (Market Rate - Risk Free Rate)

$$= 9.85\% + 1.65 (16.25 - 9.85) = 20.41\%$$
3. Cost of Preference shares = 15%
4. Cost of Debt = Interest Rate x (1 - tax rate) = 15% x (1 - 0.30) = 10.5%
5. Total Capital Employed = [Equity Share Capital + Retained Earnings + Preference Share Capital + Debentures]

$$= [400 + (220 - 20) + 200 + 1,600] = 2,400$$
6. Weighted Average Cost of Capital (WACC)

$$= \left(\frac{600}{2,400} \times 20.41\% \right) + \left(\frac{200}{2,400} \times 15\% \right) + \left(\frac{1,600}{2,400} \times 10.5\% \right)$$

$$= 5.10 + 1.25 + 7\% = 13.35\%$$

7. Operating Capital Employed

		Rs. in thousands
Total Capital		2,400
Less: Non-operating Capital Employed		
10% Non-trade Investment	140	
Land and Building held as Investment	20	
Advance given for purchase of a Plant	10	
Capital work-in-progress	<u>30</u>	<u>(200)</u>
Operating Capital Employed		<u>2,200</u>

- (b) As per paragraph 8 of Ind AS 16, Property, Plant and Equipment, items such as spare parts are to be recognised, when they meet the definition of 'property, plant and equipment'. Otherwise such items are classified as inventory.

As per Ind AS 16, 'property, plant and equipment', are tangible items that:

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period.

Paragraph 7 of Ind AS 16, Property, Plant and Equipment, states as under:

“The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

- (a) it is probable that future economic benefits associated with the item will flow to the entity; and
- (b) the cost of the item can be measured reliably.”

Therefore, if an item of spare part meets the definition of ‘property, plant and equipment’ as mentioned above and satisfies the recognition criteria as per paragraph 7 of Ind AS 16, such an item of spare has to be recognised as property, plant and equipment. If that spare part does not meet the definition and recognition criteria as cited above that spare is to be recognised as inventory.

Paragraph 10 of Ind AS 101, First-time Adoption of Indian Accounting Standards, inter alia, states that an entity, shall in its opening Ind AS Balance Sheet, recognise all assets and liabilities whose recognition is required by Ind AS.

Further, as per paragraph D7AA, once the company chooses previous GAAP as deemed cost, it is not allowed to adjust the carrying value of property, plant and equipment for any adjustments other than those in accordance with paragraph D21 and D21A of Ind AS 101. In this case, a question arises whether the company may capitalise spares as a part of property, plant and equipment on the date of transition to Ind AS. It may be noted deemed cost exemption as the previous GAAP is in respect of carrying value of property, plant and equipment capitalised under previous GAAP on the date of transition to Ind AS. This condition does not prevent a company to recognise an asset whose recognition is required by Ind AS on the date of transition.

In the given case, the capital spares were recognised as inventory under previous GAAP and they were not appearing under carrying amount of PPE.

In view of the above, it is clear that ABC Ltd. should recognise ‘capital spares’ if they meet definition of PPE as on the date of transition, in addition to continuing carrying value of PPE.

6. Balance Sheet of Atharv Ltd. as at 30th April, 2016 (after demerger)

Particulars	Note No.	(Rs.)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	8,00,000
(b) Reserves and Surplus	2	20,54,000
(2) Non-current Liabilities		

Long-term borrowings	3	5,00,000
(3) Current Liabilities		
Trade payables		<u>1,50,000</u>
Total		<u>35,04,000</u>
II. Assets		
(1) Non-current assets		
Fixed assets		
Tangible assets	4	14,60,000
(2) Current assets		
(a) Trade receivables (8,00,000-2,00,000)		6,00,000
(b) Current investment		9,50,000
(c) Cash and cash equivalents (W.N.2)		<u>4,94,000</u>
Total		<u>35,04,000</u>

Notes to Accounts

		Rs.	Rs.
1.	Share Capital		
	Authorised share capital:		
	10,000 Equity shares of Rs. 100 each	10,00,000	
	Issued share capital:		
	8,000 Equity shares of Rs. 100 each		8,00,000
2.	Reserves and surplus		
	Revaluation reserve (W.N.6)	5,00,000	
	General reserve	5,00,000	
	Capital reserve (W.N.3)	11,00,000	
	Securities Premium	4,00,000	
	Profit and Loss Account (W.N.1)	<u>(4,46,000)</u>	20,54,000
3.	Long-term Borrowings		
	Secured borrowings		
	11% Debentures secured against the assets of the Co.		5,00,000
4.	Tangible Assets		
	Plant & Machinery at depreciated value (8,60,000 - 4,00,000)	4,60,000	
	Land (W.N.6)	10,00,000	14,60,000

Working Notes:**1. Computation of Profit and Loss Account as on 30th April, 2016**

		<i>Rs.</i>
Balance as on 31 st March, 2016		3,60,000
Add: Profit earned during the month of April, 2016 (W.N.4)		<u>1,44,000</u>
		5,04,000
Less: Expenses on sale of department (share of Atharv Ltd.) (Rs. 8,00,000 x 50%)	4,00,000	
Patents, trademarks and copyrights written off (W.N.5)	2,50,000	
Diminution in the value of investment (W.N.7)	2,50,000	
Loss due to on foreign exchange translation difference (W.N.8)	<u>50,000</u>	<u>(9,50,000)</u>
		<u>(4,46,000)</u>

2. Cash and bank

		<i>Rs.</i>
Cash received from Overseas buyer on 30 th April, 2016 (£ 10,000 x Rs. 75)		7,50,000
Add: Cash reimbursed by overseas buyer (Rs. 8,00,000 x 50%)		4,00,000
Cash profit earned during the month of April, 2016 by Atharv Ltd. (See Note)		<u>2,40,000</u>
		13,90,000
Less: Expenses on sale of department to overseas buyer	8,00,000	
Share of profit (for April, 2016) paid to overseas buyer (W.N.4)	<u>96,000</u>	<u>(8,96,000)</u>
		<u>4,94,000</u>

3. Calculation of gain on sale of department and discharge of purchase consideration

	<i>Rs.</i>
Purchase consideration	20,00,000
Less: Net assets sold	<u>(9,00,000)</u>

Gain on sale of department transferred to capital reserve	<u>11,00,000</u>
Purchase consideration	20,00,000
Less: Discharged by issue of Overseas Buyer's Equity shares of Rs. 10,00,000 at 20% premium	<u>(12,00,000)</u>
Balance discharged in cash i.e. (8,00,000/80) = £ 10,000	<u>8,00,000</u>

4. Profit earned during the month of April, 2016

	Rs.
Total profit earned by Atharv Ltd. during the month of April, 2016	2,40,000
Less: 40% Profit of the sold department	<u>(96,000)</u>
Profit of Atharv Ltd. on the retained department	<u>1,44,000</u>

5. Patents, trademarks and copyrights written off

	Rs.
Patents, trademarks and copyrights as per balance sheet of Atharv Ltd.	6,00,000
Less: Patents, trademarks and copyrights taken over by Overseas buyer	<u>(3,50,000)</u>
Patents, trademarks and copyrights written off (charged to Profit and Loss Account)	<u>2,50,000</u>

6. Land

	Rs.
Land as per balance sheet of Atharv Ltd.	7,00,000
Less: Land taken over by Overseas buyer	<u>(2,00,000)</u>
Book value of land retained by Atharv Ltd.	<u>5,00,000</u>
Revalued value (200% of book value)	<u>10,00,000</u>
Revaluation reserve (10,00,000-5,00,000)	5,00,000

7. Diminution in the market value of equity shares of Overseas Buyer

	Rs.
Nominal value of shares	<u>10,00,000</u>
Issued at 20% Premium	12,00,000
Market value of shares on 30 th April, 2016 is 95% of nominal value (10,00,000 x 95%)	<u>(9,50,000)</u>
Diminution charged to Profit and Loss Account	<u>2,50,000</u>

8. Loss due to foreign exchange translation difference

	Rs.
Cash payment by overseas buyer £ 10,000 due on 31 st March, 2016 @ Rs. 80 per £	8,00,000
Exchange rate on 30 th April, 2016 is Rs. 75 per £	
Less: Amount remitted in Indian Currency (£ 10,000 x Rs. 75)	<u>(7,50,000)</u>
Loss on foreign exchange translation transferred to Profit and Loss Account	<u>50,000</u>

Note:

1. The above solution has been given on the assumption that Atharv Ltd intends to hold investment in shares of overseas buyer as temporary investment. Therefore, its carrying value has been shown in the balance sheet at market value and reduction to market value has been included in the profit and loss account. In case it is assumed as long term investment, then investment in shares of Overseas buyer will be shown at cost i.e. Rs. 12,00,000 and Profit and Loss account balance will be Rs. 9,04,000. The Balance Sheet total will be Rs. 37,54,000.
 2. It is also assumed that the profit earned during the month of April, 2016 is entirely the cash profit and also the amount of current assets and current liabilities of Atharv Ltd. has been same as on 31.3.2016.
7. (a) (i) Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. Tasty Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.
- (ii) As per AS 2 "Valuation of Inventories", inventories are assets held for sale in the ordinary course of business. Inventory of empty bottles existing on the Balance Sheet date is the inventory and Tasty Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality. Hence empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.
- (b) Net effect on the Statement of Profit and Loss in the year of sale in the books of Lessee (Allen Ltd.)

For calculation of net effect on the statement of profit and loss on sale of equipment, it has to be judged whether lease is an operating lease or finance lease.

The lease term is for 10 years which covers the entire economic life of the equipment. At the inception of the lease, the present value of the minimum lease payments (MLP) is Rs. 6,14,400 [Rs. 1,00,000 x 6.144 (Annuity factor of Re. 1

@10% for 10 years)] and amounts to at least substantially all of the fair value (sale price i.e. Rs. 6,14,460) of the leased equipment. Thus lease is a finance lease.

As per para 48 of AS 19 "Leases", if a sale and leaseback transaction results in a finance lease, profit of Rs. 5,14,460 (Sale value Rs. 6,14,460 less carrying amount Rs. 1,00,000) will not be recognized as income in the year of sale in the books of lessee i.e. Allen Ltd. It should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

Therefore, assuming that depreciation is charged on straight line basis, Allen Ltd. will recognize depreciation of Rs. 61,446 per annum for 10 years (Rs. 6,14,460/ 10) and amortise profit of Rs. 5,14,460 over the lease term of 10 years, i.e. Rs. 51,446 p.a. The net effect is a debit of (Rs. 61,446 - Rs. 51,446) Rs. 10,000 p.a. to the Statement of Profit and Loss, for 10 years as covered under the lease term.

Note: Had there been no sale and lease back transaction, the Statement of Profit and Loss for each year (covered in the lease term) would have been charged by (Rs. 1,00,000/10) Rs. 10,000, towards depreciation. Thus, the sale and lease back transaction will have no impact on profit or loss account to be reported by the lessee (vendor in the sales transaction) over the lease period.

- (c) As per para 29 of AS 25 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

	Rs.
Estimated Annual Income (A)	<u>50,00,000</u>
Tax expense:	
30% on Rs. 25,00,000	7,50,000
40% on remaining Rs. 25,00,000	<u>10,00,000</u>
(B)	<u>17,50,000</u>

$$\text{Weighted average annual income tax rate} = \frac{B}{A} = \frac{17,50,000}{50,00,000} = 35\%$$

<i>Tax expense to be recognised in each of the quarterly reports</i>	Rs.
Quarter I - Rs. 3,75,000 x 35%	1,31,250
Quarter II - Rs. 12,50,000 x 35%	4,37,500
Quarter III - Rs. 18,75,000 x 35%	6,56,250
Quarter IV - Rs. <u>15,00,000</u> x 35%	<u>5,25,000</u>
Rs. <u>50,00,000</u>	<u>17,50,000</u>

(d) Treatment of Impairment Loss

As per para 57 of AS 28 "Impairment of assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is Rs. 64.50 lakhs (Rs. 67.50 lakhs – Rs. 3 lakhs) and value in use is Rs. 60 lakhs. Therefore, recoverable amount will be Rs. 64.50 lakhs. Impairment loss will be calculated as Rs. 10.50 lakhs [Rs. 75 lakhs (Carrying Amount after revaluation - Refer Working Note) less Rs. 64.50 lakhs (Recoverable Amount)].

Thus impairment loss of Rs. 10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.

Working Note:

Calculation of carrying amount of the fixed asset at the end of the fourth year on revaluation

(Rs. in lakhs)	
Purchase price of a fixed asset	150.00
Less: Depreciation for four years [(150 lakhs / 10 years) x 4 years]	<u>(60.00)</u>
Carrying value at the end of fourth year	90.00
Less: Downward revaluation charged to profit and loss account	<u>(15.00)</u>
Revalued carrying amount	<u>75.00</u>

- (e)** Market Value Added (MVA) is the difference between the current market value of a firm and the capital contributed by investors (both debenture holders and shareholders). In other words, it is the sum of all capital claims held against the company plus market value of debt and equity. If MVA is positive, firm has added value.

Market Value Added = Market value of firm less amount invested in the firm

		Rs. in lakhs
Equity Share Capital (market value) (505 lakhs x 600%)		3030
Preference share capital (15,00,000 x 30)		450
Debentures		50
Current market value of firm		3,530
Less: Equity Share Capital	505	

Preference share capital	150	
Reserves	101	
Debentures	50	
Statutory Reserve	50.50	(856.50)
Market Value Added		2,673.50
The significant Market Value addition implies that the management of W Ltd. has created wealth for its shareholders and that market investors are willing to pay a price greater than the historical net worth of the company.		

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL COURSE : GROUP – I

PAPER – 2 : STRATEGIC FINANCIAL MANAGEMENT

Question No. 1 is compulsory. Attempt any **five** questions from the remaining **six** questions.
Working notes should form part of the answer.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) Followings are the spot exchange rates quoted at three different forex markets:

USD/INR	68.30 in Mumbai
GBP/INR	95.80 in London
GBP/USD	1.3231 in New York

The arbitrageur has USD1,000,000. Assuming that there are no transaction costs, explain whether there is any arbitrage gain possible from the quoted spot exchange rates. (5 Marks)

- (b) An investors is considering the purchase of the following Bond:

Face value	Rs. 100
Coupon rate	11%
Maturity	3 years

- (i) If he wants a yield of 13% what is the maximum price he should be ready to pay for?
- (ii) If the Bond is selling for Rs. 97.60, what would be his yield? (5 Marks)

- (c) ABC Ltd. is considering a project in US, which will involve an initial investment of US \$ 1,10,00,000. The project will have 5 years of life. Current spot exchange rate is Rs. 68 per US \$. The risk free rate in US is 8% and the same in India is 12%. Cash inflow from the project is as follows:

Year	Cash inflow
1	US \$ 20,00,000
2	US \$ 25,00,000
3	US \$ 30,00,000
4	US \$ 40,00,000
5	US \$ 50,00,000

Calculate the NPV of the project using foreign currency approach. Required rate of return on this project is 14%. (5 Marks)

- (d) Sahu & Co. earns Rs. 6 per share having capitalisation rate of 10 per cent and has a return on investment at the rate of 20 per cent. According to Walter's model, what should be the price per share at 30 per cent dividend payout ratio? Is this the optimum payout ratio as per Walter? (5 Marks)

2. (a) ABC Ltd. is contemplating have an access to a machine for a period of 5 years. The company can have use of the machine for the stipulated period through leasing arrangement or the requisite amount can be borrowed to buy the machine. In case of leasing, the company received a proposal to pay annual end of year rent of Rs. 2.4 lakhs for a period of 5 years.

In case of purchase (which costs Rs. 10,00,000/-) the company would have a 12%, 5 years loan to be paid in equated installments, each installment becoming due to the beginning of each years. It is estimated that the machine can be sold for Rs. 2,00,000/- at the end of 5th year. The company uses straight line method of depreciation. Corporate tax rate is 30%. Post tax cost of capital of ABC Ltd. is 10%.

You are required to advice

- Whether the machine should be bought or taken on lease.
- Analyze the financial viability from the point of view of the lessor assuming its pre-tax cost of debt is 9% and Debt : Equity as 1 : 2. The lessor is unlisted entity and the proxy company is having Debt: Equity as 1:3 and beta of 1.3. Virtually the beta of debt is zero and risk free rate of return and market rate of return are 7% and 12.50% respectively.

	PV of Rs. 1@10% for 5 years	PV of Rs. 1 @ 12% for 5 years
1	.909	.893
2	.826	.797
3	.751	.712
4	.683	.636
5	.621	.567

(10 Marks)

- (b) A mutual fund that had a net asset value of Rs. 16 at the beginning of a month, made income and capital gain distribution of Rs. 0.04 and Rs. 0.03 respectively per unit during the month, and then ended the month with a net asset value of Rs. 16.08. Calculate monthly and annual rate of return. (6 Marks)

3. (a) ABC, a large business house is planning to acquire KLM another business entity in similar line of business. XYZ has expressed its interest in making a bid for KLM. XYZ expects that after acquisition the annual earning of KLM will increase by 10%. Following information, ignoring any potential synergistic benefits arising out of possible acquisitions, are available:

	XYZ	ABC	Proxy entity for KLM & ABC in the same line of business
Paid up Capital (Rs. Crore)	1025	106	--
Face Value of Share is Rs.10			
Current share price	Rs. 129.60	Rs. 55	--
Debt: Equity at market values	1 : 2	1 : 3	1 : 4
Equity beta	--	--	1.1

Assuming debt beta to be zero and corporate tax rate as 30%, determine the beta of combined entity. (8 Marks)

- (b) Calculate the value of share from the following information:

Profit after Tax (PAT) of the company	€ 2900 million
Equity capital of company	€ 13,000 million
Par value of share	€ 40 each
Debt to Equity ratio of the company	1 : 3
Debt to Equity ratio of the proxy company	1 : 2
Beta of proxy company	0.20
Long run growth rate of the company	8%
Risk free interest rate	8.7%
Market returns	10.3%
Capital expenditure per share	€ 47
Depreciation per share	€ 39
Change in Working capital	€ 3.45 per share

Assume corporate tax rate to be 30% and Beta of Debt as zero. (8 Marks)

4. (a) A & Co. is contemplating whether to replace an existing machine or to spend money on overhauling it. A & Co. currently pays no taxes. The replacement machine costs Rs. 90,000 now and requires maintenance of Rs. 10,000 at the end of every year for eight years. At the end of eight years it would have a salvage value of Rs. 20,000

and would be sold. The existing machine requires increasing amounts of maintenance each year and its salvage value falls each year as follows:

Year	Maintenance (Rs.)	Salvage (Rs.)
Present	0	40,000
1	10,000	25,000
2	20,000	15,000
3	30,000	10,000
4	40,000	0

The opportunity cost of capital for A & Co. is 15%.

Required:

When should the company replace the machine?

(Notes: Present value of an annuity of Re. 1 per period for 8 years at interest rate of 15% : 4.4873; present value of Re. 1 to be received after 8 years at interest rate of 15% : 0.3269). (8 Marks)

- (b) Trupti Co. Ltd. promoted by a Multinational group "INTERNATIONAL INC" is listed on stock exchange holding 84% i.e. 63 lakhs shares.

Profit after Tax is Rs. 4.80 crores.

Free Float Market Capitalisation is Rs. 19.20 crores.

As per the SEBI guidelines promoters have to restrict their holding to 75% to avoid delisting from the stock exchange. Board of Directors has decided not to delist the share but to comply with the SEBI guidelines by issuing Bonus shares to minority shareholders while maintaining the same P/E ratio.

Calculate

- (i) P/E Ratio
- (ii) Bonus Ratio
- (iii) Market price of share before and after the issue of bonus shares
- (iv) Free Float Market capitalization of the company after the bonus shares.

(8 Marks)

5. (a) The Easygoing Company Limited is considering a new project with initial investment, for a product "Survival". It is estimated that IRR of the project is 16% having an estimated life of 5 years.

Financial Manager has studied that project with sensitivity analysis and informed that annual fixed cost sensitivity is 7.8416%, whereas cost of capital (discount rate) sensitivity is 60%.

Other information available are:

Profit Volume Ratio (P/V) is 70%,

Variable cost Rs. 60/- per unit

Annual Cash Flow Rs. 57,500/-

Ignore Depreciation on initial investment and impact of taxation.

Calculate

- (i) Initial Investment of the Project
- (ii) Net Present Value of the Project
- (iii) Annual Fixed Cost
- (iv) Estimated annual unit of sales
- (v) Break Even Units

Cumulative Discounting Factor for 5 years

8%	9%	10%	11%	12%	13%	14%	15%	16%	17%	18%
3.993	3.890	3.791	3.696	3.605	3.517	3.433	3.352	3.274	3.199	3.127

(8 Marks)

- (b)** Mr. FedUp wants to invest an amount of Rs. 520 lakhs and had approached his Portfolio Manager. The Portfolio Manager had advised Mr. FedUp to invest in the following manner:

Security	Moderate	Better	Good	Very Good	Best
Amount (in Rs. Lakhs)	60	80	100	120	160
Beta	0.5	1.00	0.80	1.20	1.50

You are required to advise Mr. FedUp in regard to the following, using Capital Asset Pricing Methodology:

- (i) Expected return on the portfolio, if the Government Securities are at 8% and the NIFTY is yielding 10%.
- (ii) Advisability of replacing Security 'Better' with NIFTY.

(8 Marks)

- 6. (a)** Nitrogen Ltd, a UK company is in the process of negotiating an order amounting to €4 million with a large German retailer on 6 months credit. If successful, this will be the first time that Nitrogen Ltd has exported goods into the highly competitive German market. The following three alternatives are being considered for managing

the transaction risk before the order is finalized.

- (i) Invoice the German firm in Sterling using the current exchange rate to calculate the invoice amount.
- (ii) Alternative of invoicing the German firm in € and using a forward foreign exchange contract to hedge the transaction risk.
- (iii) Invoice the German first in € and use sufficient 6 months sterling future contracts (to the nearly whole number) to hedge the transaction risk.

Following data is available:

Spot Rate	€ 1.1750 - €1.1770/£
6 months forward premium	0.60-0.55 Euro Cents
6 months further contract is currently trading at	€1.1760/£
6 months future contract size is	£62500
Spot rate and 6 months future rate	€1.1785/£

Required:

- (i) Calculate to the nearest £ the receipt for Nitrogen Ltd, under each of the three proposals.
- (ii) In your opinion, which alternative would you consider to be the most appropriate and the reason thereof. *(8 Marks)*

- (b)** Using the chop-shop approach (or Break-up value approach), assign a value for Cranberry Ltd. whose stock is currently trading at a total market price of €4 million. For Cranberry Ltd, the accounting data set forth three business segments: consumer wholesale, retail and general centers. Data for the firm's three segments are as follows:

Business Segment	Segment Sales	Segment Assets	Segment Operating Income
Wholesale	€225,000	€600,000	€75,000
Retail	€720,000	€500,000	€150,000
General	€ 2,500,000	€4,000,000	€700,000

Industry data for "pure-play" firms have been compiled and are summarized as follows:

Business Segment	Capitalization/ Sales	Capitalization/ Assets	Capitalization/Operating Income
Wholesale	0.85	0.7	9

Retail	1.2	0.7	8
General	0.8	0.7	4

(8 Marks)

7. Write short notes on any of **four** of the following:

- (a) Linkage of Financial Policy with Strategic Management
- (b) Depository Participant
- (c) Elliot Wave Theory
- (d) Meaning and Advantages of Netting
- (e) Difference between Equity Curve Out and Spin Off

(4 × 4 = 16 Marks)

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 2: STRATEGIC FINANCIAL MANAGEMENT

SUGGESTED ANSWERS/HINTS

1. (a) The arbitrageur can proceed as stated below to realize arbitrage gains.
- (i) Buy GBP from USD 1,000,000 At New York 1,000,000/ 1.3231 GBP 755,801
 - (ii) Convert these GBP to Rs. at London (755,801 x 95.80) Rs. 72,405,736
 - (iii) Convert Rs. to USD at Mumbai Rs. 72,405,736/ 68.30 USD 1,060,113.26
- There is net gain of USD 1,060,113.26 less USD 10,000,000 i.e. USD 60,113.26
- (b) (i) Calculation of Maximum price
- $$B_0 = \text{Rs. } 11 \times \text{PVIFA} (13\%, 3) + \text{Rs. } 100 \times \text{PVIF} (13\%, 3)$$
- $$= \text{Rs. } 11 \times 2.361 + \text{Rs. } 100 \times 0.693 = \text{Rs. } 25.97 + \text{Rs. } 69.30 = \text{Rs. } 95.27$$
- (ii) Calculation of yield
- At 12% the value = Rs. $11 \times \text{PVIFA} (12\%, 3) + 100 \times \text{PVIF} (12\%, 3)$
- $$= \text{Rs. } 11 \times 2.402 + \text{Rs. } 100 \times 0.712 = \text{Rs. } 26.42 + \text{Rs. } 71.20 = \text{Rs. } 97.62$$
- Since bond is selling at Rs. 97.60, the YTM of the bond shall be approximately 12%.
- (c) $(1 + 0.12) (1 + \text{Risk Premium}) = (1 + 0.14)$
- Or, $1 + \text{Risk Premium} = 1.14/1.12 = 1.0179$
- Therefore, Risk adjusted dollar rate is $= 1.0179 \times 1.08 = 1.099 - 1 = 0.099$
- Calculation of NPV

Year	Cash flow (Million) US\$	PV Factor at 9.9%	P.V.
1	2.00	0.910	1.820
2	2.50	0.828	2.070
3	3.00	0.753	2.259
4	4.00	0.686	2.744
5	5.00	0.624	<u>3.120</u>
			12.013
		Less: Investment	<u>11.000</u>
		NPV	<u>1.013</u>

Therefore, Rupee NPV of the project is = Rs. (68 x 1.013) Million
= Rs. 68.884 Million

(d) Walter Model is
$$V_c = \frac{D + \frac{R_a}{R_c} (E - D)}{R_c}$$

Where:

V_c = Market value of the share

R_a = Return on Retained earnings

R_c = Capitalisation Rate

E = Earning per share

D = Dividend per share

Hence, if Walter model is applied

$$\text{Market Value of the Share} = \frac{1.80 + \frac{.20}{.10} (6 - 1.80)}{0.10} \quad P = \frac{1.80 + \frac{.20}{.10} (4.20)}{0.10}$$

$$P = \frac{1.80 + 8.40}{0.10} \quad P = \text{Rs. } 102$$

This is not the optimum payout ratio because $R_a > R_c$ and therefore V_c can further go up if payout ratio is reduced.

2. (a) (i) From Lessee's Point of View

Calculation of loan installment:

Rs. 10,00,000 / (1+ PVIFA 12%, 4)

Rs. 10,00,000 / (1 + 3.038) = Rs. 2,47,647

Debt Alternative: Calculation of Present Value of Outflows

(Amount in Rs.)

(1) End of year	(2) Debt Payment	(3) Interest	(4) Dep.	(5) Tax Shield [(3)+(4)]x0.3	(6) Cash outflows (2) – (5)	(7) PV factors @ 10%	(8) PV
0	2,47,647	0	0	0	2,47,647	1.000	2,47,647
1	2,47,647	90,282	1,60,000	75,085	1,72,562	0.909	1,56,859
2	2,47,647	71,398	1,60,000	69,419	1,78,228	0.826	1,47,216
3	2,47,647	50,249	1,60,000	63,075	1,84,572	0.751	1,38,614

4	2,47,647	26,305*	1,60,000	55,892	1,91,755	0.683	1,30,969
5	0	0	1,60,000	48,000	(48,000)	0.621	(29,808)
							7,91,497
Less: Salvage Value Rs. 2,00,000 x 0.621							1,24,200
Total Present Value of Outflow							6,67,297

*balancing figure

Leasing Decision: Calculation of Present Value of Outflows

Yrs. 1-5 Rs. 2,40,000 x (1 - 0.30) x 3.790 = Rs. 6,36,720

Decision: Leasing option is viable.

(ii) **From Lessor's Point of View**

First of all we shall calculate Weighted Average Cost of Capital (WACC) of the lessor and to calculate the same we require cost of equity which shall be computed as follows:

β ungereared for the proxy company = $1.3 \times 3 / [3 + (1 - 0.3)] = 1.054$

$1.054 = \beta$ equity gereared $\times 2 / [2 + (1 - 0.3)]$

β equity gereared = 1.423

Cost of equity = $0.07 + 1.423 \times (0.125 - 0.07) = 14.83\%$

$WACC = 14.83\% \times \frac{2}{3} + 9\%(1 - 0.30) \times \frac{1}{3}$

= $9.89\% + 2.10\% = 11.99\%$ say 12.00%

Computation of NPV

		(Rs.)
Cost of Machine		(-) 10,00,000
PV of Post tax lease Rental (Rs. 2,40,000 x 0.7 x 3.605)	6,05,640	
PV of Depreciation tax shield (Rs. 1,60,000 x 0.3 x 3.605)	1,73,040	
PV of salvage value (Rs. 2,00,000 x 0.567)	<u>1,13,400</u>	<u>8,92,080</u>
NPV		(-) <u>1,07,920</u>

Decision – Leasing proposal is not viable.

Note: Student can also solve the above calculation using 11.99% precisely.

(b) Calculation of monthly return on the mutual funds:

$$r = \frac{(\text{NAV}_t - \text{NAV}_{t-1}) + I_t + G_t}{\text{NAV}_{t-1}}$$

$$\text{Or, } r = \frac{(\text{₹ } 16.08 - \text{₹ } 16.00) + (\text{₹ } 0.04 + \text{₹ } 0.03)}{16}$$

$$= \frac{0.08 + 0.07}{16} = 0.009375 \quad \text{or, } r = 0.9375\% \text{ or } 11.25\% \text{ p.a.}$$

3. (a) β ungereared for the proxy company = $1.1 \times 4 / [4 + (1 - 0.3)] = 0.9362$

$$0.9362 = \beta_{\text{Gereared of XYZ}} \times 2 / [2 + (1 - 0.3)]$$

$$\beta_{\text{Gereared of XYZ}} = 1.264$$

$$0.9362 = \beta_{\text{Gereared of ABC}} \times 3 / [3 + (1 - 0.3)]$$

$$\beta_{\text{Gereared of ABC}} = 1.155$$

	XYZ	ABC	Total
No. of Share (1)	Rs.1025 crore Rs.10 =102.50 crore	Rs.106 crore Rs.10 = 10.60 crore	--
Current share price (2)	Rs. 129.60	Rs. 55	--
Market Values (3) = (1) × (2)	Rs. 13284 crore	Rs. 583 crore	Rs. 13867 crore
Equity beta (4)	1.264	1.155	
Market Values × Equity beta	Rs. 16790.976 crore	Rs. 673.365 crore	Rs. 17464.341 crore

$$\text{Portfolio Beta after Merger} = \frac{\text{₹ } 17464.341 \text{ crore}}{\text{₹ } 13867 \text{ crore}} = 1.26$$

(b) No. of Shares = $\frac{\text{€ } 13000 \text{ million}}{\text{€ } 40} = 325 \text{ million}$

$$\text{EPS} = \frac{\text{PAT}}{\text{No. of shares}}$$

$$\text{EPS} = \frac{\text{€ } 2900 \text{ million}}{325 \text{ million}} = \text{€ } 8.923$$

$$\text{FCFE} = \text{Net income} - [(1-b) (\text{capex} - \text{dep}) + (1-b) (\Delta \text{WC})]$$

$$\begin{aligned}
\text{FCFE} &= 8.923 - [(1-0.25) (\text{€}47 - \text{€}39) + (1 - 0.25) (\text{€}3.45)] \\
&= \text{€}8.923 - [\text{€}6.00 + \text{€}2.5875] = \text{€}0.3355 \\
\beta \text{ ungereared for the proxy company} &= 0.20 \times 2 / [2 + (1 - 0.30)] = 0.148 \\
0.148 &= \beta \text{ equity gereared} \times 3 / [3 + (1 - 0.3)] \\
\beta \text{ equity gereared} &= 0.1825 \\
\text{Cost of Equity} &= R_f + \beta (R_m - R_f) \\
&= 8.7 + 0.1825 (10.3 - 8.7) = 8.992\% \\
P_0 &= \frac{\text{FCFE}(1+g)}{K_e - g} = \frac{0.3355(1.08)}{0.08992 - 0.08} = \frac{0.36234}{0.00992} = \text{€} 36.53
\end{aligned}$$

4. (a)

A & Co.

Equivalent cost of (EAC) of new machine

		Rs.
(i)	Cost of new machine now	90,000
	Add: PV of annual repairs @ Rs. 10,000 per annum for 8 years (Rs. 10,000 × 4.4873)	<u>44,873</u>
		1,34,873
	Less: PV of salvage value at the end of 8 years (Rs. 20,000 × 0.3269)	<u>6,538</u>
		<u>1,28,335</u>
	Equivalent annual cost (EAC) (Rs. 1,28,335/4.4873)	<u>28,600</u>

PV of cost of replacing the old machine in each of 4 years with new machine

Scenario	Year	Cash Flow	PV @ 15%	PV
		(Rs.)		(Rs.)
Replace Immediately	0	(28,600)	1.00	(28,600)
		40,000	1.00	<u>40,000</u>
				<u>11,400</u>
Replace in one year	1	(28,600)	0.870	(24,882)
	1	(10,000)	0.870	(8,700)
	1	25,000	0.870	<u>21,750</u>
				<u>(11,832)</u>
Replace in two years	1	(10,000)	0.870	(8,700)

Replace in three years	2	(28,600)	0.756	(21,622)
	2	(20,000)	0.756	(15,120)
	2	15,000	0.756	<u>11,340</u>
				<u>(34,102)</u>
	1	(10,000)	0.870	(8,700)
	2	(20,000)	0.756	(15,120)
	3	(28,600)	0.658	(18,819)
	3	(30,000)	0.658	(19,740)
	3	10,000	0.658	<u>6,580</u>
				<u>(55,799)</u>
Replace in four years	1	(10,000)	0.870	(8,700)
	2	(20,000)	0.756	(15,120)
	3	(30,000)	0.658	(19,740)
	4	(28,600)	0.572	(16,359)
	4	(40,000)	0.572	<u>(22,880)</u>
				<u>(82,799)</u>

Advice: The company should replace the old machine immediately because the PV of cost of replacing the old machine with new machine is least.

Note: Students can also solve the question by adopting another approach with same conclusion.

(b) 1. P/E Ratio:

	% of holding	No. of Shares
Promoter's Holding	84%	63 Lacs
Minority Holding	16%	12 Lacs
Total Shares	100%	75 Lacs

Free Float Market Capitalization = Rs. 19.20 crores

Hence Market price $\frac{\text{Rs. 19.20 crores}}{12.00 \text{ lacs}}$ = Rs. 160 per share

EPS (PAT/No. of Shares) (Rs. 4.80 crores /75 lac) = Rs. 6.40 per share

P/E Ratio (Rs. 160/ Rs. 6.40) = 25

2. No. of Bonus Shares to be issued:

Promoters holding 84%, = 63 lacs shares

Shares remains the same, but holding % to be taken as 75%

$$\text{Hence Total shares} = \frac{63 \text{ lacs}}{75\%} = 84 \text{ lacs}$$

Shares of Minority = 84 lacs – 63 lacs = 21 lacs

Bonus 9 lacs for 12 lacs i.e. 3 bonus for 4 held

3. Market price before & after Bonus:

Before Bonus = Rs. 160 per share

After Bonus

$$\text{New EPS} = \frac{\text{₹ 4.80 crores}}{84 \text{ lacs}} = \text{Rs. 5.71}$$

New Market Price (25 x Rs. 5.71) = Rs. 142.75

4. Free Float Capitalization is

Rs. 142.75 x 21 lacs = Rs. 29.9775 crores

5. (a) (i) Initial Investment

IRR = 16% (Given)

At IRR, NPV shall be zero, therefore

$$\begin{aligned} \text{Initial Cost of Investment} &= \text{PVAF (16\%,5) x Cash Flow (Annual)} \\ &= 3.274 \times \text{Rs. 57,500} \\ &= \text{Rs. 1,88,255} \end{aligned}$$

(ii) Net Present Value (NPV)

$$\text{Let Cost of Capital be X, then } \frac{16 - X}{X} = 60\%$$

$$X = 10\%$$

Thus NPV of the project

= Annual Cash Flow x PVAF (10%, 5) – Initial Investment

= Rs. 57,500 x 3.791 – Rs. 1,88,255

= Rs. 2,17,982.50 – Rs. 1,88,255 = Rs. 29,727.50

(iii) Annual Fixed Cost

Let change in the Fixed Cost which makes NPV zero is X. Then,

$$\text{Rs. } 29,727.50 - 3.791X = 0$$

$$\text{Thus } X = \text{Rs. } 7,841.60$$

Let original Fixed Cost be Y then,

$$Y \times 7.8416\% = \text{Rs. } 7,841.60$$

$$Y = \text{Rs. } 1,00,000$$

Thus Fixed Cost is equal to Rs. 1,00,000

(iv) Estimated Annual Units of Sales

$$\text{Selling Price per unit} = \frac{\text{Rs. } 60}{100\% - 70\%} = \text{Rs. } 200$$

$$\frac{\text{Annual Cash Flow} + \text{Fixed Cost}}{\text{P/V Ratio}} = \text{Sales Value}$$

$$\frac{\text{Rs. } 57,500 + \text{Rs. } 1,00,000}{0.70} = \text{Rs. } 2,25,000$$

$$\text{Sales in Units} = \frac{\text{Rs. } 2,25,000}{\text{Rs. } 200} = 1,125 \text{ units}$$

(v) Break Even Units

$$\frac{\text{Fixed Cost}}{\text{Contribution Per Unit}} = \frac{1,00,000}{140} = 714.285 \text{ units}$$

(b) (i) Computation of Expected Return from Portfolio

Security	Beta (β)	Expected Return (r) as per CAPM	Amount (Rs. Lakhs)	Weights (w)	wr
Moderate	0.50	$8\% + 0.50(10\% - 8\%) = 9\%$	60	0.115	1.035
Better	1.00	$8\% + 1.00(10\% - 8\%) = 10\%$	80	0.154	1.540
Good	0.80	$8\% + 0.80(10\% - 8\%) = 9.60\%$	100	0.192	1.843
Very Good	1.20	$8\% + 1.20(10\% - 8\%) = 10.40\%$	120	0.231	2.402
Best	1.50	$8\% + 1.50(10\% - 8\%) = 11\%$	160	0.308	3.388
Total			520	1	10.208

Thus Expected Return from Portfolio 10.208% say 10.21%.

- (ii) As computed above the expected return from Better is 10% same as from Nifty, hence there will be no difference even if the replacement of security is made. The main logic behind this neutrality is that the beta of security 'Better' is 1 which clearly indicates that this security shall yield same return as market return.

6. (a) (i) Receipt under three proposals

- (a) Invoicing in Sterling

$$\text{Invoicing in } \text{£} \text{ will produce} = \frac{\text{€ 4 million}}{1.1770} = \text{£}3398471$$

- (b) Use of Forward Contract

$$\text{Forward Rate} = \text{€}1.1770 + 0.0055 = 1.1825$$

Using Forward Market hedge Sterling receipt would be

$$\frac{\text{€ 4 million}}{1.1825} = \text{£} 3382664$$

- (c) Use of Future Contract

The equivalent sterling of the order placed based on future price

$$(\text{€}1.1760) = \frac{\text{€}4.00\text{million}}{1.1760} = \text{£} 3401360$$

$$\text{Number of Contracts} = \frac{\text{£}3401360}{62,500} = 54 \text{ Contracts (to the nearest whole number)}$$

$$\begin{aligned} \text{Thus, € amount hedged by future contract will be} &= 54 \times \text{£}62,500 \\ &= \text{£}3375000 \end{aligned}$$

$$\text{Buy Future at} \quad \text{€}1.1760$$

$$\text{Sell Future at} \quad \text{€}1.1785$$

$$\underline{\text{€}0.0025}$$

$$\text{Total profit on Future Contracts} = 54 \times \text{£}62,500 \times \text{€}0.0025 = \text{€}8438$$

After 6 months

$$\text{Amount Received} \quad \text{€}4000000$$

$$\text{Add: Profit on Future Contracts} \quad \text{€} \quad \underline{8438}$$

$$\text{€} \quad \underline{\underline{4008438}}$$

Sterling Receipts

$$\text{On sale of € at spot} = \frac{€4008438}{1.1785} = €3401305$$

- (ii) Proposal of option (c) is preferable because the option (a) & (b) produces least receipts.

Alternative solution:

Assuming that 6 month forward premium is considered as discount, because generally premium is mentioned in ascending order and discount is mentioned in descending order.

(i) Receipt under three proposals

- (a) Invoicing in Sterling

$$\text{Invoicing in £ will produce} = \frac{€4 \text{ million}}{1.1770} = £3398471$$

- (b) Use of Forward Contract

$$\text{Forward Rate} = €1.1770 - 0.0055 = 1.1715$$

$$\begin{aligned} \text{Using Forward Market hedge Sterling receipt would be} &= \frac{€4 \text{ million}}{1.1715} \\ &= £3414426 \end{aligned}$$

- (c) Use of Future Contract

The equivalent sterling of the order placed based on future price

$$(€1.1760) = \frac{€4.00 \text{ million}}{1.1760} = £3401360$$

$$\begin{aligned} \text{Number of Contracts} &= \frac{£3401360}{62,500} = 54 \text{ Contracts (to the nearest whole} \\ &\text{number)} \end{aligned}$$

$$\begin{aligned} \text{Thus, € amount hedged by future contract will be} &= 54 \times £62,500 \\ &= £3375000 \end{aligned}$$

Buy Future at	€1.1760
Sell Future at	<u>€1.1785</u>
	<u>€0.0025</u>

Total profit on Future Contracts = $54 \times £62,500 \times €0.0025 = €8438$

After 6 months

Amount Received € 4000000

Add: Profit on Future Contracts € 8438

€ 4008438

Sterling Receipts

On sale of € at spot = $\frac{€4008438}{1.1785} = €3401305$

- (ii) Proposal of option (b) is preferable because the option (a) & (c) produces least receipts.

(b)

Business Segment	Capital-to-Sales	Segment Sales	Theoretical Values
Wholesale	0.85	€225000	€191250
Retail	1.2	€720000	€864000
General	0.8	€2500000	<u>€2000000</u>
Total value			<u>€3055250</u>

Business Segment	Capital-to-Assets	Segment Assets	Theoretical Values
Wholesale	0.7	€600000	€420000
Retail	0.7	€500000	€350000
General	0.7	€4000000	<u>€2800000</u>
Total value			<u>€3570000</u>

Business Segment	Capital-to-Operating Income	Operating Income	Theoretical Values
Wholesale	9	€75000	€675000
Retail	8	€150000	€1200000
General	4	€700000	<u>€2800000</u>
Total value			<u>€4675000</u>

Average theoretical value = $\frac{3055250 + 3570000 + 4675000}{3} = 3766750$

Average theoretical value of Cranberry Ltd. = €3766750

7. (a) The success of any business is measured in financial terms. Maximising value to the shareholders is the ultimate objective. For this to happen, at every stage of its operations including policy-making, the firm should be taking strategic steps with value-maximization objective. This is the basis of financial policy being linked to strategic management.

The linkage can be clearly seen in respect of many business decisions. For example :

- (i) Manner of raising capital as source of finance and capital structure are the most important dimensions of strategic plan.
- (ii) Cut-off rate (opportunity cost of capital) for acceptance of investment decisions.
- (iii) Investment and fund allocation is another important dimension of interface of strategic management and financial policy.
- (iv) Foreign Exchange exposure and risk management.
- (v) Liquidity management
- (vi) A dividend policy decision deals with the extent of earnings to be distributed and a close interface is needed to frame the policy so that the policy should be beneficial for all.
- (vii) Issue of bonus share is another dimension involving the strategic decision.

Thus from above discussions it can be said that financial policy of a company cannot be worked out in isolation to other functional policies. It has a wider appeal and closer link with the overall organizational performance and direction of growth.

- (b) Under this system, the securities (shares, debentures, bonds, Government Securities, MF units etc.) are held in electronic form just like cash in a bank account. To speed up the transfer mechanism of securities from sale, purchase, transmission, SEBI introduced Depository Services also known as Dematerialization of listed securities. It is the process by which certificates held by investors in physical form are converted to an equivalent number of securities in electronic form. The securities are credited to the investor's account maintained through an intermediary called Depository Participant (DP). Shares/Securities once dematerialized lose their independent identities. Separate numbers are allotted for such dematerialized securities. Organization holding securities of investors in electronic form and which renders services related to transactions in securities is called a Depository. A depository holds securities in an account, transfers securities from one account holder to another without the investors having to handle these in their physical form. The depository is a safe keeper of securities for and on behalf of the investors. All corporate benefits such as Dividends, Bonus, Rights etc. are issued to security holders as were used to be issued in case of physical form.

- (c) Inspired by the Dow Theory and by observations found throughout nature, Ralph Elliot formulated Elliot Wave Theory in 1934. This theory was based on analysis of 75 years stock price movements and charts. From his studies, he defined price movements in terms of waves. Accordingly, this theory was named Elliot Wave Theory. Elliot found that the markets exhibited certain repeated patterns or waves. As per this theory wave is a movement of the market price from one change in the direction to the next change in the same direction. These waves are resulted from buying and selling impulses emerging from the demand and supply pressures on the market. Depending on the demand and supply pressures, waves are generated in the prices.

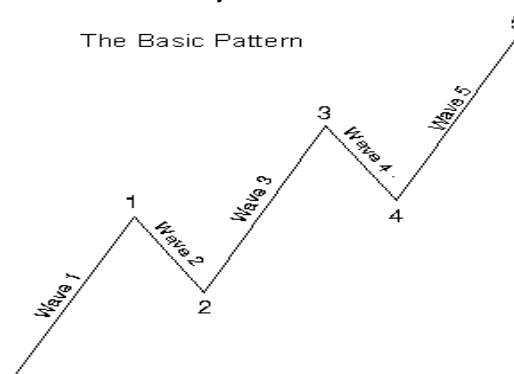
As per this theory, waves can be classified into two parts:-

- Impulsive patterns
- Corrective patterns

Let us discuss each of these patterns.

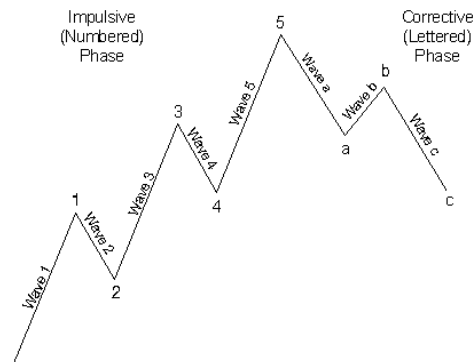
- (i) **Impulsive Patterns-(Basic Waves)** - In this pattern there will be 3 or 5 waves in a given direction (going upward or downward). These waves shall move in the direction of the basic movement. This movement can indicate bull phase or bear phase.
- (ii) **Corrective Patterns- (Reaction Waves)** - These 3 waves are against the basic direction of the basic movement. Correction involves correcting the earlier rise in case of bull market and fall in case of bear market.

As shown in the following diagram waves 1, 3 and 5 are directional movements, which are separated or corrected by wave 2 & 4, termed as corrective movements.



Source: <http://elliottwave.net/>

Complete Cycle - As shown in following figure five-wave impulses is following by a three-wave correction (a,b & c) to form a complete cycle of eight waves.



Source: <http://elliottwave.net/>

One complete cycle consists of waves made up of two distinct phases, bullish and bearish. On completion of full one cycle i.e. termination of 8 waves movement, the fresh cycle starts with similar impulses arising out of market trading.

- (d) It is a technique of optimising cash flow movements with the combined efforts of the subsidiaries thereby reducing administrative and transaction costs resulting from currency conversion. There is a co-ordinated international interchange of materials, finished products and parts among the different units of MNC with many subsidiaries buying /selling from/to each other. Netting helps in minimising the total volume of inter-company fund flow.

Advantages derived from netting system includes:

- (1) Reduces the number of cross-border transactions between subsidiaries thereby decreasing the overall administrative costs of such cash transfers
 - (2) Reduces the need for foreign exchange conversion and hence decreases transaction costs associated with foreign exchange conversion.
 - (3) Improves cash flow forecasting since net cash transfers are made at the end of each period
 - (4) Gives an accurate report and settles accounts through co-ordinated efforts among all subsidiaries.
- (e) Equity Curve out can be defined as partial spin off in which a company creates its own new subsidiary and subsequently bring out its IPO. It should be however noted that parent company retains its control and only a part of new shares are issued to public.

On the other hand in Spin off parent company does not receive any cash as shares of subsidiary company are issued to existing shareholder in the form of dividend. Thus, shareholders in new company remain the same but not in case of Equity curve out.

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

Question No. 1 is compulsory.

*Attempt any **five** questions from the Rest.*

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) While auditing a lawyer company, Mr. X, the statutory auditor of the company, was unable to get the confirmation about the existence and value of certain books existed in the library worth Rs. 35 lakh. However, the management gave him a certificate to prove the existence and value of the books as appearing in the books of account. The auditor accepted the same without any further procedure and signed the audit report. Is he right in his approach?
- (b) CA. X has been appointed as an auditor of ABC Ltd. for the financial year 2015-16 which was audited by CA. Y in 2014-15. As the Auditor of ABC Ltd., state the steps that CA. X would take to ensure that the Closing Balances of the financial year 2014-15 have been brought to account in 2015-16 as Opening Balances and the Opening Balances do not contain any misstatements.
- (c) As an auditor of XYZ Ltd., Mr. A applied the concept of materiality for the financial statements as a whole. On the basis of obtaining additional information of significant contractual arrangements that draw attention to a particular aspect of a company's business, he wants to re-evaluate the materiality concept. Please, guide him.
- (d) As an auditor of garment manufacturing company for the last five years you have observed that new venture of online shopping has been added by the company during current year. As an auditor what specific factors for online shopping would be considered by you in formulating the audit strategy of the company? (5 × 4 = 20 Marks)
2. (a) Yamma Co. Ltd. has five entertainment centers to provide recreational facilities for public especially for children and youngsters at 5 different locations in the peripheral of 250 kilometers. Collections are made in cash. Specify the adequate system towards sale of tickets and collection of money. (4 Marks)
- (b) In the course of audit of Kishan Ltd. for the financial year 2015-16, its auditor M/s Zen & Co. observed that the management has passed certain forged transactions against the company amounting to Rs. 50 lakh at the year end. Suspecting fraud, the auditors requested explanations and documentary supportings, for which the management remained silent. You are required to guide the auditor of the company stating the fraud reporting requirements as provided under the Companies Act, 2013. (6 Marks)

- (c) While auditing in a Computerised Information System (CIS) Environment, the reliability of a component is a function of control that acts on the component. There are certain types of controls used to enhance component reliability which the auditor must evaluate. You are required to briefly explain those controls. (6 Marks)
3. (a) "Permanent Consolidation Adjustments are made only on the first occasion of the preparation and presentation of consolidated financial statements". What are the Permanent Consolidation Adjustments? Explain the role of auditor in this context. (6 Marks)
- (b) Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry into certain specific areas which the auditor needs to examine from propriety angle also. You are required to enumerate those areas of propriety audit under section 143(1) of the Companies Act, 2013. (6 Marks)
- (c) Ansh Pvt. Ltd. is a private limited company, not being a subsidiary or holding company of a public company, having fully paid capital and reserves and surplus of Rs. 50 lakh. During the financial year, the company had borrowed Rs. 80 lakh from a financial institution. It has the revenue of Rs. 8 crore from normal operations and Rs. 3 crore from discontinuing operations as disclosed in Scheduled III to the Companies Act, 2013. Will Companies (Auditor's Report) Order, 2016 (CARO, 2016) be applicable to Ansh Pvt. Ltd.? (4 Marks)
4. (a) While auditing Zindagi Insurance Ltd., you observed that the major proportion of expense of the company is the remuneration/commission paid to its insurance agents. As the auditor of the company, what audit procedure would you adopt for verification of such expense? (5 Marks)
- (b) Energy shortage and the cost of environmental quality control have made the use of energy very costly to many industrial establishments which encouraged Green Ltd. to opt for energy audit being first step of any energy management programmes.
- The management of the company consults you to guide regarding key functions of the energy auditor so that the management may appoint the same for the company. (6 Marks)
- (c) Alloy Ltd. appointed you as the tax auditor for the financial year 2015-16. The company made payment of 2 invoices of Rs. 19,000 each in cash to Mr. Zuke on 5th July, 2015 and 6th July, 2015 respectively on account of leasing of goods carriage. How would you deal with the matter in your tax audit report? (5 Marks)
5. (a) Raksha Ltd., a company engaged in manufacturing of chemicals is consistently recording higher sales turnover, but declining net profits since the last 5 years. As an investigator appointed to find out the reasons for the same, what are the points you would verify? (6 Marks)
- (b) "An asset, including a leased asset, becomes non-performing when it ceases to generate income for the Bank." Discuss the criteria for classification of non-performing assets. (6 Marks)

- (c) Review of the internal audit function in specified companies has become a statutory responsibility for the statutory auditor. This general evaluation assists him in determining the extent to which he can place reliance upon the work of the internal auditor.

In view of the above, you are required to state the factors that should be taken into account while reviewing the internal auditor's work? (4 Marks)

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

- (a) CA. Rajan, in practice, was appointed to carry out internal audit of a stock broker, listed with DSE. However, he failed to communicate his appointment to the statutory auditors of the company. The statutory auditors feel this is violation of professional code of ethics.
- (b) CA. Roshan, in practice, was requested by one of his client to examine and report prospective financial information prepared for next five years. CA. Roshan after having examined the same stated in his report that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same.
- (c) M/s Soni Mittal & Co., a firm of Chartered Accountants, received Rs. 60,000 in March, 2016 from a client to pay the Advance Tax. However, the firm used that money for its own purpose and later on adjusted the same with the outstanding fee payable.
- (d) CA. Manoj and CA. Saroj are two partners of the firm 'M/s Manoj Saroj and Associates'. Being very pious, CA. Manoj organised a religious ceremony at his home for which he instructed his printing agent to add his designation "Chartered Accountant" with his name in the invitation cards. Later on, the invitations were distributed to all the relatives, close friends and clients of both the partners.

(4 × 4 = 16 Marks)

7. Write short notes on **any four** of the following:

- (a) Block selection.
- (b) True and Fair Cost of Production.
- (c) Classification of frauds by NBFC.
- (d) Collection of Evidence by Peer Reviewer.
- (e) Types of Companies required to constitute Audit Committee under section 177 of the Companies Act, 2013

(4 × 4 = 16 Marks)

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS

SUGGESTED ANSWERS/HINTS

1. (a) **Validity of Written Representation:** The physical verification of Assets is the primary responsibility of the management. The auditor, however, is required to examine the verification programme adopted by the management. He must satisfy himself about the existence, ownership and valuation of Assets. In the given case of audit of a lawyer company, the auditor has not been able to verify the existence and value of some books despite the verification procedure followed in routine audit. He accepted the certificate given to him by the management without making any further enquiry.

As per SA 580 “Written Representations”, when representation relate to matters which are material to the financial information, then the auditor should seek corroborative audit evidence for other sources inside or outside the entity.

He should evaluate whether such representations are reasonable and consistent with other evidences and should consider whether individuals making such representations can be expected to be well informed on the matter. “Written Representations” cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available.

If the auditor is unable to obtain sufficient appropriate audit evidence that he believes would be available regarding a matter which has or may have a material effect on the financial information, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter. Therefore, the approach adopted by the auditor is not right.

- (b) **Obtaining sufficient appropriate audit evidence while conducting Initial Audit Engagement:** According to SA 510 on “Initial Audit Engagements- Opening Balances”, the objective of the Auditor while conducting an initial audit engagement with respect to opening balances is to obtain sufficient appropriate audit evidence so that the-

- (i) opening balances of the preceding period have been correctly brought forward to the current period;
- (ii) opening balances do not contain any misstatement that materially affect the current period's financial statements; and
- (iii) appropriate accounting policies reflected in the opening balances have been

consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Being a new assignment, audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection/ payment of opening accounts receivable/ accounts payable during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In respect of other assets and liabilities such as property plant and equipment, investments, long term debts, the auditor will examine the records relating to opening balances. The auditor may also be able to get the confirmation from third parties (e.g., balances of long term loan obtained from banks can be confirmed from the Bank Loan statement).

- (c) **Re-evaluation of the Materiality Concept:** In the instant case, Mr. A, as an auditor of XYZ Ltd. has applied the concept of materiality for the financial statements as a whole. But he wants to re-evaluate the materiality concept on the basis of additional information of significant contractual arrangements which draws attention to a particular aspect of the company's business.

As per SA 320 "Materiality in Planning and Performing an Audit", while establishing the overall audit strategy, the auditor shall determine materiality for the financial statement as a whole. He should set the benchmark on the basis of which he performs his audit procedure. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall revise materiality for the financial statements in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.

If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

Thus, Mr. A can re-evaluate the materiality concepts after considering the necessity of such revision.

- (d) **Formulation of Audit Strategy:** The auditor shall obtain an understanding of the information system including the related business processes due to new venture of online shopping in the following areas-
- (i) The classes of transactions in the entity's operations that are significant to the financial statements;
 - (ii) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
 - (iii) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;
 - (iv) How the information system captures events and conditions, other than transactions, that are significant to the financial statements;
 - (v) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.
2. (a) **Control System Over Selling and Collection of Tickets:** In order to achieve proper internal control over the sale of tickets and its collection by the Yamma Co. Ltd., following system should be adopted -
- (i) **Printing of tickets:** Serially numbered pre-printed tickets should be used and designed in such a way that any type of ticket used cannot be duplicated by others in order to avoid forgery. Serial numbers should not be repeated during a reasonable period, say a month or year depending on the turnover. The separate series of the serial should be used for such denomination.
 - (ii) **Ticket sales:** The sale of tickets should take place from the Central ticket office at each of the 5 centres, preferably through machines. There should be proper control over the keys of the machines.
 - (iii) **Daily cash reconciliation:** Cash collection at each office and machine should be reconciled with the number of tickets sold. Serial number of tickets for each entertainment activity/denomination will facilitate the reconciliation.
 - (iv) **Daily banking:** Each day's collection should be deposited in the bank on next working day of the bank. Till that time, the cash should be in the custody of properly authorized person preferably in joint custody for which the daily cash in hand report should be signed by the authorized persons.
 - (v) **Entrance ticket:** Entrance tickets should be cancelled at the entrance gate when public enters the centre.

- (vi) **Advance booking:** If advance booking of facility is made available, the system should ensure that all advance booked tickets are paid for.
- (vii) **Discounts and free pass:** The discount policy of the Yamma Co. Ltd. should be such that the concessional rates, say, for group booking should be properly authorized and signed forms for such authorization should be preserved.
- (viii) **Surprise checks:** Internal audit system should carry out periodic surprise checks for cash counts, daily banking, reconciliation and stock of unsold tickets etc.

(b) Auditor's Responsibilities Relating to Fraud under the Companies Act, 2013:

As per section 143(12) of the Companies Act, 2013, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving lesser than Rs. 1 crore, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

In this regard, the Companies (Audit and Auditors) Rules, 2014 states that in case of a fraud involving lesser than Rs. 1 crore, the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:

- (a) Nature of Fraud with description;
- (b) Approximate amount involved; and
- (c) Parties involved.

The section 143(12) of the said Act further prescribes that the companies, whose auditors have reported frauds under this sub-section (12) to the audit committee or the Board, but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

In this regard, the Companies (Audit and Auditors) Rules, 2014 states that the company is required to disclose in the Board's Report the following details of each of the fraud reported to the Audit Committee or the Board during the year:

- (a) Nature of Fraud with description;
- (b) Approximate Amount involved;
- (c) Parties involved, if remedial action not taken; and
- (d) Remedial actions taken.

Furthermore, the auditor is also required to report as per Clause (x) of Paragraph 3 of Companies (Auditor's Report) Order, 2016, whether any fraud by the company or

any fraud on the Company by its officers or employees has been noticed or reported during the year. The nature and the amount involved are to be indicated.

In the given case, M/s Zen & Co, the auditor of the company, observed certain forged transactions amounting to Rs. 50 lakh for which no explanation received from the management.

Therefore, M/s Zen & Co. is required to report the same to the Board or Audit Committee and in the Board's Report along with reporting under CARO, 2016 complying the fraud reporting requirements as explained above.

- (c) The reliability of a component is a function of control that acts on the component. In a Computerised Information System (CIS) Environment, the following are the major types of controls used to enhance component reliability which the auditor must evaluate:
- (i) **Authenticity Control:** They are exercised to verify the identity of the individuals or process involved in a system. (Pass word, digital signature etc.)
 - (ii) **Accuracy Control:** These attempts to ensure the correctness of the data and processes in a system (Programme validation check).
 - (iii) **Completeness Control:** This ensures that no data is missing and all processing is carried through to its proper conclusion.
 - (iv) **Privacy Control:** This ensures the protection of data from inadvertent or unauthorised disclosure.
 - (v) **Audit Trail Controls:** This ensures the traceability of all events occurred in a system.
 - (vi) **Redundancy Control:** It ensures that processing of data is done only once.
 - (vii) **Existence Control:** It attempts to ensure the on-going availability of all system resources.
 - (viii) **Asset safeguarding controls:** It attempts to ensure that all resources within a system are protected from destruction or corruption.
 - (ix) **Effectiveness Control:** It attempts to ensure that the system achieves its goals.
 - (x) **Efficiency Control:** It attempts to ensure that a system uses minimum resources to achieve its goals.
3. (a) **Permanent Consolidation Adjustments:** Permanent consolidation adjustments are those adjustments that are made only on the first occasion of the preparation and presentation of consolidated financial statements. Permanent consolidation adjustments are-
- (i) determination of excess or deficit of the cost to the parent of its investment in a

subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made (determination of goodwill or capital reserve);

- (ii) determination of the amount of equity attributable to minorities at the date on which investment in subsidiary is made; and
- (iii) determination of goodwill or capital reserve arising on application of equity method to account for investments in associates in consolidated financial statements.

Role of Auditor – Verification Procedure:

- (i) The auditor should verify that the above calculations have been made appropriately.
 - (ii) The auditor should pay particular attention to the determination of pre-acquisition reserves of the subsidiary and associates. Date(s) of investment in subsidiary and associates assumes importance in this regard.
 - (iii) The auditor should also examine whether the pre-acquisition reserves have been allocated appropriately between the parent and the minorities of the subsidiary.
 - (iv) The auditor should also verify the changes that might have taken place in these permanent adjustments on account of subsequent acquisition of shares in the subsidiary/ associates, disposal of the subsidiary/associate in the subsequent years.
 - (v) The auditor should also examine the joint venture agreements, to establish whether any change has taken place in the interest of the parent in the joint venture.
 - (vi) It may happen that in the case of one subsidiary, goodwill arises and in the case of another subsidiary a capital reserve arises. The parent may choose to net off these amounts to disclose a single amount in the consolidated balance sheet. In such cases, the auditor should verify that the gross amounts of goodwill and capital reserves arising on acquisition of various subsidiaries have been disclosed in the notes to the consolidated financial statements to reflect the excess/shortage over the parents' portion of the subsidiary's equity.
- (b) **Areas of Propriety Audit:** Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry into certain specific areas. In some of the areas, the auditor has to examine the same from propriety angle as to -
- (i) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

- (ii) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company; Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made;
- (iii) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
- (iv) whether loans and advances made by the company have been shown as deposits;
- (v) whether personal expenses have been charged to revenue account;
- (vi) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

A control has been set up to verify the receipt of cash in case of allotment of shares for cash. Further, if cash is not received, the books of accounts and statement of affairs shows the true picture.

- (c) **Applicability of CARO, 2016:** The CARO, 2016 specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than Rs. 1 crore as on the balance sheet date and which does not have total borrowings exceeding Rs. 1 crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding Rs. 10 crore during the financial year as per the financial statements.

In the given case, Ansh Pvt. Ltd. is a private limited company, not being a subsidiary or holding company of a public company. It has paid capital and reserves and surplus of Rs. 50 lakh i.e. less than Rs. 1 crore, outstanding loan of Rs. 80 lakh i.e. less than Rs. 1 crore. However, it has total revenue of Rs. 11 crore (Rs. 8 crore from normal operations + Rs. 3 crore from discontinuing operations) i.e. exceeding Rs. 10 crore as disclosed in Scheduled III to the Companies Act, 2013.

Therefore, it fails to fulfill the condition relating to total revenue. Thus, CARO, 2016 will be applicable to Ansh Pvt. Ltd. accordingly.

- 4. (a) **Commission Paid to Insurance Agents:** It is a well-known fact that insurance business is solicited by insurance agents. The remuneration of an agent is paid by way of commission which is calculated by applying a percentage to the premium collected by him. Commission is payable to the agents for the business procured

through them and is debited to Commission on Direct Business Account. There is a separate head for commission on reinsurance accepted which usually arise in case of Head Office. It may be noted that under section 40 of Insurance Act, 1938, no commission can be paid to a person who is not an agent or intermediary of the insurance company.

The auditor should, inter alia, do the following for verification of commission-

- (i) Vouch disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements.
- (ii) Check whether the vouchers are authorised by the officers-in-charge as per rules in force and income tax is deducted at source, as applicable.
- (iii) Test check correctness of amounts of commission allowed.
- (iv) Scrutinise agents' ledger and the balances, examine accounts having debit balances, if any, and obtain information on the same. Necessary rectification of accounts and other remedial actions have to be considered.
- (v) Check whether commission outgo for the period under audit been duly accounted.

(b) Key functions of Energy Auditor: Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities. In that context, energy management involves the basis approaches reducing avoidable losses, improving the effectiveness of energy use, and increasing energy use efficiency. The function of an energy auditor could be compared with that of a financial auditor. The energy auditor is normally expected to give recommendations on efficiency improvements leading to monetary benefits and also advise on energy management issues. Generally, energy auditor for the industry is an external party. The following are some of the key functions of the energy auditor:

- (i) Quantify energy costs and quantities.
- (ii) Correlate trends of production or activity to energy costs.
- (iii) Devise energy database formats to ensure they depict the correct picture – by product, department, consumer, etc.
- (iv) Advise and check the compliance of the organisation for policy and regulation aspects.
- (v) Highlight areas that need attention for detailed investigations.
- (vi) Conduct preliminary and detailed energy audits which should include the following:
 - (a) Data collection and analysis.

- (b) Measurements, mass and energy balances.
- (c) Reviewing energy procurement practices.
- (d) Identification of energy efficiency projects and techno-economic evaluation.
- (e) Establishing action plan including energy saving targets, staffing requirements, implementation time requirements, procurement issues, details and cost estimates.
- (f) Recommendations on goal setting for energy saving, record keeping, reporting and energy accounting, organisation requirements, communications and public relations.

- (c) **Reporting of Payments Exceeding Rs. 35,000 in Cash:** Disallowance under section 40A(3) of the Income Tax Act, 1961 is attracted if the assessee incurs any expenses in respect of which payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on bank or account payee draft, exceeds ₹ 20,000. However, in case of payment made for plying, hiring or leasing of goods carriage, limit is ₹ 35,000 instead of ₹ 20,000.

However, exemption is provided under Rule 6DD having regard to nature and extent of banking facilities available and other relevant factors.

Subsequently, under clause 21(d)(A) of Form 3CD, the tax auditor has to scrutinize on the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, the same has to be reported under abovementioned clause.

In the given case, Alloy Ltd. has made payment of 2 invoices of Rs. 19,000 each in cash to Mr. Zuke on 5th July, 2015 and 6th July, 2015 respectively on account of leasing of goods carriage aggregating Rs. 38,000.

Therefore, as per the provisions and explanations discussed above, the said payment need not be reported as the payments do not exceed Rs. 35,000 in a day.

5. (a) **Investigation for Higher Sales Turnover but Declining Net Profits:** As per the facts that there has been consistently high turnover but declining net profits is an anomalous situation. It may be attributed to one or more following reasons requiring further investigation-
- (i) **Unfavourable Sales mix** - Where the company sells different chemical products with different product margins, the product with the maximum PV ratio/margin should have a higher share in the total sales. If due to revision of sales mix, more quantities of unprofitable products are sold, profits will be reduced in spite of an increase in sales.

- (ii) **Negative Impact of Financial Leverage** - Where the company does not have sufficient own funds (equity) but has a higher debt-equity ratio, the interest commitments will be higher. As the volume of its operation increases, higher debt and interest charges would result in lower profits.
 - (iii) **Other Items Included in Sales** - The figure of sales as per Profit and Loss Account may include incidental revenues, e.g., freight, excise duty, sales-tax, etc. where the amount of excise duty goes up considerably the total sales may show an increase which is not represented by a real increase in sales quantity/value.
 - (iv) **High Administrative and Selling Expenses** - Administrative and selling costs are generally period costs which are fixed in nature. Their increase is generally not proportional to sale increase. However, a reduction in profit could also be due to increase in administrative overheads and sales overheads at a rate higher than the rate of increase in sales.
 - (v) **Cost-Price Relationship** - If the increases in cost of raw materials and labour has not been compensated by a corresponding increase in the sales price this would also result in higher sales and declining profits. In spite of same sales quantity, for the increasing cost of raw materials and other services, per unit values of the product has been increased which is however unmatched by the increase in cost.
 - (vi) **Competitive Price** - Where sales have been made at cut-throat prices in order to eliminate competition from the market, the profits would be in the declining trend in the short-run.
 - (vii) **Additions to Fixed Assets** - Where there are heavy additions to fixed assets and consequent depreciation charges in the initial years of additions, there may be reduction in profits in spite of increased sales.
- (b) **Classification of Non-Performing Assets:** An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank.
- The following criteria are to be applied for determining the status of various types of credit facilities:
- (i) **Term Loans:** A term loan is treated as a non-performing asset (NPA) if interest and/or instalment of principal remain overdue for a period of more than 90 days.
 - (ii) **Cash Credits and Overdrafts:** A cash credit or overdraft account is treated as NPA if it remains out of order as indicated above.
 - (iii) **Bills Purchased and Discounted:** Bills purchased and discounted are treated as NPA if they remain overdue and unpaid for a period of more than 90 days.
 - (iv) **Securitisation:** The asset is to be treated as NPA if the amount of liquidity

facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation.

- (v) **Agricultural Advances:** A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons and, a loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.
 - (vi) **Credit Card Accounts:** RBI vide its Circular on “Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Credit Card Accounts” advised that a credit card account will be treated as non-performing asset if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the next statement date. The gap between two statements should not be more than a month.
- (c) **Review of Internal Audit Function:** The external auditor’s general evaluation of the internal audit function will assist him in determining the extent to which he can place reliance upon the work of the internal auditor. The external auditor should document his evaluation and conclusions in this respect. He should review the internal auditor’s work, taking into account the following factors -
- (i) The scope of work and related audit programme are adequate for the external auditor’s purpose.
 - (ii) The work is properly planned and the work of assistants is properly supervised, reviewed, and documented.
 - (iii) Sufficient appropriate evidence is obtained to afford a reasonable basis for conclusions reached.
 - (iv) Conclusions reached are appropriate in the circumstances and any reports prepared are consistent with the results of the work performed.
 - (v) Any exceptions or unusual matters are disclosed by the internal auditor’s procedures. The external auditor should document his conclusions in respect of the specific work which he has reviewed.

The external auditor should also test the work of the internal auditor on which he intends to rely. The nature, timing and extent of the external auditor’s tests will depend upon his judgement as to the materiality of the area concerned to the financial statements taken as a whole and the results of his evaluation of the internal audit function and of the specific internal audit work. His tests may include examination of items already examined by the internal auditor, examination of other similar items, and observation of the internal auditor’s procedure.

Finally, in India even the statute has now recognised that internal audit is necessary for efficient running of companies. Thus a review of the internal audit function in specified companies has become a statutory responsibility for the statutory auditor.

6. (a) **Communication with the Previous Auditor:** As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct, if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been Issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

This clause is applicable in situation of replacing of one auditor by another auditor. Internal auditor and statutory auditor are parallel positions and not replacement positions. The management generally appoints the internal auditor whereas the statutory auditor will be appointed by the shareholders in the AGM. In this situation there is no need for communication by one to other.

In the given case, CA. Rajan, the internal auditor has not communicated his appointment to the statutory auditors of the company.

In view of above, the contention of the statutory auditor is unacceptable and there is no question of communicating in writing by CA. Rajan.

- (b) **Certification of Financial Forecast:** As per Clause (3) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast.

Further, SAE 3400 "The Examination of Prospective Financial Information", provides that the management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes. Thus, while making report on projection, the auditor need to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same.

In the instant case, CA. Roshan after having examined the projections for next five years stated in his report that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the

projections, therefore, he does not vouch for the accuracy of the same. Therefore, there is no violation of the Chartered Accountants Act, 1949 and its Regulations.

- (c) **Money of Clients to be Deposited in Separate Bank Account:** Clause (10) of Part I of Second Schedule to the Chartered Accountant Act, 1949 states that a Chartered Accountant shall be deemed to be guilty of professional misconduct if he fails to keep money of his clients other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

In the given case, M/s Soni Mittal & Co. received Rs. 60,000 in March, 2016 from a client for payment of the advance tax, hence, it should be deposited in a separate bank account. Since in this case M/s Soni Mittal & Co. has failed to keep the sum received on behalf of their client in a separate Bank Account, it amounts to professional misconduct under Clause (10) of Part I of Second Schedule to the Chartered Accountant Act, 1949.

- (d) **Printing of Designation “Chartered Accountant” on Invitations for Religious Ceremony:** As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

However, the Council of the ICAI is of the view that the designation “Chartered Accountant” as well as the name of the firm may be used in greeting cards, invitations for marriages, religious ceremonies and any other specified matters, provided that such greeting cards or invitations etc. are sent only to clients, relatives and close friends of the members concerned.

In the given case, CA. Manoj has instructed to write designation “Chartered Accountant” on invitation cards for a religious ceremony and distributed the same to all the relatives, close friends and clients of both the partners.

In this context, it may be noted that the Council has allowed using designation “Chartered Accountant” in invitations for religious ceremony, provided these are sent to clients, relatives and close friends of the members concerned only.

Therefore, CA. Manoj would be held guilty of professional misconduct under the said clause for sending such invitations to the relatives, close friends and clients of CA. Saroj as well.

7. (a) **Block Selection:** As per SA 530 “Audit Sampling”, block selection method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in

the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

- (b) **True and Fair Cost of Production:** A cost auditor checks the cost accounting records to verify that the cost statements are properly drawn up as per the records and that they present a true and fair view of the cost of production and marketing of various products dealt with by the undertaking. The Companies (Cost Records and Audit) Rules, 2014, prescribe the rules regarding the cost audit report and also prescribes the classes of companies required to include cost records in their books of account, applicability of cost audit, maintenance of records etc. The prescribed format of the report contains assertions regarding whether cost accounting records have been properly kept so as to give a true and fair view of the cost of production/ etc. The provisions of sub-section (12) of section 143 of the Companies Act, 2013 and the relevant rules on duty to report on fraud shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules. In any case, the true and fair concept is known to us in the context of financial accounts. Based on that knowledge, it may be assumed that the following are the relevant considerations in determining whether the cost of production determined is true and fair:
- (i) Determination of cost following the generally accepted cost accounting principles.
 - (ii) Application of the costing system appropriate to the product.
 - (iii) Materiality.
 - (iv) Consistency in the application of costing system and cost accounting principles.
 - (v) Maintenance of cost records and preparation of cost statements in the prescribed form and having the prescribed contents.
 - (vi) Elimination of material prior-period adjustments.
 - (vii) Abnormal wastes and losses and other unusual transactions being ignored in determination of cost.
- (c) **Classification of Frauds by NBFC:** In order to have uniformity in reporting, frauds have been classified as under -
- (i) Misappropriation and criminal breach of trust.
 - (ii) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.
 - (iii) Unauthorised credit facilities extended for reward or for illegal gratification.

- (iv) Negligence and cash shortages.
- (v) Cheating and forgery.
- (vi) Irregularities in foreign exchange transactions.
- (vii) Any other type of fraud not coming under the specific heads as above.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (iv) and (v) above are to be reported as fraud if the intention to cheat/ defraud is suspected/ proved. However, the following cases where fraudulent intention is not suspected/ proved, at the time of detection, will be treated as fraud and reported accordingly:

- (i) cases of cash shortages more than Rs. 10,000/- and
- (ii) cases of cash shortages more than Rs. 5000/- if detected by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash.

NBFCs having overseas branches/offices should report all frauds perpetrated at such branches/offices also to the Reserve Bank as per the prescribed format and procedures.

(d) Collection of Evidence by Peer Reviewer: A Peer Reviewer collects evidence by applying the following methods-

- (i) Inspection mainly consists of examination of documentation (working papers) and other records maintained by the practice unit.
- (ii) Observation consists of witnessing a procedure or process being performed by others. For example, while conducting on-site review, the reviewer may review the performance of internal control.
- (iii) Inquiry consists of seeking appropriate information from the partner (designated by the practice unit for the purpose)/sole proprietor or other knowledgeable persons within the practice unit. The inquiries may originate from the responses to the questions given in the questionnaire. The inquiries may also arise from the inspection of documentation maintained by the practice unit.

While observation and inquiry may be considered as external independent sources of review evidence, inspection remains the most significant method for confirming the effective observance of control procedures in the practice unit. Observation and inquiry may also corroborate the evidence provided by inspection. The reviewer, in order to carry out the review effectively, should have an understanding of the documentation maintained by the practice unit.

(e) Constitution of Audit Committee: As per the section 177 of the Companies Act, 2013, every listed company and the following classes of companies shall constitute

an Audit Committee -

- (i) all public companies with a paid up capital of ten crore rupees or more;
- (ii) all public companies having turnover of one hundred crore rupees or more;
- (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 4 : CORPORATE AND ALLIED LAWS

Question No.1 is compulsory.

*Attempt any **five** questions from the remaining **six** Questions.*

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) Fortune Limited is facing loss in business during the current financial year 2016-17. In the immediate preceding three financial years, the company had declared dividend at the rate of 10%, 15% and 20% respectively. To maintain the reputation of the company, the Board of Directors has decided to declare 20% interim dividend for the current financial year.

Examining the relevant provisions of the Companies Act, 2013, state whether the decision of the Board of Directors of Fortune Limited is tenable? (6 Marks)

- (b) The Board of Directors of Vidhyut Nigam Limited consists of Mr. X, Mr. Y and Mr. Z. Mr. X and Mr. Y are Directors and Mr. Z is Managing Director in the Board. The company has also employed Mr. F as the Chief Financial Officer.

The Profit and Loss Account and Balance Sheet of the company were signed by Mr. X and Mr. Y. Examine whether the authentication of financial statements of the company was in accordance with the provisions of the Companies Act, 2013?

(6 Marks)

- (c) A section of complainants have suspected that Mr. Sathiya, who is a member of the Securities and Exchange Board of India (SEBI) has monetary interest in some of the cases that came up before the Board. Also he embezzled his position and therefore, he should be removed from his office. Considering the provisions of the Securities and Exchange Board of India Act, 1992, guide the complainants what steps they can take in the respective situation. (4 Marks)

- (d) Mr. Beginner, a newly entered investor in the field of securities business seeks your advice on the investments to be made in securities of large Companies for long term purposes. With this object in view, he wants to know the meaning of the following terms commonly used in any stock exchange. Advise suitably.

- (i) Derivative
- (ii) Option in securities
- (iii) Spot delivery contract.

(4 Marks)

2. (a) (i) Mr. X, an auditor of the company, to be retired in the coming Annual General Meeting. Board of directors of the company fails to appoint any auditor in the said meeting. Even Members did not find any person competent to be so appointed as an auditor in place of retiring auditor. Decide in the light of the Companies Act, 2013, what shall be the consequences of such situation.
(4 Marks)
- (ii) Mr. Competent is the managing director of victory Ltd. Being satisfied with his caliber and track record, the Board of Directors of Growth Limited decided to appoint him as the managing Director of the company. Mr. Competent has agreed to the proposal to be appointed as the managing director of Growth Ltd. but subject to the condition that he will continue to be the managing director of Victory Ltd. Being the Company secretary of Growth Limited, discuss the steps to be taken in this regard referring to the applicable provisions of the Companies Act, 2013.
(4 Marks)
- (b) (i) An Unlisted Public Company, having a paid-up equity share capital of ₹ 5 Crores consisting of 50,00,000 equity shares of ₹ 10 each fully paid-up, proposes to reduce the denomination of equity shares to less than ₹ 10 Per share and make an initial public offer of equity shares at a premium. Examine whether it is possible for the company to issue shares at a denomination of less than ₹ 10 and, if so, state the minimum issue price and other conditions to be fulfilled under the SEBI (ICDR) Regulations.
(4 Marks)
- (ii) Ally Ltd. is a foreign collaborator in Bharat Ltd. incorporated in India under the Companies Act, 2013. The foreign collaborator holds 49% of the shareholding. The Board meetings of Bharat Ltd are usually held in India and sometimes meetings of the Board are called at a very short notice for which there is a provision in the Articles of Association that during such situations notices of the meetings of the Board can be sent by e-mail. State in this connection, whether such a provision in the Articles of Association of a foreign collaborated company is valid within the purview of the provisions of the Companies Act, 2013.
(4 Marks)
- 3 (a) Answer the following with reference to a scheme of amalgamation of companies explaining the relevant provisions of the Companies Act, 1956:
- (i) Whether companies being amalgamated must be companies registered in India.
- (ii) What is the majority required for approving the scheme of amalgamation in a meeting of members of a company called as per directions of the court? Is the scheme to be approved by preference shareholders?
- (iii) When will the court order dissolution of the transferor company? (8 Marks)

- (b) (i) Mr. Raman of Nagpur wants to travel to Bhutan and for this purpose proposes to draw Foreign Exchange. Specify.
- (1) Can Mr. Raman draw any Foreign Exchange for his journey?
 - (2) What are the purposes for which Foreign Exchange drawal is not allowed for Current Account Transaction? (4 Marks)
- (ii) The Board of directors of Unite Ltd. filled up a casual vacancy caused by the death of Mr. Puri by appointing Mr. Chauhan as a director on 3rd April, 2016. Unfortunately Mr. Chauhan expired on 15th May, 2016 after working about 40 days as a director. The Board now wishes to fill up the casual vacancy by appointing Mrs. Chauhan in the forthcoming meeting of the Board. Advise the Board in this regard as per the provisions under the Companies Act, 2013. (4 Marks)
- 4 (a) 60% shares of Indo-French Ltd. are held by the French group and balance by the Indian group. As per Articles of Association of the company, both groups had equal managerial powers. The relationship between the two groups soured and the operations of the company reached a deadlock. The Indian group approached the Company Law Board (CLB) for action against the French group for oppression as stated in section 397 of the Companies Act, 1956.
- Based on the above said facts, decide the following issues.
- (i) Whether the contention of oppression against the French group by the Indian group is tenable?
 - (ii) What are the powers of CLB in this regard? (8 Marks)
- (b) (i) X, a foreign company registered in UK and carrying on Trading Activity, with Principal Place of Business in Chennai. Since the company did not obtain registration or make arrangement to file Return, the State VAT Officer having jurisdiction, intends to serve show cause notice on the Foreign Company. As Standing Counsel for the department, advise the VAT Officer on valid service of notice. (4 Marks)
- (ii) ABC Ltd. made an initial public offer of certain number of equity shares. Examine whether these shares can be considered as 'Goods' under the Competition Act, 2002 before allotment. (4 Marks)
5. (a) Analyse and Advise with reference to the provisions of the Companies Act, 2013, the following situations.
- (i) There are 9 directors in a company and out of which 2 offices of the directors have fallen vacant. What will be the quorum for the Board Meeting? What if, the company is a non-profit making company.

- (ii) There are 15 directors in a company and during discussion of a particular item, 13 of the directors are said to be 'interested' within the meaning of section 184(2) of the Companies Act, 2013. What shall be quorum of the meeting?

(8 Marks)

- (b) (i) It is apprehended by the Directors of a Public Company that they are likely to be prosecuted for an offence under the Companies Act, 2013 which is not compoundable. Explain the provisions of the Companies Act, 2013 under which the Directors can seek relief from the liability for offence. What will be the position in case prosecution has already been launched? (4 Marks)

- (ii) The Reserve Bank of India issued certain directives to a Banking Company. The company does not care to act as per the directives. This fact comes to the notice of the officials of the Government of India. The officials, therefore, desire to exercise the Central Government's powers to acquire the said Banking Company. Examining the provisions of the Banking Regulation Act, 1949, state the manner, in which such powers of Central Government to acquire the undertaking of Banking Companies can be exercised. (4 Marks)

6. (a) (i) Mr. Z, is a member of a Krishna Producer Company. He intends to transfer his shares to Mr. X who is a member of a same Company. You are required to state as to how he can transfer his shares under the provisions of the Companies Act, 1956. (4 Marks)

- (ii) XYZ Limited has its subsidiary company PRM Ltd, which is formed to carry out some of the objectives of XYZ Limited. XYZ Ltd. suspends one of its several businesses, by passing a resolution at the company's extraordinary general meeting, with effect from 1st January 2016. The business so suspended continues to be suspended until March 2016. On 1st April 2016, a group of shareholders of XYZ Ltd file a petition in the court for winding of the company on the ground of suspension of business by the company.

Referring to the provisions of the Companies Act, 1956, decide:

- (1) Whether the shareholders' contention shall be tenable?
- (2) What would be your answer in case XYZ Ltd suspends all its business?
- (3) Can shareholders of PRM Ltd. file a petition in the court for winding up of their company (PRM Ltd) on the ground that the holding company viz., XYZ Ltd has suspended its entire business, though PRM Ltd. has not suspended business? (4 Marks)

- (b) (i) Draft a board resolution for appointment of Mr. P as the Manager for 5 years with effect from 1st June, 2016 of Deliberate Limited passed in the board meeting. (4 Marks)

- (ii) What is the punishment defined for the offence of money laundering in the Prevention of money Laundering Act, 2002? (4 Marks)

7. Attempt any **Four**

- (a) With reference to the provisions of the Insurance Act, 1938 as amended by Insurance Regulatory and Development Authority Act, 1999, vide Insurance Laws (Amendment) Act, 2015, state the norms in respect of paid up equity capital for carrying out the business of an insurer. (4 Marks)
- (b) Which offences are deemed to be Non- cognizable under the Companies Act, 2013? Enumerate the relevant provisions. (4 Marks)
- (c) Secure Ltd. is a securitization and reconstruction company under SARFAESI Act, 2002. The certificate of registration granted to it was cancelled. State the authority which can cancel the registration and the right of Secure Ltd. against such cancellation. (4 Marks)
- (d) Many a time a proviso is added to a Section of the enactment. Explain the function of such a proviso while carrying out the interpretation? (4 Marks)
- (e) Examine the validity of the following:
Mr. Q, a Director of PQR Limited proceeding on a long foreign tour, appointed Mr. Y as an alternate director to act for him during his absence. The articles of the company provide for appointment of alternate directors. Mr. Q claims that he has a right to appoint alternate director. (4 Marks)

Test Series: August, 2016

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 4 : CORPORATE AND ALLIED LAWS

SUGGESTED ANSWER/HINTS

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) **Declaration of Interim Dividend:** According to section 123(3) of the Companies Act, 2013, the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared.

However, in case the company has incurred loss during the current financial year up to the end of quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

In the given case the company is facing loss during the current financial year 2016-17. In the immediate preceding three financial years, the company declared dividend at the rate of 10%, 15% and 20%. As per the above mentioned provision, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years [i.e. $10+15+20=45/3=15\%$]. Therefore, decision of Board of Directors of Fortune Limited to declare 20% of the interim dividend for the current financial year is not tenable.

- (b) Under section 134(1) of the Companies Act, 2013 the financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by at least:

- (a) The chairperson of the company where he is authorised by the Board; or two directors out of which one shall be managing director, and
- (b) the Chief Executive Officer, if he is a director in the company, and
- (c) the Chief Financial Officer and the Company Secretary of the company, wherever they are appointed.

In given instance, the Balance Sheet and Profit and Loss Account have been signed by Mr. X and Mr. Y, the directors. In view of Section 134(1) of the Companies Act, 2013, Mr. Z, the Managing Director should be one of the two signing directors. Since the company has also employed Mr. F as the Chief Financial Officer, he

should also sign the Balance Sheet and Profit and Loss Account. So, the authentication of the financial statements of the company by Mr. X and Mr. Y was not in accordance with the provisions of the Companies Act, 2013.

(c) Removal of Member of the SEBI (Section 6 of the Securities and Exchange Board of India Act, 1992)

According to section 6 of the Securities and Exchange Board of India Act, 1992, the Central Government shall have the power to remove a member appointed to the Board, if he:

- (i) is, or at any time has been adjudicated as insolvent;
- (ii) is of unsound mind and stands so declared by a competent court;
- (iii) has been convicted of an offence which, in the opinion of the Central Government, involves a moral turpitude.
- (iv) has, in the opinion of the Central Government so abused his position as to render his continuance in office detrimental to the public interest.

Before removing a member, he will be given a reasonable opportunity of being heard in the matter.

In the present case, a section of complainants have suspected that Mr. Sathiya, a member of the SEBI has monetary interest in some of the cases that came up before the Board and he embezzled his position and therefore, he should be removed from his office.

Here, above complainants may approach the Central Government for removal of Mr. Sathiya, a member of the SEBI and if the Central Government is of the opinion that Mr. Sathiya has so abused his position as to render his continuation in office detrimental to the public interest, the Central Government may remove Mr. Sathiya from his office after giving him a reasonable opportunity of being heard in the matter.

(d) Mr. Beginner, a new investor, desirous of entering into investments business in any Stock Exchange, can be advised on following terms commonly used in any Stock Exchange.

- (i) **Derivative:** "derivative" includes—
 - (A) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;
 - (B) a contract, which derives its value from the prices, or index of prices, of underlying securities;
 - (C) commodity derivatives; and
 - (D) such other instruments as may be declared by the Central Government to be derivatives;

- (ii) **Option in Securities:** Option in Securities means a contract for the purchase or sale of a right to buy or sell or a right to buy and sell, securities in future, and includes a teji, a mandi, a tejimandi, a galli, a put, a call or a put and call securities.
- (iii) **Spot Delivery Contract:** Spot delivery contract means a contract which provides for:
 - (a) actual delivery of securities and the payment of a price therefore either on the same day as the date of the contract or on the next day, the actual period taken for the dispatch of the securities or the remittance of money therefore through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality.
 - (b) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository.

2. (a) (i) **Re-appointment of retiring auditor [section 139 (9) &(10) of the Companies Act, 2013]:** As per provision of the Companies Act, 2013, where at any annual general meeting, no auditor is appointed or re-appointed and also fulfilling the requirements of Section 139(9), the existing auditor shall continue to be the auditor of the company.

In the given situation, Mr. X is an auditor of the company who is to be retired in the AGM. Due to failure of Board and Members in appointing of the auditor in place of Mr. X and in compliance with Section 139(9) and 139(10), the existing auditor, Mr. X shall continue to be the auditor of the company.

- (ii) **Managing Director or manager in more than one company [Third proviso to section 203(3) of the Companies Act, 2013]:** According to the Companies Act, 2013:
 - (a) A company may appoint or employ a person as its managing director, if he is the managing director or manager of one, and of not more than one, other company.
 - (b) Such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting.
 - (c) It is further provided that specific notice of such meeting, and of the resolution to be moved thereat has been given to all the directors then in India.

Accordingly, though Mr. Competent is the managing director of Victory limited, he can be the managing director of Growth Ltd. simultaneously. But it has to be ensure that such appointment/employment is made or approved by a resolution passed at a meeting of the board with the consent

of all the directors present at the meeting and specific notice of such meeting and of the resolution to be moved thereat has been given to all the directors then in India.

- (b) (i) **Denomination of shares for public issue:** An eligible company shall be free to make a public or right issue of equity shares in any denomination determined by it by complying with section 13(4) of the Companies Act, 1956 and also SEBI (ICDR) Regulations:

According to SEBI (ICDR) Regulations, in case of initial public offer by an unlisted company,

- (1) **if the issue price is Rs. 500 or more**, the issuer company shall have a discretion to fix the face value below Rs. 10 per share. However, the face value shall in no case be less than Rs. 1 per share and also it shall not be is decimal of a rupee.
- (2) **If issue price is less than Rs. 500 per share** the face value shall be Rs.10 per share.

Here the issue price has not been given in the question. It is possible for the company to issue shares having a face value of less than Rs. 10 per share only if the issue price is Rs. 500 or more.

However, at any one time, shares shall be only of one denomination. Hence the denomination of existing shares can be altered by changing memorandum and articles by passing special resolution. The face value shall be disclosed in the advertisement offer documents and in application forms, in the same font size as that of issue price or price band.

- (ii) In terms of the proviso to section 173(3) of the Companies Act, 2013 a meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting. No exception is made for any class or classes of companies.

Further, under section 173(3) a meeting of the Board shall be called by giving not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

Hence, the sending of notice by e mail is an ordinary mode of sending notice of a board meeting under the Companies Act, 2013.

Therefore, in the given case the shorter notice is legally permitted with the only condition being the presence of the quorum and at least one independent director. The provision of the Articles in this regard is not relevant as the position is amply clear in the Act itself.

3. (a) (i) A scheme of compromise or arrangement may provide for amalgamation of companies under section 394 of the Companies Act, 1956. Section 394(4)(b) defines the 'transferee' and 'transferor' companies. While the 'transferee company' does not include any company other than a company within the meaning of the Companies Act, 1956, the transferor company includes anybody corporate whether a company within the meaning of the Companies Act or not. Hence the scheme of amalgamation may provide for transfer of foreign companies to Indian companies.
- (ii) Majority in number representing three-fourths in value of members or class of members, as the case may be, present and voting either in person or by proxy, where proxies are allowed under the rules made under section 643 must approve the scheme or arrangement providing for amalgamation of companies [Section 391(2)]. Any member who though present at the meeting, does not vote for or against, but remains neutral, is not to be taken into consideration.

As the expression used is 'member', not only holders of equity shares but also preference shareholders will have to be taken into account and the value of their shares be included or, if the meeting of holders of preference shares and equity shares are ordered by the court to be held separately, the three-fourths majority of each class will have to be ascertained separately.
- (iii) The scheme may provide for the dissolution, without winding up, of any transferor company [Section 394(1)]. The Court shall not order dissolution of any transferor company unless the official liquidator has, on scrutiny of the books and papers of the company, made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest [Second proviso to Section 394(2)].
- (b) (i) (1) No. According to the rules, drawal of foreign exchange is not allowed for travel to Nepal or Bhutan.
- (2) Following are the transactions (current account) for which drawal of foreign exchange is prohibited.
 - (i) Remittance out of lottery winnings.
 - (ii) Remittance of income from racing/riding, etc., or any other hobby.
 - (iii) Remittance for purchase of lottery tickets, banned/prescribed magazines, football pools, sweepstakes etc.
 - (iv) Payment of commission on exports made towards equity investment in Joint Ventures/Wholly Owned Subsidiaries abroad of Indian companies.
 - (v) Remittance of dividend by any company to which the requirement of dividend balancing is applicable.
 - (vi) Payment of commission on exports under Rupee State Credit Route,

except commission up to 10% of invoice value of exports of tea and tobacco.

(vii) Payment related to “Call Back Services” of telephones.

(viii) Remittance of interest income on funds held in Non-resident Special Rupee Scheme a/c.

- (ii) **Filling of casual vacancies:** Section 161(4) of the Companies Act, 2013 provides that in the case of a public company, if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board.

Provided that any person so appointed shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.

In view of the above provisions, in the given case, the appointment of Mr. Chauhan in place of the deceased director Mr. Puri was in order. In normal course, Mr. Chauhan could have held his office as director up to the date to which Mr. Puri would have held the same.

However, Mr. Chauhan expired on 15th May, 2016 and again a vacancy has arisen in the office of director owing to death of Mr. Chauhan who was appointed by the board to fill up the casual vacancy resulting from Puri's demise. Vacancy arising on the Board due to vacation of office by the director appointed to fill a casual vacancy in the first place, does not create another casual vacancy as section 161 (4) clearly mentions that such vacancy is created by the vacation of office by any director appointed by the company in general meeting. Hence, the Board cannot fill in the vacancy arising from the death of Mr. Chauhan.

The Board may however appoint Mrs. Chauhan as an additional director under section 161 (1) of the Companies Act, 2013 provided the articles of association authorises the board to do so, in which case Mrs. Chauhan will hold the office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

4. (a) (i) Section 397 of the Companies Act, 1956 deals with the remedy in a situation when the affairs of the company are being conducted in a manner oppressive to a shareholder or shareholders. This means that some of the shareholders must be in such a position that they can be oppressed by other shareholders or the management.

In the present case as given in the question, both the Indian Group and the French Group of Indo-French Ltd. are equally strong and none is able to oppress the other. The situation stated in the question is a deadlock but it cannot be termed as

oppression. Since it is not a case of winding up of the company, the relief under the said section 397 is not available to the Indian Group. [*Gnanasambandam v. Tamilnad Transporters (Coimbatore) p. Ltd.*] In view of the position discussed, the contention of the Indian Group is not tenable.

- (ii) The powers of the CLB under the provisions of section 397 of the Companies Act, 1956 are discretionary in character. Apart from the general powers envisaged therein, the CLB under section 402 (b) of the said Act, may order the purchase of the shares of one group by the other group. In the case of *Yashovardhan Saboo Vs. Groz Beckert Saboo Ltd.*, the presiding officer ordered the foreign group to buy out the shares of the minority group at the fair price with deadlock and the matters are not sorted out by any other means, an order for winding up of the company may also be made under the just and equitable clause, [*Kishan Kumar Ahuja Vs. Suresh Kumar Ahuja*]. Thus, if the Indian Group or the French Group fails to buy out the shares of the other group, an order for winding up of the company may be made under the just and equitable clause.
- (b) (i) **Service of notice on foreign company (Section 383 of the Companies Act, 2013):** According to section 383 of the Companies Act, 2013, any process, notice, or other document required to be served on a foreign company shall be deemed to be sufficiently served, if addressed to any person whose name and address have been delivered to the Registrar under section 380 of the Companies Act, 2013, and left at, or sent by post to, the address which has been so delivered to the Registrar or by electronic mode. Hence, the VAT Officer may serve the show cause notice by following the above provisions.
- (ii) Section 2(i) of the Competition Act, 2002 defines 'goods' as follows: 'Goods' means goods as defined in the Sale of Goods Act, 1930 and includes –
 - (a) products manufactured, processed or mined;
 - (b) debentures, stock and shares after allotment
 - (c) in relation to goods supplied, distributed or controlled in India, goods imported into India.

Hence, debentures and shares can be considered as 'goods' within the meaning of section 2(i) of the Competition Act, 2002 only after allotment and not before allotment.

- 5. (a) (i) According to section 174(1) of the Companies Act, 2013, quorum is one third of the total strength of Board (any fraction contained in the said one third being rounded off as one) or two directors whichever is higher. The total strength's to be derived after deducting the number of directors whose offices are vacant. Therefore, where total number of directors is 9 and 2 offices of the directors have fallen vacant, we find: $\frac{1}{3}$ of $(9-2) = \frac{1}{3}$ of $7 = \frac{7}{3}$ directors which will be

rounded off as 3. Being higher than 2, therefore 3 directors would constitute the quorum for the Board meetings.

Vide Notification G.S.R.466(E) dated 5th June 2015 the companies covered under section 8 of the Companies Act, 2013 shall constitute quorum for the Board meeting, either eight members or 25% of its total strength whichever is less. Provided that quorum shall not be less than two members.

- (ii) Under section 174(3) of the Companies Act, 2013 if at any time the number of the interested directors exceeds or is equal to two thirds of the total strength of the Board of Directors, the number of the directors who are non-interested but present at the meeting, not being less than two shall constitute the quorum. Accordingly in the given problem, there are in all 15 directors and the Board meeting commences with all the 15 directors. During the meeting, an item comes up for discussion in respect of which 13 happen to be "interested" directors. In this case, in spite of the excess of the interested directors being more than two-thirds, the prescribed minimum number of non-interested directors constituting the quorum, namely, 2 are present at the meeting and can transact the particular item of business.
- (b) (i) **Relief under Section 463:** Under section 463(1) of the Companies Act, 2013 if in any proceeding for negligence, default, breach of duty, misfeasance or breach of trust against an officer of a company, it appears to the court hearing the case he is or may be liable in respect of the negligence, default, breach of duty, misfeasance or breach of trust, but that he has acted honestly and reasonably, and that having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused, the court may relieve him, either wholly or partly, from his liability on such terms, as it may think fit.

Provided that in a criminal proceeding under this sub-section, the court shall have no power to grant relief from any civil liability which may attach to an officer in respect of such negligence, default, breach of duty, misfeasance or breach of trust.

In the given case, the offence is not compoundable i.e. it carries imprisonment as a punishment either alone or with a fine. In either case, it would indicate that a criminal liability is indicated. Hence, the court will not have the power to grant relief under section 463. However, the nature of the offence will have to be examined.

- (ii) **Power of Central Government to acquire the undertaking of Banking Companies in certain cases:** According to Section 36AE of the Banking Regulation Act, 1949, if Central Government is of the opinion that the Banking Company has failed to comply with the direction given to it by Reserve Bank of India (RBI) relating to policy matters under section 21 and 35A and/ or the affairs of the bank being managed in a manner is detrimental to the interest of the depositors or that of to the banking policy, or for better provision of credit generally or of credit to any particular section of the community or in any particular area; it is

necessary to acquire the undertaking of such banking company, it (Central Government) may after consultation with RBI as it thinks fit, by notified order, acquire the undertaking of such banking company with effect from such date as may be specified in this behalf by the Central Government.

In case of such a notification, on the specified date the undertaking of the acquired bank and its assets & liabilities shall stand transferred to, and vests in Central Government. Before acquiring the undertaking of any banking company, the Central Government shall give a reasonable opportunity to the banking company proposed to be acquired of showing cause against the proposed action.

6. (i) According to the provisions of section 581ZD (1) and (2) of the Companies Act, 1956, the shares of a member of a Producer Company shall not be transferable but a member of a Producer Company may after obtaining the previous approval of the Board, transfer the whole or part of his shares along with any special rights, to an active member at par value.

Based on the above provisions relating to the transfer of shares of a member in a Producer Company, member of a Producer Company has to obtain prior approval of the Board and then transfer his shares to an active member of the Producer Company at par value.

Accordingly, Mr. Z can transfer his shares to Mr. X.

- (ii) **The problem relates to suspension of business by a company.** Section 433 of the Companies Act, 1956 provides that if a company does not commence its business within a year from its incorporation or suspends its business for a whole year, it may be wound up by the court. The contention of the shareholders of XYZ Ltd that the company is liable to be wound up on the ground of suspensions of business, is not tenable for the following reasons:

- (1) A company may be wound up by court if a company suspends its business for a whole year. Here the business was suspended only on 1.1.2016. Hence on 1st April, 2016 the business has not been suspended for the whole year to attract Section 433(c)
- (2) Where a company having many business discontinues one of them, it cannot be said to have suspended business within the meaning of Section 433(c).
- (3) Where a company ceases to do any business but is a holding company of subsidiaries engaged in the pursuit of the business, which it was previously doing, it cannot be said that the company has suspended its business (*Ref; Eastern Telegraph Company Ltd*).

- (b) (i) Resolution passed at the meeting of board of directors of Deliberate Limited held at its registered office situated at on 2nd May, 2016 at A.M.

“RESOLVED that subject to the approval by the shareholders in a general meeting and pursuant to the provisions of the applicable provisions of the Companies Act, 2013, Mr. P be and is hereby appointed as the Manager of the Company with effect from 1st June, 2016 for a period of five years on a remuneration approved by the Remuneration Committee as enumerated below:

- (1) Salary: Rs. per month
- (2) Perquisites, Benefits and Facilities

RESOLVED FURTHER that Mr. P, so long as he functions as the Manager of the Company shall not be entitled to any sitting fee for attending the meeting of the board of directors or any committee thereof and that he shall not be liable to retire by rotation.

RESOLVED FURTHER that the Secretary of the company be and is hereby directed and authorized to file necessary returns with the Registrar of Companies and to do all other necessary things required under the provisions of the Companies Act, 2013.”

- (ii) Chapter II of the Prevention of Money Laundering Act, 2002, deals with offence of Money laundering covering section 3 & 4. Section 3 deals with the offence of money laundering. Section 4 provides for the punishment for Money-Laundering. Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine. But where the proceeds of crime involved in money-laundering relate to any offence specified under paragraph 2 of Part A of the Schedule, the maximum punishment may extend to ten years instead of seven years.

- 7. (a) **Requirement of Paid Up equity capital for insurance business:** No insurer carrying on the business of life insurance, general insurance, health insurance or re-insurance in India on or after the commencement of the Insurance Regulatory and Development Authority of India Act, 1999, shall be registered unless he has, —

- (i) a paid-up equity capital of rupees one hundred crores, in case of a person carrying on the business of life insurance or general insurance; or
- (ii) a paid-up equity capital of rupees one hundred crore, in case of a person carrying on exclusively the business of health insurance; or
- (iii) a paid-up equity capital of rupees two hundred crore, in case of a person carrying on exclusively the business as a re-insurer.

- (b) **Offences to be non-cognizable:** Section 439 of the Companies Act, provides for offences to be non-cognizable. According to this section:

- (i) Notwithstanding anything in the Code of Criminal Procedure, 1973, every offence under this Act except the offences referred to in sub-section (6) of section 212

shall be deemed to be non-cognizable within the meaning of the said Code.

- (ii) No court shall take cognizance of any offence under this Act which is alleged to have been committed by any company or any officer thereof, except on the complaint in writing of the Registrar, a shareholder of the company, or of a person authorised by the Central Government in that behalf.

Whereas in case of a government companies, court shall take cognizance of an offence under this Act which is alleged to have been committed by any company or any officer thereof on the complaint in writing of a person authorized by the Central Government in that behalf.

- (iii) The court may take cognizance of offences relating to issue and transfer of securities and non-payment of dividend, on a complaint in writing, by a person authorised by the Securities and Exchange Board of India.
 - (iv) Nothing in this sub-section shall apply to a prosecution by a company of any of its officers.
 - (v) Where the complainant is the Registrar or a person authorised by the Central Government, the presence of such officer before the Court trying the offences shall not be necessary unless the court requires his personal attendance at the trial.
 - (vi) The above provisions shall not apply to any action taken by the liquidator of a company in respect of any offence alleged to have been committed in respect of any of the matters in Chapter XX or in any other provision of this Act relating to winding up of companies.
 - (vii) The liquidator of a company shall not be deemed to be an officer of the company.
- (c) **Cancellation of Certificate of Registration under SARFAESI Act, 2002:** The Reserve Bank of India may cancel a certificate of registration granted to a securitisation and reconstruction company for the reasons stated in Section 4 of SARFAESI Act, 2002.

Secure Ltd., can prefer an appeal to the Central Government (Secretary, Ministry of Finance, Government of India) within a period of 30 days from the date on which order of cancellation was communicated to it. The Central Government must also give such company a reasonable opportunity of being heard before rejecting the appeal. If Secure Ltd., is holding investments of qualified institutional buyers at the time of cancellation of certificate of registration, it shall be deemed to be a securitisation and reconstruction company until it repays the entire investments held by it, together with interest if any, within such period as may be specified by the Reserve Bank.

- (d) The normal function of a proviso is to except something out of the enactment or to qualify something stated in the enactment which would be within its purview if the proviso were not there. The effect of the proviso is to qualify the preceding

enactment which is expressed in terms which are too general. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment ordinarily a proviso is not interpreted as it stating a general rule.

It is a cardinal rule of interpretation that a proviso to a particular provision of a statute only embraces the field which is covered by the main provision. It carves out an exception to the provision to which it has been enacted as a proviso and not to the other. (*Ram Narain Sons Ltd. Vs. Assistant Commissioner of Sales Tax*, A.I.R, 1995 SC 765)

- (e) Under section 161(2) of the Companies Act, 2013 the Board of Directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint a person, not being a person holding any alternate directorship for any other director in the company, to act as an alternate director for a director during his absence for a period of not less than three months from India.

From the above provision it is clear that the authority to appoint alternate director has been vested in the board of directors only and that too subject to empowerment by the Articles.

Therefore, Q is not authorized to appoint an alternate director and the appointment of Mr. Y is not valid.