

**PRIME ACADEMY
PROGRESS TEST – JANUARY 2008**

Time Allowed : 2 Hours

**FINAL
ADVANCED ACCOUNTING**

Maximum Marks : 75

PART B

Answer All Questions

(50 Marks)

1. The Balance Sheet of Small Ltd. as on 31st March, 2005 was as under:

(Rupees in lakhs)					
<i>Liabilities</i>			<i>Assets</i>		
Share capital			Land and building		4.00
In Equity shares of Rs. 100 each		6.00	Machinery balance B/F	3.50	
Reserves and surplus:		3.00	Less: Depreciation for the year	<u>0.50</u>	3.00
Profit and loss A/c	1.20		Stock at cost		1.50
Balance B/F	<u>0.60</u>	1.80	Debtors		1.00
Profit for the year		1.20	Cash and Bank balance		0.50
Trade Creditors			Preliminary expenses		
		12.00			12.00

Big Ltd. purchased 4000 Equity shares of Rs. 100 each on 1st October, 2004 on which date it was found that Land and Buildings were under valued by Rs. 1 lakh and machinery was worth only Rs. 2.75 lakhs. In preparing the consolidated Balance Sheet of holding company, it was decided to adopt proper values of Assets, and write off preliminary expenses. On the above information given,

Ascertain:

- (a) Capital Profits
- (b) Revenue Profits
- (c) Minority interest

(12 Marks)

2. On 31st March, 2004 Bee Ltd. became the holding company of Cee Ltd. and Dee Ltd. by acquiring 450 lakhs fully paid shares in Cee Ltd. for Rs. 6,750 lakhs and Rs. 240 lakhs fully paid shares in Dee Ltd. for Rs. 2,160 lakhs. On that date, Cee Ltd. showed a balance of Rs. 2,550 lakhs in General Reserve and a credit balance of Rs. 900 lakhs in Profit and Loss Account. On the same date, Dee Ltd. showed a debit balance of Rs. 360 lakhs in Profit and Loss Account while the Preliminary Expenses Account showed a balance of Rs. 30 lakhs.

After one year, on 31st March, 2005 the Balance Sheets of three companies stood as

follows :

	(Rs in lakhs)		
Liabilities	Bee Ltd.	Cee Ltd.	Dee Ltd.
Fully paid equity shares of Rs. 10 each	27,000	7,500	3,000
General Reserve	33,000	3,150	—
Profit and Loss Account	9,000	1,200	750
15 lakh fully paid 9.5% Debentures of Rs. 100 each	—	—	1,500
Loan from Cee Ltd.	—	—	75
Bills Payable	—	—	150
Sundry Creditors	14,100	2,700	930
	83,100	14,550	6,405

	(Rs in lakhs)		
Assets			
Machinery	39,000	7,500	2,100
Furniture and Fixtures	6,000	1,500	600
Investments :			
450 lakhs shares in Cee Ltd.	6,750	—	—
240 lakhs shares in Dee Ltd.	2,160	—	—
3 lakhs debentures in Dee Ltd.	294	—	—
stocks	16,500	3,000	1,500
Sundry Debtors	9,000	1,350	1,290
Cash and Bank balances	3,201	1,050	900
Loan to Dee Ltd.	—	90	—
Bills Receivable	195	60	—
Preliminary Expenses	—	—	15
	83,100	14,550	6,405

The following points relating to the above mentioned Balance Sheets are to be noted

- (i) All the bills payable appearing in Dee Ltd.' s Balance Sheet were accepted in favour of Cee Ltd. out of which bills amounting to Rs. 75 lakh were endorsed by Cee Ltd. in favour of Bee Ltd. and bills amounting to Rs. 45 lakh had been discount by Cee Ltd. with its bank.
- (ii) On 29th March, 2005 Dee Ltd. remitted Rs. 15 lakh by means of a cheque to Cee Ltd. to return part of the loan; Cee Ltd. received the cheque only after 31st March, 2005.
- (iii) Stocks with Cee Ltd. includes goods purchased from Dee Ltd. for Rs.200 lakhs. Bee Ltd. invoiced the goods at cost plus 25%.
- (iv) In August, 2004 Cee Ltd. declared and distributed dividend @ 10% for the year ended 31st March, 2004. Bee Ltd. credited the dividend received to its Profit and Loss Account.

You are required to prepare a consolidated Balance Sheet of Bee Ltd and its subsidiaries Cee Ltd and Dee Ltd as at 31st March 2005

(16 Marks)

3.The Balance Sheets of Football Ltd. and its subsidiary Hockey Ltd. as on 31st March, 2005 are as under :

Liabilities	Football Ltd. Rs.	Hockey Ltd. Rs.	Assets	Football Ltd Rs.	Hockey Ltd. Rs.
Equity shares of Rs.10 each			Goodwill		3,00,000
10% preference shares	48,00,000	20,00,000	Plant & machinery	4,50,000	5,00,000
of Rs. 10 each	7,00,000	3,80,000	Motor vehicles	12,00,000 9,50,000	7,50,000 4,00,000
General reserve	5,50,000	4,20,000	Furniture & fittings	6,50,000	4,50,000
P/L A/c	10,00,000	6,00,000	Investments	26,00,000	7,20,000
Bank overdraft	1,20,000	70,000	Stock	4,50,000	2,10,000
Sundry creditors	4,30,000	4,80,000	Cash at bank	2,25,000	7,80,000
Bills payable	—	1,60,000	Debtors	9,30,000	—
			Bills receivable	1,45,000	
	76,00,000	41,10,000		76,00,000	41,10,000

Details of acquisition of shares by Football Ltd. are as under :

Nature of shares	Nos. acquired	Date of acquisition	Cost of
------------------	---------------	---------------------	---------

			acquisition Rs.
Preference shares	14,250	1.4.2002	3,10,000
Equity shares	80,000	1.4.2003	9,50,000
Equity shares	70,000	1.4.2004	8,00,000

Other information :

- (i) On 1.4.2004 Profit and Loss Account and General reserve of Hockey Ltd. had credit balance of Rs. 3,00,000 and Rs. 2,00,000 respectively.
- (ii) Dividend @ 10% was paid by Hockey Ltd. for the year 2003-04 out of its P/L A/c balance as on 1.4.2004. Football Ltd. credited its share of dividend to its P/L A/c.
- (iii) Hockey Ltd. allotted bonus shares out of General reserve at the rate of 1 share for every 10 shares held. Accounting thereof has not yet been made.
- (iv) Bills receivable of Football Ltd. were drawn upon Hockey Ltd.
- (v) During the year 2004-05 Football Ltd. purchased goods from Hockey Ltd. for Rs. 1,00,000 at a sale price of Rs. 1,20,000. 40% of these goods remained unsold at close of the year
- (vi) On 1.4.2004 Motor vehicles of Hockey Ltd. were overvalued by Rs. 1,00,000. Applicable depreciation rate is 20%
- (vii) Dividends recommended for the year 2004-05 in the holding and the subsidiary companies are 15% and 10% respectively.

Prepare consolidated Balance Sheet as on 31st March, 2005.

(16 Marks)

4

In May 2004 Speed Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2005 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2005 amounted to 25 lakhs. Can Rs. 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? Justify your answer with reference to the relevant accounting standards.

(6 Marks)

PRIME ACADEMY
PROGRESS TEST – JANUARY 2008
FINAL
ADVANCED ACCOUNTING

PART B

(50 Marks)

Answers:

1 Capital Profits : Rs 4.50 Lakhs

Revenue Profits: Rs 0.30 lakh

Minority interest: Rs 3.60 Lakhs

2 **Consolidated Balance Sheet of Bee Limited and its subsidiaries Cee Ltd. & Dee Ltd.**

As at 31st March 2005

Liabilities	Rs. In lakhs	Assets	Rs in lakhs
Share Capital		Fixed Assets	
Authorised	?	Goodwill (W.N.3)	246
Issued and Subscribed		Machinery	48,600
Fully Paid Equity		Furniture	8,100
Shares of Rs.10 each	27,000		
Minority Interest (W.N.2)	5,487	Current Assets, Loans	
Reserves and Surplus		& Advances	
General Reserve (W.N.4)	33,360	(A) Current Assets	
Profit & Loss A/c (W.N. 4)	10,040	Stock	21,000
Secured Loans		Less: Unrealised Profit	40
Debentures	1,200		----- 20,960
Current Liabilities		Sundry Debtors	11,640
Acceptances	150	Cash Bank Balances	5,151
Less : Mutual Owing	105	Cash in Transit	15
	----- 45	(B) Loans and Advances	
Sundry Creditors	17,730	Bills Receivable	255
		Less : Mutual Owing	105
			----- 150
	-----		-----
	94,862		94,862
	-----		-----

Working Notes

1. Analysis of reserves and profits of subsidiary companies Cee Ltd. and Dee Ltd.

	Pre-acquisition Capital Profit	Post-acquisition General Profit & Reserve	Loss A/c
Cee Ltd.			
General Reserve	2,550	600	
Profit & Loss Account on 31.3.2004	900		
Less : Dividend	750		

	-----	150	-	1,050
		-----	-----	-----
		2,700	600	1,050
		-----	-----	-----
Share of Bee Ltd (60 %)		1,620	360	630
Minority Interest (40 %)		1,080	240	420

	Pre-acquisition Capital Profit	Prelim.	Post-acquisition Profit & Expenses Written off	Loss A/c
Dee Ltd.				
Profit & Loss Account	(360)			1,110
Preliminary Expenses	(30)		15	
	-----		-----	-----
Less : Dividend	(390)		15	1,110
	-----		-----	-----
Share of Bee Ltd (80 %)	(312)		12	888
Minority Interest (20.5)	(78)		3	222

2. Minority Interest

Cee Ltd.				
Share Capital		3,000		
Capital (pre-acquisition) profits	1,080			
Revenue (post-acquisition) profits				
General Reserve	240			
Profit & Loss Account	420			

		1,740		

				4,740
Dee Ltd.				
Share Capital		600		
Capital (Pre-acquisition)				
Profits / (Losses)		(78)		
Revenue (Post acquisition) profits	222			
Add : Preliminary Expenses Written off	3			

		225	147	747
		-----	-----	-----
				5,487

3. Cost of Control

Cee Ltd.				
Investment	6,750			
Less : Dividend received and wrongly Credited to Profit and loss account	450			

		6,300		
Less : Paid up share capital (60 %)	4,500			
Capital Profits	1,620			

		6,120		

				180
Dee Ltd.				
Investment in shares	2,160			
Investment in debentures	294			

		2,454		
Less : Paid up share capital (80 %)	2,400			
Nominal value of debentures	300			
Capital Profits	(312)			

	-----	2,388	
		-----	66
Cost of Control - Goodwill			-----
			246

4. Consolidated General reserve and profit and loss account :

	General Reserve	Profit and Loss Account
Bee Ltd.	33,000	9,000
Less : Wrong Dividend credited	--	450
	-----	-----
	33,000	8,550
Cee Ltd.	360	630
Dee Ltd. (888 + 12)	--	900
	-----	-----
	33,360	10,080
Less : Unrealised profit on stock	--	40
	-----	-----
	33,360	10,040
	-----	-----

5. Mutual owing regarding bills :

Rs. (150 - 45) lakhs = Rs. 105 lakhs

6. Unrealised Profit

Rs.200 x (25 / 125) lakhs = Rs. 40 lakhs

7. Amount of dividend wrongly credited to profit and loss account by Bee Ltd.

60 % of Rs. 750 lakhs = Rs. 450 lakhs.

3. **FOOTBALL LTD. and its subsidiary HOCKEY LTD.**
Consolidated Balance Sheet as on 31st March 2005

Liabilities	Rs.	Amount Rs	Assets	Rs.	Amount Rs
Share Capital			Fixed Assets		
Authorised, Issued and Paid up capital		48,00,000	Goodwill		
4,80,000 equity shares of Rs.10 each			Football Ltd.	4,50,000	
70,000 10 % Preference Shares of Rs.10 each		7,00,000	Hockey Ltd.	3,00,000	
Minority Interest (as per working note 3)		9,86,750	Add : Goodwill on consolidation	7,50,000	
			(W.N. 2)	1,97,500	
				-----	9,47,500
Reserves and Surplus			Plant and Machinery		
General Reserve (as per working note 5)		7,15,000	Football Ltd.	12,00,000	
Profit & Loss Account (as per WN 4)		5,07,750	Hockey Ltd. (7,50,000-1,00,000 + 20,000)	0	
				6,70,000	
Current Liabilities and Provisions				-----	
Bank Overdraft					
Football Ltd.	1,20,000				16,20,000
Hockey Ltd.	70,000				
	-----	1,90,000			
Sundry Creditors			Furniture and Fittings		
Football Ltd.	1,60,000		Football Ltd.	6,50,000	
Hockey Ltd.	1,45,000		Hockey Ltd.	4,00,000	
	-----	9,10,000		-----	10,50,000
Bills Payable			Investments		

Cost of Investments in Hockey Ltd.		20,60,000
Less: Paid up value of equity shares (including bonus Shares) [80,000+70,000+(10% of 1,50,000)] x Rs.10	16,50,000	
Paid up value of preference shares	1,42,500	
Pre-acquisition dividend (see note)	70,000	
	-----	18,62,500
Cost of Control / Goodwill		----- 1,97,500

Note :The dividend on 70,000 shares only (acquired on 1.4.2004) is pre-acquisition dividend.

(3) Minority Interest

Equity Share capital (Rs.5,00,000 + Rs.50,000 (Bonus))		5,50,000
Preference Share capital (Rs.3,80,000 - Rs.1,42,500)		2,37,500
Share of revenue reserve		55,000
Share of revenue profit		1,20,500
Proposed preference dividend		23,750
		----- 9,86,750

(4) Profit and Loss Account - Football Ltd.

Balance		10,00,000
Share in Profit of Hockey Ltd.		3,61,500
Share in proposed preference dividend of Hockey Ltd.		14,250
		----- 13,75,750
Less : Pre-acquisition dividend credited to Profit and Loss Account	70,000	
Unrealised profit on stock (40 % of Rs.20,000)	8,000	
Proposed equity dividend	7,20,000	
Proposed preference dividend	70,000	
	-----	8,68,000
		----- 5,07,750

(5) General Reserve - Football Ltd.

Balance		5,50,000
Add : Share in Hockey Ltd.		1,65,000
		----- 7,15,000

Note :Date of bonus issue by Hockey Ltd. is not given. It is also not mentioned whether the bonus share are issued from pre-acquisition general reserve or post-acquisition general reserve. Therefore, it has been assumed that Hockey Ltd. allotted bonus shares out of pre-acquisition general reserve.

4. As per para 19 of AS 16 “Borrowing Costs” capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Therefore, interest on the amount that has been used for the construction of the building upto the date of completion (January 2005) i.e. Rs. 18 lakhs alone can be capitlised. It cannot be extended to Rs.25 lakhs.

**PRIME ACADEMY
PROGRESS TEST – JANUARY 2008**

Time Allowed : 2 Hours

FINAL

Maximum Marks : 75

MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS

PART B: ANSWER ALL THE QUESTIONS

1. a) How is simulation useful in the context of capital budgeting? (4 marks)
- b) A project with an initial outlay of Rs 2,50,000 has a life of 5 years and 12% discount rate. The annuity cashflow per annum is 70,000. You are required to
- (i) Compute the NPV
 - (ii) Measure the sensitivity of the project to size, cashflow, life and discount factor. (8 marks)
- c) The following details are available for a project that has a discount rate of 10%.

	Year	P=0.3	p=0.5	p=0.2
Initial investment	0	400,000	400,000	400,000
Estimated net after tax cashflow per year	1 to 5	100,000	110,000	120,000
Estimated post tax salvage value	5	20,000	50,000	60,000

Compute (i) Expected NPV of the project; b) the best and worst case NPVs & c) the probability of the occurrence of the worst case if the cashflows are perfectly dependant over time . (8 marks)

- 2) a) What is the difference between an American quote and a European quote? Explain with examples. (4 marks)
- b) The US\$ is selling in India at Rs 40. The interest rate for a 3 month borrowing in India is 10% per annum and that in USA is 3.5% per annum.
- (i) Do you expect the Indian rupee to be at forward premium or discount to the US\$ in the Indian fwd market?
 - (ii) What is the expected 3 month forward rate for US\$ in India?
 - (iii) What is the rate of fwd premium or discount? (8 marks)
- c) The following (indirect) quotes are available in the Indian currency market for spot & fwd.

	Spot	Swap points 1	premium/discount in fwd market

		month fwd	
US\$	0.23-0.25	30-20	Premium
Euro	0.018-0.020	10-20	Discount
SGD	0.04-0.045	20-30	Discount

Calculate the cost or value in Indian rupees to a customer who wishes to

- (i) Sell US\$ 25,000 spot
- (ii) Buy Euro 35,000 1 month forward
- (iii) Sell SGD 17,000 1 month forward

(8 marks)

3) a) Write a short note on Security Market Line (3 marks)

b) The expected return and beta of 2 stocks are as follows.

	A	B
Expected return	15%	16%
Beta	0.9	1.2

The risk free rate is 8% per annum and the return on a broad based index is 15% per Annum. You are required to

- (i) Comment on the valuation (under/over valued) of the aforesaid stocks based on CAPM
 - (ii) Based on above, what would be your strategy (buy/sell/hold)
- (4 marks)

c) The following information is available for a stock.

Year	Dividend yield(%)	Price appreciation(%)
2004	5.62%	20%
2005	4.07%	16%
2006	4.5%	12.55%

The return from the market for 2004,2005 & 2006 are 12.62%, 21.79% and 5.32% respectively. You are required to compute the beta of the stock & comment on the same.

(3 marks)

**PRIME ACADEMY
PROGRESS TEST – JANUARY 2008
FINAL
MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS**

PART - B

(50 Marks)

1a)

- Simulation means construction of a model to represent a real life situation, which facilitates substitution of critical variables within the model and assists in predicting possible outcomes.
- Simulation helps in gaining insight into certain complex problems where actual environment is difficult to observe or where the project is highly critical that real life experimentations cannot be afforded.

1b) NPV of the project

Year	Cashflow	Discount factor	PV of cashflow
0	(250,000)	1	(250,000)
1-5	70,000	3.605	252,350
			2,350

Sensitivity to size:

Change that causes NPV to become zero = 2350.

Sensitivity (%) = change/base x 100 = (2350/250000) x 100 = 0.94%

Sensitivity to Cash flow:

Let “Y” be the cashflow that causes NPV to become zero.

Therefore, $3.605 \times Y = 2,50,000$

Hence, $Y = 2,50,000/3.605 = 69,348$.

Therefore change in cashflow = $70,000 - 69,348 = 652$.

Sensitivity(%) = change/base x 100 = $(652/70,000) \times 100 = 0.93\%$

Sensitivity to Life :

Let “Y” be the Discount factor that causes NPV to become zero
 Therefore, $70,000 \times Y = 2,50,000$
 Hence, $Y = 2,50,000/70,000 = 3.571$

PVAF for 4 years @ 12% = 3.037

PVAF for 5 years @ 12% = 3.605

By interpolation, the required change that will make NPV zero is $(3.605-3.571)/(3.605-3.037) = 0.06$

Sensitivity (%) = change/base x 100 = $0.06/5 = 1.19\%$

Sensitivity to Discount rate :

Let “Y” be the Discount factor that causes NPV to become zero
 Therefore, $70,000 \times Y = 2,50,000$
 Hence, $Y = 2,50,000/70,000 = 3.571$

PVAF for 5 years @ 12% = 3.605

PVAF for 5 years @ 13% = 3.517

By interpolation, the required change that will make NPV zero is $(3.605-3.571)/(3.605-3.517) = 0.38$

Sensitivity (%) = change/base x 100 = $0.38/12 = 3.16\%$

1c) (I) EXPECTED NPV

Step 1: EV of initial outflow

	Obs	Flow	Prob	EV
	1	400,000	0.30	120,000
	2	400,000	0.50	200,000
	3	400,000	0.20	80,000
				400,000

Step 2: EV of inbetween cashflows

	Obs	Flow	Prob	EV
	1	100,000	0.30	30,000
	2	110,000	0.50	55,000
	3	120,000	0.20	24,000
				109,000

Step 3: EV of terminal flow

	Obs	Flow	Prob	EV
	1	20,000	0.30	6,000
	2	50,000	0.50	25,000
	3	60,000	0.20	12,000
				43,000

Step 4: NPV analysis

	Year	EV	Dis factor	Disc cashflow
	0	(400,000)	1.00	(400,000)
	1-5	109,000	3.79	413,219
	5	43,000	0.62	26,703
				39,922

II & III BEST & WORST CASE SCENARIO

By inspection, we know that following are best & worst cases

Year	Best	Probability	Worst	Probability
0	400,000	1.00	400,000	1.00
1-5	120,000	0.20	100,000	0.30
5	60,000	0.20	20,000	0.30
Product		0.04		0.09

Best Case NPV

Year	Value	Dis factor	Dis cashflow
0	(400,000)	1.00	(400,000)

1-5	120,000	3.79	454,920
5	60,000	0.62	37,260
			92,180

**Worst Case
NPV**

Year	Value	Dis factor	Dis cashflow
0	(400,000)	1.00	(400,000)
1-5	100,000	3.79	379,100
5	20,000	0.62	12,420
			(8,480)

2a) American quote : A direct quote for an American. i.e in an American quote, US\$ is the price.
Example: US\$ 1.25 per Euro.

European quote: An indirect quote for an American, i.e in a European quote, US\$ is the commodity. Example: 0.8 Euro per US\$.

2b) (i) As per Interest Rate Parity theory, *ceteris paribus*, a higher interest rate in one country will be offset by depreciation of the currency of that country. Since interest rate in India is higher than that in USA, rupee is expected to depreciate against the dollar.

(ii) As per IRPT, $(1 + R_h)/(1 + R_f) = F/S$
Therefore, $(1 + 0.025)/(1 + 0.00875) = F/40$.
Solving the above equation, we get $F = 40.64$.

Note : Since 3 month fwd rate is computed, interest has to be taken only for 3 months in the IRPT formula. Hence $R_h = 0.10/4 = 0.025$; $R_f = 0.035/4 = 0.00875$.

(iii) Fwd premium (%) = $(F - S)/S = (40.64 - 40)/40 = 0.064$ or 6.4%.

2c) The given quotes are for Indian Rupees. Hence bid/ask should be computed only with reference to Indian rupees.

(i) Customer sells US\$
 Therefore he buys Indian Rupees from bank
 Therefore **bank sells** Indian rupees to the customer.
 Hence **Ask** rate is relevant.
 Value to the customer = $25,000/0.25 = \text{Rs } 1,00,000$.

(ii) Customer buys Euros
 Therefore he sells Indian rupees to the bank
 Therefore **bank buys** Indian rupees from the customer.
 Hence **BID** rate is relevant.

Since customer buys Euro 1 month fwd, Fwd bid is relevant.

Since Swap ask > swap bid, Euro is trading at a discount to Rupee. Hence to arrive at Fwd bid, swap points have to be added. Hence Fwd bid = $0.018+0.0010 = 0.019$.
 Therefore cost to the customer = $35,000/0.019 = 18,42,105$.

(iii) Customer sells SGD
 Therefore he buys Indian rupees from the bank
 Therefore **bank sells** Indian rupees to the customer.
 Hence **ASK** rate is relevant.

Since customer sells SGD 1 month fwd, **Fwd** ask is relevant.

Since Swap ask > swap bid, SGD is trading at a discount to Rupee. Hence to arrive at Fwd ask, swap points have to be added. Hence Fwd ask = $0.045+0.0030 = 0.048$.

Therefore value to the customer in Rupees = $17,000/0.0408 = 6,54,166$.

3a)

- Security market line is a graphical representation of CAPM and indicates what rate of return is required to compensate for a given level of risk.
- The graph is drawn by plotting Beta in X axis & expected return in Y axis. The resulting upward sloping line is called as Security market line & this measures the relationship between expected return & systematic risk.

3b) CAPM = $R_f + \text{Beta} (R_m - R_f)$

	A	B
Rf	8%	8%
Rm	15%	15%
Beta	0.9	1.2
CAPM return	$8\% + 0.9 (15\% - 8\%) = 14.3\%$	$8\% + 1.2 (15\% - 8\%) = 16.4\%$

Expected return	15%	16%
Evaluation	CAPM < expected return, hence undervalued	CAPM > expected return, hence overvalued
Strategy	Undervalued, hence buy	Overvalued, hence sell

3c)

Year	Stock return (X)	Market return (Y)	XY	Y ²
2004	20+5.62=25.62	12.62	323.32	159.26
2005	16+4.07=20.07	21.59	437.33	474.8
2006	4.5+12.55=17.05	5.32	90.71	28.3
	62.74	39.53	851.36	662.36

$$\text{Beta} = \frac{851.36 - 3(20.91) \times (13.24)}{662.36 - 3(13.24) \times 13.24} = \frac{20.81}{136.47} = 0.15.$$

Observation: This is a low beta stock.

**PRIME ACADEMY
PROGRESS TEST – JANUARY 2008**

Time Allowed : 2 Hours

**FINAL
ADVANCED AUDITING**

Maximum Marks : 75

PART – B

(50 Marks)

1. Comment on the following: **(4 X 5 = 20)**
 - a. The members of C. Ltd preferred a complaint against auditors stating that he has failed to send audit report to them
 - b. One of the directors of Hitech Ltd is attracted by the disqualification under Section 274 (1) (g) of the Company's Act, 1956
 - c. M/s;. ABC Ltd has not deposited provident fund contribution of Rs 20 Lakhs to the authorities but accounting in the books of accounts.
 - d. Mr. Rajendra, a fellow member of the Institute of Chartered Accountants of India, work as a manager of Shrivastava & Co., a Chartered Accountants firm, signed the audit report of OM Ltd, on behalf of Shrivastava & Co.

2. Explain your views on the following: **(4 X 5 = 20)**
 - a. The shareholders of MIMI Ltd appointed Jodha & Co, Chartered Accountants, as statutory auditors in their 15th AGM in August 2002. Jodha & Co, accepted the appointment. The 16th AGM was scheduled for September 2003. It was held by adjourned. The board of directors appointed Rama & Co in place of Jodha & Co on the basis of argument that term of Jodha & Co was till 16th AGM and as the meeting has been adjourned their term has ended.
 - b. The auditors of XYZ Ltd have been automatically reappointed as the auditors at the annual general meeting.
 - c. Mukta Ltd has appointed Yamen & Co, Chartered Accountants, as statutory auditors by ordinary resolution in its 14th AGM. On the day of AGM, Life insurance corporation of India was holding 12% of its subscribed capital, Allahabad bank was holding 6% and BHEL was holding 10% of its subscribed share capital.
 - d. Nene and Sane Associates, Chartered Accountants in practice have been appointed as statutory auditors of Do Good Ltd for the financial year 2007-08. Mr. Nene holds 200 equity shares of DDA Ltd a subsidiary company of Do Good Ltd.

3. The auditor should have necessary skills to conduct audit in CIS environment” Comment. **(5 Marks)**

4. “There are specific risks associated with internal control system in CIS environment”. Do you agree with the statement? **(5 Marks)**

PRIME ACADEMY
PROGRESS TEST – JANUARY 2008
FINAL
ADVANCED AUDITING

PART - B

(50 Marks)

1

- (a) The auditor shall send his report to the company secretary for being laid before the company in general meeting. The auditors are not required to send their report to all the members. Section 230 has specified that the auditors report shall be read before the company in general meeting. The members of C Ltd have not taken a correct stand. The complaint against the auditor has no statutory basis.
- (b) Under Section 227(3) of the Companies Act, 1956 the auditor has a duty to report on certain statement of fact. One of the facts on which he has to report upon is whether any director is disqualified under section 274(1)(g). Further section 233 has laid down penalty for non-compliance by the auditor for provisions mentioned in section 227. According to sec 233, in case of willful default in making the auditors report, the auditor shall be punishable with fine which may extend to ten thousand rupees. In the given situation the auditor of Hitech Ltd should mention the fact of one of the directors being disqualified under section 274(1)(g), in his audit report. In case of default, he shall be liable under section 233.
- (c) As per CARO 2003 issued by the Central Government the auditor should report whether the company has been regular in depositing undisputed statutory dues including provident fund with appropriate authorities. If the company has not done so, the extent of arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they become payable, shall be indicated by the auditor. In the present case the company has not deposited the amount of provident fund contribution of Rs 20 lakhs with the appropriate authority. The auditor should, according to the requirements of CARO 2003 indicate the extent of arrears outstanding for more than six months, from the date they have become payable in his audit report.
- (d) Section 229 has laid down that only the person appointed as auditor of the company can sign the auditor's report or sign or authenticate any other document of the company as required by law to be signed or authenticated by the auditor. It further lays down that in case a partnership firm is appointed as an auditor, then only a partner of the firm practicing in India can do so. AAS 28 has emphasized that an audit report should be signed by the auditor in his personal name and in case of a firm being appointed, in the name of the audit firm also. In the present case, Mr. Rajendra though a fellow of ICAI is not a partner of M/s. Shrivastava & Co. He is a manager there; on the basis of the provisions of section 229 and the requirements of AAS 28 we can conclude that he cannot sign the audit report of OM Ltd. It shall be signed only by the partners of the firm.

2.

- (a) According to the provisions of Section 224(1), the tenure of auditor appointed by the shareholders would be from the conclusion of the meeting at which he is appointed to the conclusion of the next annual general meeting. The council of ICAI has also opined that the auditor will continue in office until the next annual general meeting is actually held and concluded. Therefore, if an annual general meeting is adjourned i.e not concluded, the auditor will continue in office till the conclusion of adjourned meeting. On the basis of above provisions of the Act and the opinion of the ICAI, we can conclude that the appointment of Rama & Co, as statutory auditors in place of Jodha and co invalid. The tenure of the office of Jodha and co is till the conclusion of 16th Annual general meeting. This meeting has been adjourned and is not yet concluded. Therefore, the directors cannot remove them.
- (b) The appointment or re-appointment of auditors at the annual general meeting is one of the items of ordinary business to be transacted at such a meeting. There cannot be any automatic reappointment of the auditor because appointment auditor is a specific item in the agenda of annual general meeting and therefore passing of resolution is necessary. The reappointment of auditors of XYZ Ltd is invalid in the given case as no resolution has been passed to this effect at the AGM.
- (c) Section 224A has laid that in case of a company in which not less than 25% of the subscribed share capital is held, whether singly or in combination by
- i.a public financial institution or a government company or central government or any state government.
 - ii.Any financial or other institution established by any provincial or state Act in which a state government holds not less than 51% of the subscribed share capital.
 - iii.A nationalized bank or an insurance company carrying on general insurance business the auditor is to be appointed or re-appointed by a special resolution only.

In the given case LIC, which is a public financial institution, is holding 12% of the subscribed capital, Allahabad bank, a nationalized bank is holding 6% and BHEL, a government company is holding 10% of the subscribed share capital of Muktha Ltd. Together, these three enterprises hold 28% of share capital. Hence, according to the provisions of section 224A, auditor should be appointed by a special resolution. Appointment of Yamen and Co by ordinary resolution is invalid.

- (d) According to section 226(3) (e) a person holding any security carrying voting rights is disqualified from being appointed as the auditor of the company. Section 224(4) has laid that any person who is disqualified on any grounds mentioned under section 226(3) from being appointed as an auditor of a company is also disqualified for being appointed in its holding company, subsidiary and co-subsidiary. Similarly, if any of the partners is disqualified under section 226(3) (e) to be an auditor of a company, then the partnership firm shall not be appointed as the statutory auditor of its holding company, subsidiary and co-subsidiary. In the given situation, Mr. Nene, one of the partners in Nene and Sane Associates, Chartered Accountants is disqualified from being appointed as statutory auditor of DDA Ltd, under Section 226(3)(e). He is disqualified from being appointed in its holding company, subsidiary and co-subsidiary. On the basis of provisions stated above,

the partnership firm, Nene and Sane Associates is also disqualified from being appointed as auditor of Do Good Ltd.

- 3. Knowledge of CIS:** According to AAS 29 the auditor should have sufficient knowledge of the computer information systems to plan, supervise, control and review the work performed.

Specialised skills: The auditor should consider whether any specialized skills are needed to understand effect of the CIS environment on various audit aspects as on accounting and internal control system, assessment of overall audit risk and designing and performing appropriate tests of control and substantive procedure.

Using the work of an expert: If auditor does not have specialized skills he may seek assistance from his staff or an outside professional.

If auditor plans to use the work of an expert, he should in accordance with AAS 9 obtain sufficient appropriate audit evidence that the work performed by the expert is adequate for the purpose of audit.

- 4.** As per AAS 2, the nature of the risk and internal control characteristics in the CIS environment include:

- i.**Lack of transaction trail: In a computer based accounting records system, audit trail is often missing. Transactions are recorded electronically and trail exist only in computer readable form.
- ii.**Uniform processing of transactions: Errors in a CIS environment are deterministic in nature. Programming errors and other systemic errors in hardware and software will result in all transactions being processed incorrectly.
- iii.**Segregation of functions: In a computer based accounting system, internal controls are established by separation of knowledge not duties. Less number of people is therefore required to perform accounting function.
- iv.**Potential for errors: The potential for human error in the CIS environment is greater as compared to manual system.
- v.**Initiation or execution of transactions: CIS may include the capability to initiate or cause the execution of certain types of transactions automatically. The authorization of such transactions is not documented, but implicitly accepted by the management.
- vi.**Potential for increased management supervision: Computer processing can offer the management a variety of analytical tools which it can use to increase the effectiveness of internal control system.
- vii.**Potential for the use of CAATs: The auditor can process voluminous data by applying computer assisted audit techniques.

**PRIME ACADEMY
PROGRESS TEST – JANUARY 2008**

Time Allowed : 2 Hours

FINAL

Maximum Marks : 75

CORPORATE LAWS AND SECRETARIAL PRACTICE

PART B

(50 Marks)

Answer any five questions

(5 x 10 = 50 Marks)

1. How are the directors of the company is appointed?

2. Some of the small shareholders of M/s. Goodwill Company ltd approach you for advice regarding appointment of one of them as a director of the company. Explain the meaning of a small shareholder and the legal position regarding appointment of a director by such small shareholders.

3. Who is a director? What are his qualifications and disqualifications?

4. V6 Company Ltd in its First General Meeting appointed six directors whose period of office is liable to retire by rotation. Briefly explain the procedure and rules regarding retirement of these directors. Will it make any difference, if V6 Company Ltd does not carry on business for profit?

5. Mr. K chartered accountant is a Director in Sunrise Limited. The company proposes to appoint / engage the firm K & Co in which Mr K is a partner in one or more of the following capacities:
 - a) Consultants on regular retainer basis
 - b) Authorized representative to appear before tribunals . Discuss whether the provisions of Section 314 of the Companies Act are attracted in the above situations.

6. What are the rights and liabilities of the directors for their ultra vires? Is it in order for the company to indemnify the directors against all liabilities that may be incurred by them?

PRIME ACADEMY
PROGRESS TEST – JANUARY 2008
FINAL
CORPORATE LAWS AND SECRETARIAL PRACTICE

PART B

(5 x 10 = 50 Marks)

- 1** The appointment of a director may be grouped under the following heads;
1. Appointment of First Directors,
 2. Appointment at General Meeting,
 3. Appointment by the Board of Directors,
 4. Appointment by Third Parties, and,
 5. Appointment by Central Government.

1. Appointment of First Directors (Sec 254)

The first directors are usually appointed by name in the Articles or in the manner provided therein. Where the Articles do not provide for the appointment of first directors, those of the subscribers to the memorandum who are individuals shall be deemed to be first directors of the company, subject to the regulations of the company's Articles. The first directors can hold office until the directors are duly appointed in accordance with the provisions of section 255 (Section 254)

2. Appointment of Directors at General Meeting (Sec.255)

According to Section 255, the directors must be appointed by the company in general meeting. In the case of a public company or of a private company which is a subsidiary of a public company, unless the Articles provide for the retirement of all directors at every annual general meeting, at least two-thirds of the total number of directors must be persons whose period of office is liable to determination by rotation.

3 Appointment of Directors other than those retiring (Sec 257).

Section 257 recognises the right of any person, whether a member of the company or not, to contest election as a director at any general meeting of the company. This right to contest election as a director accrues to him as soon as he or some member of the company, acting on his behalf, serves on the company fourteen clear days' notice, signifying his candidature for the office of director.

4. Appointment of Directors by the Board

The Board of directors may appoint a director;

- (a) As an additional director; or
- (b) To fill a casual vacancy; or
- (c) As an alternate director.

(a) Additional Director (Sec 260)

The Board of directors are empowered, if so permitted by Articles, to appoint additional directors. However, such additional directors shall hold office only up to the date of the next annual general meeting of the company.

In *Krishna Prasad Pilani Vs. Colabo Land and Mills Company* (1959) it was held that a director appointed as an additional director vacates his office, at the latest, on the last day on which the annual general meeting should have been called as required by Section 166, and cannot continue in office thereafter on the ground that the meeting was not or could not be called within the time prescribed by that section. The expression "up to the date of the annual general meeting" means "up to the date when the next Annual General Meeting ought to be held at the latest"

As to the number that may be appointed as additional directors, sec.260 states that in no case the total number of the directors and additional directors together shall exceed the maximum strength fixed for the Board by the Articles

(b) Casual Vacancies (Sec262)

A casual vacancy is one that arises otherwise than by retirement or the expiration of the time fixed for an appointment. A casual vacancy may be filled up by the Board of Directors itself unless the Articles provide a different procedure. However, a person so appointed shall hold office up to the time his predecessor would have continued and not up to the next AGM.

(c) Alternate Directors (sec313)

The Board of directors of a company may, if so authorized by its Articles or by a resolution passed by the company in general meeting, appoint an alternate director to act for director during his absence for a period of not less than three months from the State in which meetings of the Board are ordinarily held.

An alternate director shall not hold office as such for a period longer than that permissible to the original director in whose place he has been appointed and shall vacate office if and when the original director returns to the state in which meetings of the board are ordinarily held.

5. Appointment of Directors by Third parties.

The Articles may empower a third party, e.g., a vendor of a business to the company to appoint directors (*British Murac Syndicate Vs. Alperon Rubber Co.*) similarly, a banking company to a financial institution which has advanced loans to the company may appoint their nominees on the Board.

6. Appointment of Directors by the Central Government (Sec408)

The central Government has been empowered to appoint directors on an order passed by the company Law Board. The Company Law Board may so order either on a reference by the Central Government or on the application of a not less than 100 members of the company or of members holding not less than 1/10th of the total voting power. Such appointments shall be so ordered by the Company Law Board where it finds that the affairs of the company have been conducted in manner oppressive to any member of the company or in a manner prejudicial to the interests of the company or to public interest. Such a director may be appointed for any term but not exceeding three years.

2. A public company having

A) a paid-up capital of five corer rupees or more;

B) one thousand or more small shareholders;

may' have a director elected by such small shareholders in the manner as may be prescribed.

The expression 'small shareholders' means a shareholder (including a preference shareholder) holding shares of nominal value of twenty thousand rupees or less in a public company to which this section applies.

The department of Company Affairs, in this regard, has prescribed the Companies (Appointment of the small shareholders' Director) Rules, 2001. 'These rules, interlay, provide for the following;

I) Small shareholders intending to propose a person as their representative on the board of the company would be required to give 14 days notice prior to shareholders meeting.

II) The proposed name would have to be endorsed by signatures of at least 100 small shareholders who together represent at least a tenth of the total small shareholders in a company.

III) The nominee would necessarily have to be a small shareholder of the company

IV)The proposed nominee shall give, in writing, his consent to represent small shareholders.

V) Listed public companies shall elect the small shareholders nominee through a postal ballot while unlisted company shall nominee if majority of the small shareholders recommend his candidature at their meeting

The rules also empower the company to act suo moto to elect a small shareholders

VI)A nominee of the small shareholders would not be eligible for appointment as whole time director or managing director of the company.

VII)The tenure of such director shall be a maximum of three years and he need not retire by rotation. The person can be elected for another period of three years on expiry of his tenure.

VIII)A person shall not hold office as small shareholders' director in more than two companies.

3. **Meaning of Director:** Section 2(13) of the Companies Act, 1956 defines a director as including "any person occupying the position of a director by whatever name called." Thus it is not the name by which a person is called but the position he occupies and the functions and duties which he discharges that determines whether in fact he is a director or not. In fact, the articles of certain companies designate them as governors or the members of the executive committee, etc.

Qualifications for Directors: The articles of companies usually provide for share qualification for Directorship. (Reg.66 of Tables "A" provides that a Director must hold at least one share in a company) In case, articles contain a provision to this effect, the section 270 provides that;

i) The same must be disclosed in the prospectus.

ii)Each director must acquire his qualification shares within 2 months after his appointment (Thus, any provision in the articles requiring him to hold shares before appointment or earlier than two months after his appointment shall be void):

iii)Further the normal value of qualification shares must not exceed Rs. Five thousand or the nominal value of one share where it exceeds Rs. Five thousand:

iv) Share warrants are not to be counted for the purpose of share qualification.

Disqualification of Directors:

Section 274 of the Companies Act, 1956 provides that the following persons shall not be capable of being appointed as Directors of any company:

a) A person found by competent court to be of unsound mind and such finding remaining in force.

b) An undercharged insolvent

c) A person who has appealed to be adjudged an insolvent

d) A person who has been convicted by a court of an offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months. This qualification shall however last for a period five years from the date of expiry of the sentence.

e) A person whose calls are in arrears for more than six months: and

f) A person who has been disqualified by a Court in pursuance of section 203.

Section 203 empowers the court to restrain fraudulent persons from managing companies. Non compliance with the provisions of factories act will, therefore, not be a valid ground.

g) A person who is already a director of a public company which,

- Has not filed the annual accounts and annual returns for any three financial years commencing on and after the day of April 1999:
- Has failed to repay its deposit or interest thereon on due dates or redeem its debentures on due dates or pay dividend and such failures continues for one year or more.

4. Company may have two types of directors- retiring and non-retiring. According to the companies Act unless the Articles provide for the retirement of all the directors at every annual general meeting at least 2/3rds of the total number of directors must retire by rotation. The rest will be non-retiring or ex-officio) directors (Sec. 255). Thus, the strength of non-rotational directors can in no case be more than 1/3rd of the total number of directors

Regarding the manner in which the retirement of directors by rotation and filling up of these vacancies will take place, section 256 of the Companies Act provides as follows;

At the first annual general meeting of shareholders, all the directors liable to retirement by rotation must retire and their places filled up by election. At each subsequent annual general meeting 1/3rd of the retiring directors or the number nearest to 1/3rd must retire by rotation. The retirement will take place in order of seniority, i.e., the longest in office shall retire first. In case of directors appointed in the same date, the order of retirement will be determined by mutual agreement or by draw of lots. All retiring directors shall, however, be eligible for re-election.

If a company has a total strength of six directors and Articles do not provide for retirement of all of them, their 2/3rd, i.e., 4 of them must be retiring directors. The other 2 shall be non-retiring (or ex-officio) directors. At the first annual general meeting (AGM) all the 4 retiring directors must retire. At each subsequent AGM, 1/3rd of them or the numbers nearest to 1/3rd, in this case director shall retire by rotation and the vacancies filled up by election.

Section 256 further provides that if the AGM fails to fill up the vacancy caused by retirement and the meeting has not expressly resolved not to fill up the vacancy it shall stand adjourned to

the same day, time and place in the next week. If the adjourned meeting also fails to elect a director to till up the vacancy, the retiring directors shall be deemed to have been re-appointed unless the meeting has already resolved not to full up the vacancy or a resolution for re-appointment of a retiring director had already been moved in a meeting and lost, or he has expressed in writing his unwillingness to continue or he has become disqualified or a resolution, whether special or ordinary, is required for his appointment or re-appointment.

It will not make any difference if V6 does not carry on business for profit . Section 256 of the Companies Act, 1956 is not applicable to Private limited companies. It is applicable to other companies whether carrying on business for profit or not.

5. (a) Chartered Accountants appointed by a company on a regular basis are hit by a restrictive provisions of sub-sections 1 and 1(b) of section 314 if he is a director receiving remuneration over and above to which he is entitled. In case the office or place of profit is held by individual other than a director or firm, private company or other body corporate, if he obtains from the company anything by way of remuneration whether as salary, fees, commission , perquisite or otherwise, approval of the company is not required where the monthly remuneration is less than Rs.10000. Accordingly if a director is holding the place of chartered accountants for the company he would be covered by Section 314(3) irrespective of the fact that office or place of profit carries a total monthly remuneration less than Rs.10000. In the instance case approval of the shareholders by way of special resolution is required.
 - (b) If the appointment is not on retainer or regular basis and one time only, the firm can represent the company before the Tribunal and approval of the shareholders is not required. If the representation is frequent, the approval of the shareholders by special resolution is required.
6. The Board of directors is entitled to exercise all such powers of the company and to do all such acts and things the company is authorized to exercise and do. But the board shall not exercise any power or do any act or thing which is, by the Act or any other statute or by the memorandum or articles of the company or there wise required to be exercised by the company in general meeting. In exercising such powers the Board shall be subject to regulation made by the company in that general meeting (Section 291), But this subject to regulation made by the company in general meeting can override the Board's powers of carrying on the business, by prescribing a regulation, or passing a resolution, taking away the powers which have been conferred upon the Board by the articles {Automatic self Cleaning etc, Co vs Cunningham (1906)2 Ch 34]

The Board of Directors must necessarily act according to the Memorandum and the Articles of Association. The implication of this is that the Board or the shareholders cannot exercise certain powers, which are ultra virus the company. The acts which are intra virus the company i.e., those powers which the company is entitled to exercise and the activities that the company engage itself in fall within the purview of the Board of Directors generally, unless the Articles specifically reserve them for shareholders. For Example it is common that declaration of the dividend is reserved for the shareholders, to be decided upon at the Annual General Meeting (Regulation 85 of the table A of Schedule 1 to the Companies Act)

In case power is reserved for the shareholders by the articles and the Directors happen to exercise that power, it is possible for the shareholders to ratify the action of the Board; in the final analysis, the power is exercised by the shareholders and not by the Directors.

Every officer of the company shall be indemnified out of the assets of the company against any liability incurred by him in defending any proceedings whether civil or criminal in which judgment is given in his favour or in which is acquitted or in connection with any application under section 633 in which relief is granted to him by the court.