PRIME ACADEMY
32ND SESSION PROGRESS TEST – FINANCIAL REPORTING

No. of Pages: 11 **Total Marks: 75**
Time Allowed: 2Hrs

PART - A

1. Non – monetary grants are recognized as assets at
   a. Fair value
   b. Market value
   c. None of the above
   d. Nominal value

2. Interest revenue should be recognized on
   a. A time – proportion basis, reflecting the effective yield of the asset
   b. An accrual basis
   c. A time- proportion basis, reflecting collection periods
   d. None of the above

3. Under consignment sales, revenue is recognized:
   a. After complete sale of goods by the third parties
   b. Immediately on sending the consignment
   c. When the third party starts the sale
   d. None of the above

4. Groups of companies are considered to related parties:
   a. Sometimes
   b. Never
   c. Always
   d. None of the above

5. Which of the following are related parties?
   a. Major shareholders
   b. All suppliers
   c. All government departments
   d. None of the above

6. Disclosures relating to changes in accounting policy caused by a new standard or interpretation include:
   a. The title of the standard or interpretation causing the change
   b. The nature of the change in accounting policy
   c. Both the above
   d. None of the above

7. Financing activities relate to
   a. Change in the size and composition of contributed capital
   b. Financial debt of the company not include in the cash equivalents
   c. Both the above
   d. None of the above

8. Which of the following is reported under direct method?
   a. Impairment of assets written off
   b. Unsuccessful exploration costs
   c. Trade & other receivables moment
   d. None of the above

9. The financial performance of an entity is reflected in
   a. Investing cash flows
   b. Operating cash flows
   c. Financing cash flows
   d. None of the above

10. A Ltd purchased fixed assets from USA for $50000 on 1-10-2008. It entered into currency option contract for purchase of foreign exchange to pay for fixed assets and paid a premium of ₹25000. How will you classify such premium in cash flow statement of A Ltd.
    a. Operating activities
    b. Investing activities
    c. Financing activities
    d. None of the above.

11. While valuing the inventories, any rebate or discounts should be
    a. Ignored
    b. Added with the cost of purchase
    c. Deducted from the cost of purchase
    d. None of the above

12. SILICON Ltd., is an entity with the functional currency as INR. T purchased machinery for USD 200000 from U.S.A. on Jan 10, 2009 payable on June 30, 2009. The exchange rate on the date of purchase was ₹48 to USD 1.

    SILICON Ltd.,'s repaying date is March 31st, 2009 when the exchange rate was ₹50 to USD 1

    How will SILICON Ltd., record the transaction on January 1, 2009?
    a. 200,000 x 48 = ₹9600,000.
    b. 200,000 x 50 = ₹100,00,000.
    c. 200,000 dollars.
    d. None of the above

13. Foreign operations that are an integral part of the operations of an entity would have the same functional currency as that of the entity. Where a foreign operation functions independently from the parent, the functional currency will be:
    a. That of the parent
    b. Determined using the guidance for determining the entity's functional currency.
    c. That of the country of incorporation
    d. None of the above

14. List of cash and cash equivalent includes
    a. Cash on hand at the end of the month
    b. Government Securities
    c. Overdraft balance
    d. All of the above

15. Solvency relates to ------------- availability of cash in order to settle financial liabilities
    a. Future
    b. Past
    c. Current
    d. All of the above

16. A contract for the construction of an asset or a combination of assets that are closely interrelated in terms of design, technology and function or ultimate purpose is
    a. a construction contract
    b. a fixed-price contract
    c. a cost-plus contract
    d. a service contract

17. On January 1 2007, A Ltd Company purchased for ₹240000 a machine with a useful life of 10 years and no salvage value. The machine was depreciated by diminishing balance method and the carrying amount of the machine was ₹153600 on December 31 2008. The company changed to the straight line method on Jan 1, 2009. What should be the depreciation expenses on this machine for the year ended Dec 31 2009?

a. ₹19200
b. ₹24000
c. ₹30720
d. None of the above

18. During 2007-08 AD softex India Ltd engaged in the following transactions:

Salary expenses to key employees who are also principal owners	₹100000
Sales to affiliated enterprises	₹ 250000

Which of the two transactions would be disclosed as related party transactions in AD Softex India Ltd 2007-08 financial statements?
a. ₹100000 transaction only
b. ₹250000 transaction only
c. Both transactions.
d. None of the above

19. State bank of India, received a gross ₹1500 crores demand deposits from customers withdrawn ₹1300 of demand deposit during the financial year 2007-08. How will you classify such receipts and payments in cash flow statement of SBI and the manner of such presentation? Choose any one.
a. Operating activities, on net basis (₹200 crores inflow)
b. Operating activities, on net basis (₹200 crores outflow)
c. Financing activities, on total basis (₹1300 crores outflow)
d. None of the above

20. Grants related to income can be treated as :
a. Credit in the P & L account under a separate head
b. Other income
c. Either of the above
d. None of the above

21. When the buyer has the right to return the goods purchased as per contract,
a. The seller can recognize the revenue on sale
b. The revenue cannot be recognized at all
c. The revenue cam be recognized only on approval from the buyer
d. None of the above

22. A contract for the construction of an asset or a combination of assets that are closely interrelated in terms of design, technology and function, or ultimate purpose is ________
a. a construction contract
b. a fixed-price contract
c. a cost-plus contract
d. a service contract

23. Which is not a cost directly related to the contract?
    a. Site labour costs, including site supervision
    b. Costs of materials used in construction
    c. Insurance
    d. Costs of moving plant, equipment and materials to and from the contract site

24. Identify the items of cost that should not be included in the cost of conversion
    a. Factory maintenance costs
    b. Depreciation
    c. Direct administrative costs
    d. Selling costs

25. What happens to the allocation of fixed overhead to each unit during the time of low production?
    a. Per unit cost increases
    b. Per unit cost decreases
    c. Per unit cost is fixed
    d. Per unit cost varies

(25x1=25 Marks)

PART - B

Question 1 is Compulsory. Any 3 questions from the rest

1. The Balance Sheet of three companies Angle Ltd., Bolt Ltd., and Canopy Ltd., as at 31st December, 2007 are given below:

Liabilities	Angle Ltd. ₹	Bolt Ltd. ₹	Canopy Ltd. ₹
Share capital (Equity shares of Rs.100 each)	15,00,000	10,00,000	6,00,000
Reserves	2,00,000	1,25,000	75,000
Profit and loss A/c	5,00,000	2,75,000	2,50,000
Sundry creditors	2,00,000	2,50,000	1,00,000
Bills payable	-	-	50,000
Angle Ltd	-	1,00,000	80,000
TOTAL	**24,00,000**	**17,50,000**	**11,55,000**
Goodwill	2,50,000	5,80,000	4,50,000
Plant and Machinery	400,000	2,50,000	3,25,000
Furniture and fittings	2,00,000	1,50,000	1,40,000
Shares in-			
Bolt Ltd. (7500 shares)	9,00,000	-	-
Canopy Ltd. (1000 shares)	1,50,000		
Canopy	-	5,20,000	-

Ltd. (3500 shares)			
Sundry debtors	1,40,000	70,000	70,000
Stock in trade	1,00,000	1,50,000	1,60,000
Bills receivable	50,000	20,000	-
Due from-			
Bolt Ltd.	1,20,000	-	-
Canopy Ltd.	80,000	-	-
Cash in hand	10,000	10,000	10,000
Total	**24,00,000**	**17,50,000**	**11,55,000**

All shares were acquired on 1st July, 2006

a. On 1st January, 2006, the balances were:

	Angle Ltd. ₹	**Bolt Ltd.** ₹	**Canopy Ltd.** ₹
Reserves	1,00,000	1,00,000	50,000
Profit and Loss Account	50,000	(50,000)Dr.	30,000
Profit during 2006 were earned evenly over the year	3,00,000	2,50,000	1,00,000

b. Each company declared a dividend of 10% in the year 2007 on its shares out of profits for the year 2006; Angle Ltd. and Bolt Ltd. have credited their Profit and Loss Account with the dividends received.

c. The increase in reserves in case of Angle Ltd., Bolt Ltd., and Canopy Ltd., was effected in the year 2006.

d. All the bills payable appearing in Canopy Ltd.'s Balance Sheet were accepted in favour of Bolt Ltd., out of which bills amounting ₹30000 were endorsed by Bolt Ltd., in favour of Angle Ltd.

e. Stock with Bolt Ltd. includes goods purchased from Angle Ltd., for ₹18000. Angel Ltd., invoiced the goods at cost plus 20%.

Prepare:

Consolidated Balance Sheet of the group as at 31st December, 2007. Working should be part of the answer. Ignore taxation including dividend distribution tax; disclose minority interest as per AS 21.

(20 Marks)

2. M Ltd. Group has three divisions A, B, C Details of their turnover, results and net assets are given below:

Division A	**₹('000)**
Sales to B	30,50
Other sales (Home)	60
Export sales	40,90
	72,00
Division B	
Sales to C	30
Export Sales to Europe	2,00
	2,30
Division C	
Export Sales to America	**1,80**

	Head Office ₹ ('000)	**Divisions**		
		A ('000)	**B ('000)**	**C ('000)**
Operating Profit or Loss before tax		1,60	20	(8)
Re-allocated cost from Head Office		48	24	24
Interest costs		4	5	1
Fixed assets	50	200	40	120
Net current assets	48	120	40	90
Long term liabilities	38	20	10	120

Prepare a segmental Report for publication in M Ltd. Group.

(10 Marks)

3.

a. X Ltd. received a grant of ₹2 crores from the Central Government for the purpose of a special Machinery during 1998-99. The cost of Machinery was ₹20 crores and had a useful life of 9 years. During 2002-03, the grant has become refundable due to non-fulfillment of certain conditions attached to it. Assuming the entire grant was deducted from the cost of Machinery in the year of acquisition. State with reasons, the accounting treatment to be followed in the year 2002-03.

(4 Marks)

b. A firm of a father and a son is receiving ₹2 lakhs towards job work done for XYZ Ltd. during the year ended on 31.03.04. The total job work charges paid by XYZ Ltd. during the year are over ₹50 lakhs. The father is a Managing Director of XYZ Ltd. having substantial holding. The Managing Director told the auditor that since he is not involved in the activities of the firm and since the amount paid to it is insignificant; there is no need to disclose the transaction. He further contended that such a payment made in last year was not disclosed. Is Managing Director right in his approach?

(4 Marks)

c. Himalayan Ltd. in the past three years spent ₹75,00,000 to develop a Drug to treat cancer, which was charged to Profit and Loss Account since they did not meet AS 8 criteria for capitalization. In the current year approval of the concerned Government Authority has been received. The Company wishes to capitalize ₹75,00,000 and disclose it as prior period item. Is it correct? Give reasons for your views.

(2 Marks)

4. Ms. Joythi of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year 2005:

	(₹ in lakhs)
Net Profit	25,000
Dividend(including dividend tax) paid	8,535
Provision for income tax	5,000
Income tax paid during the year	4,248
Loss on sale of asset (net)	40
Book value of the asset sold	185
Depreciation charged to Profit and Loss Account	20,000
Amortisation of Capital grant	6
Profit on sale of investment sold	100
Carrying amount of investment sold	27,765
Interest Income on Investment	2,506
Interest expenses	10,000

Interest paid during the year	10,520
Increase in Working Capital (excluding cash & Bank balance)	56.075
Purchase of fixed assets	14,560
Investment in joint venture	3,850
Expenditure on construction work in progress	34,740
Proceeds from calls in arrear	2
Receipts of grant for capital projects	12
Proceeds from long term borrowings	25,980
Proceeds from short term borrowings	20,575
Opening cash and bank balance	5,003
Closing cash and bank balance	6,988

Required:
Prepare the Cash Flow Statement for the year 2005 in accordance with As-3, Cash Flow Statement issued by the Institute of Chartered Accountants of India. (Make necessary assumptions).

(10 Marks)

5. System Ltd. and HRD Ltd. decided to amalgamate as on 01.04.2008. Their Balance Sheets as on 31.03.2008 were as follows:

(₹in ‘000)

Particulars	**System Ltd.**	**HRD Ltd.**
Source of Funds :		
Equity Share Capital (₹100 each)	1,50	1,40
9% preference share capital(₹100 each)	30	20
Investment allowance reserve	5	2
Profit and Loss Account	10	6
10% Debentures	50	30
Sundry Creditors	25	15
Tax provision	7	4
Equity Dividend Proposed	30	28
Total	**3,07**	**2,45**
Application of Funds:		
Building	60	50
Plant and Machinery	80	70
Investment	40	25
Sundry Debtors	45	35
Stock	36	40
Cash and bank	40	25
Preliminary Expenses	6	-
Total	**3,07**	**2,45**

From the following information, you are required to prepare the draft Balance sheet as on 01.04.2008 of a new company, Intranet Ltd., which was formed to take over the business of both the companies and took over all the assets and liabilities:

i. 50% Debentures are to be converted into Equity shares of the New Company.
ii. Out of the investments, 20% are non-trade investments.
iii. Fixed Assets of Systems Ltd. were valued at 10% above cost and that of HRD Ltd. at 5% above cost
iv. 10% of sundry Debtors were doubtful for both the companies, Stocks to be carried at cost.
v. Preference share holders were discharged by issuing equal number of 9% preference shares at par.
vi. Equity shareholders of both the transferor companies are to be discharged by issuing Equity shares of ₹10 each of the new company at a premium of ₹5 per share.

Amalgamation is in the nature of purchase.

(10 Marks)

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32ND SESSION PROGRESS TEST – FINANCIAL REPORTING
SUGGESTED ANSWERS

PART – A

Question	Answers
1	a
2	a
3	a
4	c
5	a
6	a
7	c
8	a
9	b
10	b
11	c
12	a
13	b
14	d
15	a
16	a
17	b
18	c
19	a
20	c
21	c
22	a
23	c
24	d
25	a

PART B

1.

Consolidated Balance Sheet of Angle Ltd. and its subsidiaries Bolt Ltd and Canopy Ltd as at 31st December, 2007

Liabilities		₹	**Assets**		₹
Share Capital: (Equity shares of ₹100 each)		15,00,000	**Goodwill**		
Minority Interest(W.N.6)			Angle Ltd. 2,50,000		
Bolt Ltd.	3,97,396		Bolt Ltd. 5,80,000		
Canopy Ltd.	2,31,250	6,28,646	Canopy Ltd. 4,50,000	12,80000	
Reserves (200000+14844+2083)		2,16,927	**Add:** Cost of control (W.N.7)	1,55,833	14,35,833
Profit and loss account (W.N.4)		7,62,260	**Plant and Machinery**:		
Sundry Creditors:			Angle Ltd.	4,00,000	
Angle Ltd.	2,00,000		Bolt Ltd.	2,50,000	
Bolt Ltd.	2,50,000		Canopy Ltd	3,25,000	9,75,000
Canopy Ltd.	1,00,000	5,50,000			
			Furniture & fittings:		
Bills Payable	50,000		Angle Ltd	2,00,000	
Less: Mutually held	50,000	Nil	Bolt Ltd	1,50,000	
			Canopy Ltd	1,40,000	4,90,000
			Stock-in-trade		
			Angle Ltd.	1,00,000	
			Bolt Ltd.	1,50,000	
			Canopy Ltd.	1,60,000	
				4,10,000	
			Less: Provision for unrealized profit	3,000	4,07,000
			Sundry Debtors:		

			Angle Ltd.	1,40,000	
			Bolt Ltd.	70,000	
			Canopy Ltd.	70,000	2,80,000
			Bills Receivable:		
			Angle Ltd.	50,000	
			Bolt Ltd	20,000	
				70,000	
			Less: Mutually held	50,000	20,000
			Cash-in-hand		
			Angle Ltd.	10,000	
			Bolt Ltd.	10,000	
			Canopy Ltd.	10,000	30,000
			Cash-in-transit / Dues from Bolt Ltd. (W.N.8)		20,000
		36,57,833			**36,57,833**

Disclosure of Minority Interest in accordance with AS-21

Amount of Equity attributable to minorities on the date of Investment i.e, 1.7.2006

	Bolt Ltd.	**Canopy Ltd.**
Share Capital	2,50,000	1,50,000
Share in Capital Reserve as on 1.1.06	25,000	12,500
Share in capital profits as on 1.1.06	(12,500)	7,500
Share in Capital profits for the period 1.1.06 to 30.06.06	31,250	12,500
	2,93,750	**1,82,500**
Total amount of Equity attributable to minorities	**4,76,250**	

Disclosure in accordance with AS-21 Minority interest as on 31.12.2007

Amount of equity as on the date of Investment i.e., 1.7.2006	4,76,250
Add: Moment in equity and proportionate share of profits less dividend from the date of Investment up to 31.12.07	1,52,396
	6,28,646

Working Notes:

1. Ascertainment of profits for the year 2007

	Angle Ltd ₹	Bolt Ltd. ₹	Canopy Ltd. ₹
Balance as on 1st January 2006	50,000	(50,000)	30,000
Add: Profits earned during 2006	3,00,000	2,50,000	1,00,000
	3,50,000	2,00,000	1,30,000
Less: Dividend Declared	1,50,000	1,00,000	60,000
	2,00,000	10,00,00	70,000
Less: Transfer to Reserve	1,00,000	25,000	25,000
	1,00,000	**75,000**	**45,000**
Profits for the year 2007 (Balancing Figure)	4,00,000	2,00,000	2,05,000
Balance as on 31st December, 2007	**5,00,000**	**2,75,000**	**2,50,000**

2. Undistributed profits for the year 2006

	Bolt Ltd. ₹	Canopy Ltd. ₹
Profits for the year 2006	2,50,000	1,00,000
Less: Dividends declared	1,00,000	60,000
	1,50,000	**40,000**
Less: Transfer to Reserves	25,000	25,000
	1,25,000	**15,000**

3. Analysis of profits

	Capital Profit ₹	Revenue Reserves ₹	Revenue Profits
Canopy Ltd.			
Reserves as on 1st January, 2006	50,000		

Transfer to Reserve in the year 2006 **[(75000-50000)/2]**	12,500	12,500	
Profit and loss Account Balance as on 1st January, 2006	30,000		
Profits for 2006 remaining undistributed **[(100000-25000-60000)/2]**	7,500		7,500
Profit for the year 2007 **(250000-30000-15000]**	________	_______	2,05,000
(A)	**1,00,000**	**12,500**	**2,12,500**
Minority Interest[1/4th of (A)	25,000	3,125	53,125
	75,000	**9,375**	**1,59,375**
Share of Angle Ltd. [1/6th of (A)]	16,667	2,083	35,417
Share of Bolt Ltd.	**58,333**	**7,292**	**1,23,958**
Bolt Ltd.			
Reserves as on 1st January, 2006	1,00,000		
Transfer to reserves 2006 **[(125000-100000)/2]**	12,500	12,500	
Profit & Loss A/c – Balance(Dr.) as on 1st January 2006	(50,000)		
Undistributed Profits for 2006 **[(250000-25000-100000)/2]**	62,500		62,500
Share in profits of Canopy Ltd.	58,333	7,292	1,23,958
Profit for the year, 2007**(275000+50000-125000)**	_______	_______	2,00,000
(B)	**1,83,333**	**14,844**	**2,89,843**
Less: Minority Interest [1/4th of (B)]	45,833	4,948	96,615
Share of Angle Ltd.	**1,37,500**	**14,844**	**2,89,843**

4. Consolidated Profit and Loss Account of Angel Ltd.

		₹
Profit and Loss Account balance as on 31.12.2007		5,00,000
Add: Share in revenue profits of Canopy Ltd.		35,417
Share in revenue profits of Bolt Ltd		2,89,843
		8,25,260
Less: Pre-acquisition dividend		
Angle Ltd. ½(₹75000+₹10000)	42,500	
Bolt Ltd. (1/2 of Rs.35000)	17,500	60,000
		7,65,260
Less: Unrealised Profit in Closing Stock(20/120×18000)		3,000
		7,62,260

5. Consolidated Reserves of Angle Ltd.

	₹
Reserves	2,00,000
Add: Share in revenue reserves of Canopy Ltd.	2,083
Add: Share in revenue reserves of Bolt Ltd.	14,844
	2,16,927

6. Minority Interest

	Bolt Ltd. ₹	**Canopy Ltd** ₹
Share capital	2,50,000	1,50,000
Share of capital profits	45,833	25,000
Share of Revenue Reserves	4,948	3,125
Share of Revenue Profits	96,615	53,125
Total	**3,97,396**	**2,31,250**
Grand Total		**6,28,646**

7. Cost of Control/Goodwill

	₹	₹
Cost of investments (900000+150000+520000)		15,70,000
Less: Dividend Attributable to Pre-Acquisition Profits for 6months i.e.[(75000+45000)/2]		60,000
		15,10,000
Less: Face value of Shares		
Bolt Ltd.	7,50,000	
Canopy Ltd.	4,50,000	
Capital Profits:		
Bolt Ltd.	1,37,500	
Canopy Ltd.	16,667	13,54,167
Goodwill		**1,55,833**

8. Cash in Transit / Dues From Bolt Ltd.

	₹	₹
Due To Angle Ltd :		
From Bolt Ltd	1,20,000	
From Canopy Ltd.	80,000	2,00,000
Due By Angle Ltd.		
To Bolt Ltd.	1,00,000	
To Canopy Ltd.	80,000	1,80,000
		20,000

2.

M Ltd.
Segmental Report

Segment Revenue	**Division's**				**Inter Segment Eliminations**		**Consolidated Total**
	A	**B**		**C**			
Sales: Domestic Export	 60 4,090	 - 200		 - 180	 - -		 60 4470
External sales	**4,150**	**200**		**180**	**-**		**4530**
Inter-segment sales	3,050	30		-	3080		-
Total revenue	**7,200**	**230**		**180**	**3080**		**4530**
Segment result (given)	160	20		(8)			172
Head office expenses							(96)
Operating profit							76
Interest expenses							(10)
Profit before tax							**66**
Other Information							
Fixed assts	200	40	120				360
Net current assets	120	40	90				250

Segment assets	**320**	**80**	**210**				**610**
Unallocated corporate assets							98
Segment liabilities	20	10	120				150
Unallocated corporate liabilities	20	10	120				38

Sales Revenue by Geographical Market

	Home Sales	**Export Sales (by division A)**	**Export to Europe**	**Export to America**	**Consolidated Total**
External Sales	60	4,090	200	180	4,530

3.

a. As per Para 11.3 of AS-12 on Accounting for Government Grants, the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset. Depreciation on the revised book value is provided prospectively over the residual useful life of the asset. In the given case, book value of machinery will be increased by ₹2 crores in the year 2002-2003. The computation for the depreciation on machinery can be given as:

Cost of machinery	₹20 crores
Less: Grant received	₹2 crores
Cost of machinery	**₹18 crores**
Useful life of machinery	9 years
Depreciation per year as per straight line method (assuming residual value to be zero) [₹18 crores/9]	₹2 crores
Total depreciation for 4years (1998-99 to 2001-2002)	₹8 crores
Book Value (in year 2002-2003)	**₹10 crores**
Add: Grant refunded	₹2 crores
Revised book value	**₹12 crores**

Remaining useful life	5 years
Revised annual depreciation [₹12crores/5]	2.4 crores

Thus the book value of machinery will be ₹12 crores in the year 2002-2003 and the depreciation amounting ₹2.4 crores will be charged on machinery. Annual depreciation of ₹2.4 crores will be charged in the next four years.

b. **Related party transactions:** Accounting Standard 18, "Related Party Disclosures" applies to the facts of the case. AS-18 requires disclosure of party relationship and transactions between a reporting enterprise and its related parties. The parties are considered to be related if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making decisions. As per the explanation given in AS-18, significant influence is said to exist in case the investing party has 20% or more voting power in the enterprise. In the instant case, the managing director of XYZ Ltd. is a partner in the firm with his son which has been paid ₹2 lakhs as job work charges. The managing director is having a substantial holding in the firm. The case is squarely covered by AS-18. The approach of the managing director is not tenable under the law and accordingly all disclosure requirements have to be complied with. Accordingly, the auditor shall have to modify his report. Also it has to be seen whether section 299 regarding disclosure of interest by interested directors has been complied with. If it is not complied with, the auditor needs to modify the report appropriately.

c. AS-8 on 'Accounting for Research and Development' stands withdrawn w.e.f 1st April, 2003 i.e, the date from which AS-26 'Intangible Assets' becomes mandatory. In any case, under either standard, the condition for recognition of a research and development asset has to be fulfilled when the expenditure was incurred. If the recognition conditions are not fulfilled the amount has to be charged to the profit and loss account, such amount cannot be restated later as a research and development asset when the condition for recognition gets fulfilled. The company therefore, cannot capitalize ₹7500000 even as a prior period item.

4.

Star Oils Limited

Cash Flow Statement for the year ended 31st December, 2005

(₹ in lakhs)

Cash flows from operating activities:			
Net Profit before taxation (25000+5000)		30,000	
Adjustments for:			
Depreciation	20,000		
Loss on sale of asset (Net)	40		
Amortization of capital grant	(6)		
Profit on sale of investments	(100)		
Interest income on investments	(2,506)		
Interest expenses	10,000	27,428	
Operating profit before working capital changes		57,428	
Changes in working capital (excluding cash and bank balance)		(56, 075)	
Cash generated from operations		1,353	
Income tax paid		(4,248)	
Net cash used in operating activities			(2,895)
Cash flow from investing activities:			
Sale of assets		145	
Sale of investments (27765+100)		27,865	
Interest income on investments		2,506	
Purchase of fixed assets		(14,560)	
Investment in joint venture		(3,850)	
Expenditure on construction work-in progress		(34,740)	
Net cash used in investing activities			(22,634)
Cash flow from financing activities			
Proceeds from calls in arrear		2	
Receipts of grant for capital projects		12	
Proceeds from long-term borrowings		25,980	
Proceeds from short-term borrowings		20,575	
Interest paid		(10,520)	
Dividend (including dividend tax) paid		(8,535)	27,514
Net increase in cash and cash equivalents			1,985
Cash and cash equivalent at the beginning of the period			5,003
Cash and Cash equivalents at the end of the period			6,988

Working Note:

Book value of the asset sold	185

Less: Loss on sale of assets	40
Proceeds on sale	145

Assumption:

Interest income on investment ₹2,506 has been received during the year.

5.

M/s Intranet Ltd.
Draft Balance sheet as on 1.04.2008

Liabilities	**₹**	**Assets**	**₹**
Equity share capital: 27799 Equity shares of ₹10, fully paid up (25133+2666) **(W.N.2)**	2,77,990	Building (₹66,000+₹53500)	1,18,500
9% Preference share capital (Share of ₹100 each) (W.N.2)	50,000	Plant and machinery (₹88000+₹73500)	1,61,500
Securities premium (125665 +13330)(W.N.2)	1,38,995	Investments (₹40000+ ₹25000)	65,000
Investment allowance reserves (₹5000+ ₹2000)	7,000	Stock (₹36000+ ₹40000)	76,000
10% Debentures (50% of ₹80000)	40,000	Sundry Debtors (90% of ₹45000+ ₹35000)	72,000
Sundry Creditors (₹25000+ ₹15000)	40,000	Cash and Bank (₹40000+ ₹25000- ₹15)	64,985
Tax provision (Rs.7000+4000)	11,000	Amalgamation adjustment account	7,000
	5,64,985		**5,64,985**

Working Notes:

1. Calculation of values of equity shares issued to transferor companies

	System Ltd. **₹**	**HRD Ltd.** **₹**
Assets taken over:		
Building	66,000	52,500
Plant and machinery	88,000	73,500
Investments (trade and non-trade)	40,000	25,000
Stock	36,000	40,000
Sundry Debtors	40,500	31,500
Cash & Bank	40,000	25,000
	3,10,500	**2,47,500**
Less: Liabilities:		
10% Debentures	50,000	30,000

Sundry Creditors	25,000		15,000	
Tax Provision	7,000	**82,000**	4,000	**49,000**
		2,28,500		1,98,500
Less: Preference Share Capital		30,000		20,000
		1,98,500		**1,78,500**

2. Number of shares issued to equity shareholder, debentures holders and preference shareholders

	System Ltd.	**HRD Ltd.**		**Total**	
Equity shares issued @ ₹15 per share(including ₹5 premium)					
198500 divided by 15	13,233 shares[1]				
178500 divided by 15		11,900 shares		25,133 shares	
Equity share capital @ ₹10	₹1,32,330	₹1,19,000		₹2,51,330	
Securities premium @ ₹5	₹66,165	₹59,500		₹1,25,665	
	₹1,98,495	₹1,78,500		₹3,76,995	
1 Cash paid for fraction of shares = ₹198500 less ₹198495 =₹5					
50% of Debentures are converted into equity shares @ ₹15 per share					
25000 divided by 15	1,666 shares[2]				
15000 divided by 15			1,000 shares		2,666 shares
Equity share capital @ ₹10	₹16,660		₹10,000		₹26,660
Security premium @ ₹5	₹8,330		₹5,000		₹13,330
	₹24,990		₹15,000		₹39,990
9% Preference share capital issued	₹30,000		₹20,000		₹50,000
2 Cash paid for					

fraction of shares = ₹25,000 less ₹24,990 = ₹10					

PRIME ACADEMY
32ND SESSION PROGRESS TEST – STRATEGIC FINANCIAL MANAGEMENT

No. of Pages: 6 **Total Marks: 75**
Time Allowed: 2Hrs

PART - A

1. Under Graham & Dodd model the weight attached to dividends is equal to --- times the weight attached to retained earnings
   a. 1
   b. 2
   c. 3
   d. 4

2. _____________ theory assumes that the dividend declaration of dividend does not affect the market price
   a. Graham & Dodd model
   b. Lintner's model
   c. Modigliani-Miller model
   d. Gordon's model

3. Ns Ltd's stock trades at ₹80 per share. The company is contemplating a 5 for 2 stock split. What will be the stock price post split?
   a. ₹32
   b. ₹28
   c. ₹30
   d. ₹40

4. _________________ model assumes cost of equity is greater than growth rate
   a. Gordon's model
   b. Walter's model
   c. Graham & Dodd model
   d. None of the above

5. With stock split share capital of the company
   a. Increases
   b. Decreases
   c. Remains the same
   d. None of the above

6. The earning per share of a company is ₹30 and the dividend pay our ratio is 60% and the share price is ₹56. The multiplier applicable to the company (approx) according to Graham and Dodd model is

a. 3
b. 2
c. 4
d. 5

7. In capital rationing situation the method used is
   a. NPV method
   b. IRR method
   c. PI method
   d. ARR method

8. A reverse split increases the market price per share
   a. True
   b. False
   c. Partly true
   d. None of the above

9. Higher the standard deviation , higher is the risk attached with a project
   a. True
   b. False
   c. Partly true
   d. None of the above

10. Standard Deviation is standardized unit of deviation from __________
    a. Median
    b. Mode
    c. Mean
    d. None of the above

11. Cash flows expected in a project are converted into risk less equivalent amounts using_______
    a. Standard Deviation
    b. Certainty Equivalent Factor
    c. Risk adjusted discount rate
    d. None of the above

12. Record date and Ex dividend date are one and the same
    a. True
    b. False
    c. None of the above
    d. Partly true

13. Share buyback tend to increase the market price of shares because
    a. EPS increases
    b. EPS decreases
    c. EPS remains the same
    d. None of the above

14. Corn Ltd has 12 lakh equity shares with current market price ₹450. The company wants to buy back 2 lakh shares. What should be the buy back price per share?
    a. 500
    b. 540
    c. 525
    d. 600

15. Sensitivity analysis measures the absolute change in input parameter due to changes in variables
    a. True
    b. False
    c. Partly true
    d. None of the above

16. In capital budgeting to measure the resilience level of identified variable due to changes in assumptions we use
    a. Decision trees
    b. Simulation
    c. Risk adjusted discount rate
    d. Sensitivity analysis

17. Perfectly correlated cash flows carry greater risks than those that are less perfectly correlated
    a. False
    b. Partly true
    c. True
    d. None of the above

18. For assessing probability of sequential events , probability of each of which is conditioned by preceding event we calculate
    a. Standard deviation
    b. Mean of the events
    c. Joint probability
    d. Coefficient of variation

19. IRR is the discount rate at which
    a. NPV is + ve
    b. NPV is – ve
    c. NPV is zero
    d. None of the above

20. When money is in short supply, selecting projects on the basis of NPV would lead to an incorrect decision
    a. True
    b. False
    c. Partly true
    d. None of the above

21. Market capitalization is
    a. No. of equity shares x Market price of share
    b. No. of equity shares x Face value of share
    c. Share capital x Market price of share
    d. Share capital x Face value of share

22. Under all-or-nothing approach to dividends for a growth company the optimum pay out ratio is
    a. 100 %
    b. 0 %
    c. Indifference
    d. None of the above.

23. What would be the dividend per share for the calendar year 2010 using Lintner's model with the given data. Its EPS is ₹6 with target payout ratio 0.8. Its dividend per share in previous year is ₹3. Use adjustment factor 0.8
    a. 3.33
    b. 4.44
    c. 3.80
    d. 4.20

24. A ltd has 2000 shares of ₹10 each raised at a premium of ₹12 per share. The company's stock sells for ₹25 per share. If a 10% stock dividend is declared how many new shares would be issued
    a. 240 shares
    b. 250 shares
    c. 200 shares
    d. 180 shares

25. In problem no.24 What would be the market price after the stock dividend?
    a. 22.73
    b. 27.50
    c. 20.00
    d. 25.00

(25x1=25 Marks)

PART – B

1.

a. BST Ltd has a capital of ₹15,00,000 in equity shares of ₹100 each. The shares are currently quoting at par. The company proposes to declare a dividend of ₹15 per share at the end of current financial year. The capitalization rate for the risk class of which the company belongs is 18%. What will be the market price of the share at the end of the year if

   i. a dividend is not declared
   ii. a dividend is declared
   iii. If the company pays the dividend and has net profit of ₹8,00,000 and makes new investment of ₹12,00,000 during the period, how many new shares must be issued? Use MM model

(10 Marks)

b. Govind Ltd has surplus cash of ₹75 lakhs and wants to distribute 25% of it to the shareholders. The company decides to buy back shares and it estimates that its share price after buy back is likely to be 12% above the buyback price. The number of shares outstanding at present is 8 lakhs and the current EPS is ₹5. Determine

   i. the price at which the shares can be repurchased, if the market capitalization of the company should be ₹180 lakhs after buy back
   ii. the number of shares that can be re purchased
   iii. The impact of shares repurchase on the EPS, assuming that net income is the same

(10 marks)

2. A firm has an investment proposal requiring an outlay of ₹40,000. The investment proposal is expected to have 2 years economical life with no salvage value. In year I, there is a 0.4 probability that cash inflow after tax will be ₹25,000 and 0.6 probability that cash inflow after tax will be 30,000.The probabilities assigned to cash inflow after tax for the year II are as follows:

The Cash inflow year I	₹25,000		₹30,000	
The Cash inflow year II	₹12,000	0.2	₹20,000	0.4
With Probabilities	₹16,000	0.3	₹25,000	0.5
	₹22,000	0.5	₹30,000	0.1

The firm uses 10% discount rate of this type of investment.

Required:

a. What net present value will the project yield if worst yield if worst outcome is released? What is the probability of occurrence of this NPV?
b. What will be the best and the probability of that occurrence?
c. Will the project be accepted?

(15 marks)

3. Electronics Ltd an existing company, is considering a new project for manufacture of pocket video games involving a capital expenditure of ₹600 lakhs and working capital of ₹150 lakhs. The capacity of the plant is for an annual production of 12 lakh unit and capacity utilization during the 6 year working life of the project is expected to be as indicated below:

Year	Capacity utilization %
1	33-1/3%
2	66-2/3%
3	90%
4-6	100%

The average price per unit of the product is expected to be ₹200 netting a contribution of 40%. Annual fixed costs, excluding depreciation are estimated to be 480 lakhs per annum from the third year on ward; for the first and second year it would be 240 lakhs and 360 lakhs respectively. The average rate of depreciation for tax purposes is 33-1/3% on the capital assets. No other tax relief is anticipated. The rate of income tax may be taken at 50%.At the end of the third year, an additional investment of ₹100 lakhs would be required for working capital. The company without taking into account the effects of financial average, has targeted for a rate of return of 15%. You are required to indicate whether the proposal is advisable, giving your working notes and analysis, the present value factor at 15%, discount rate, Terminal value for the fixed assets may be taken at 10% and for the current assets at 100%.Calculation may be rounded off to lakhs of rupees.

(15 marks)

PRIME ACADEMY
32ND SESSION PROGRESS TEST – STRATEGIC FINANCIAL MANAGEMENT
SUGGESTED ANSWERS

PART – A

Question	Answers
1	d
2	c
3	a
4	a
5	c
6	b
7	c
8	a
9	a
10	c
11	b
12	b
13	a
14	b
15	b
16	d
17	c
18	c
19	c
20	a
21	a
22	b
23	b
24	c
25	a

PART - B

1.

a. As per MM model, the current market price of equity share is

$$P(0) = \frac{1}{1 + Ke}(D1 + P(1))$$

i) If dividend is not declared

$$100 = \frac{1}{1 + 0.18}(0 + P(1))$$

P(1) = ₹118

The market price at the end of the year would be ₹118

(ii) If dividend is declared

$$100 = \frac{1}{1 + 0.18}(15 + P(1))$$

P(1) = ₹103

The market price at the end of the year would be ₹103

iii) In case the firm pays a dividend of ₹15 per share out of total profits of ₹8,00,000 and plans to make new investment of ₹12,00,000, the number of new shares to be issued is

Total earnings = ₹8,00,000
Dividend paid = ₹2,25,000
Retained earnings = ₹5,75,000
Total funds required - ₹12,00,000
Fresh funds to be raised = ₹12,00,000 – ₹5,75,000 = ₹6,25,000
Number of shares to be issued is = ₹6,25,000/103 = 6067.961
i.e the firm would issue 6068 equity shares at the rate of ₹103

b. Let A be the buy back price decided by the company
Market capitalization after buy back

$$= 1.12\,A\left(\text{Original shares} - \frac{25\ \%\ \text{of}\ ₹75\ \text{lakhs}}{A}\right)$$

= 1.12 A (8 lakhs – 18.75 lakhs/A)
= 8.96 lakhs A - 21 lakhs should be equal = ₹180 lakhs
8.96 lakhs A = 180 + 21 = 201 lakhs
solving A= ₹22.43 per share

ii) Number of shares to be bought back = 18.75 lakhs / 22.43
= 83,593 shares (approx)

iii) After buyback number of shares left = 8,00,000 – 83,593 = 7,16,407
EPS = 5 x 8 lakhs/ 7,16,407
= ₹5.58 (approx)
Thus EPS increase to ₹5.58 after buy back

c. As per Walter model $P = \frac{D + (r/k)(E - D)}{K}$

P = market price of the share = ₹42
E = Earning per share = (Net profit – Preference dividend) / No of shares
= (30 lakhs – 12% of 100 lakhs) / 3 lakhs = ₹6
r = return on investment = 20%
K = is the cost of capital and it is nothing but the inverse of P/E.
P/E can be viewed as the valuation given by the share holders to purchase any share. Inverse is the expected rate of return they demand, which is nothing but the cost of capital = 1/ (P/E) = 1/ (42/6) = 14.29
D = Dividend per share?

$$42 = \frac{D + 0.2/0.1429\ (6 - D)}{0.1429}$$

Solving we get D = ₹6 implying company's payout has to be 100% to the shareholders

2. The decision tree given below, shows that there are six possible outcome each represented by a path. The net present value of each path at 10% discount rate is gives in the table below. Let us denote year 1 cash flows as CF1 and year 2 cash flows as CF2

			Joint probability
		0.2, ₹12,000	0.08
	25,000	0.3, ₹16,000	0.12
		0.5, ₹22,000	0.20
40000			
		0.4, ₹20,000	0.24
	30,000	0.5, ₹25,000	0.30
		0.1, ₹30,000	0.06

CF1x PV Factor1*	CF2 X PV Factor2 **	Total inflow	Outflow	NPV
(a)	(b)	(c)=(a)+(b)	(d)	(e)=(c)-(d)
25,000x0.909=22,725	12,000x0.826= 9,912	32,637	40,000	-7363
25,000x0.909=22,725	16,000x0.826= 13,216	35,941	40,000	-4059
25,000x0.909=22,725	22,000x0.826= 18,172	40,897	40,000	897
30,000x 0.909=27,270	20,000x0.826= 16,520	43,790	40,000	3790
30,000x0.909=27,270	25,000x0.826 = 20,650	47,920	40,000	7920

30,000x0.909=27,270 30,000x0.826 = 24,780 52,050 40,000 12,050

* 0.909 ** 0.826

Statement showing the Expected Net present Value

Path	NPV @10% (a)	Joint probability (b)	Expected net Present Value (a) x (b)
1	-7,363	0.08	-589.04
2	-4,059	0.12	-487.08
3	897	0.20	179.40
4.	3,790	0.24	909.60
5	7,920	0.30	2,376.00
6.	12,050	0.06	723.00
		1.0	3,111.88

If the worst outcome is realized the net present value which the project will yield is ₹7,363(negative).The probability of occurrence of this net present value is 8%.The best outcomes will be path 6 when net present value is higher i.e ₹12,050(positive).

The probability of occurrence of this net present value is 6%.Yes the project will be accepted since the expected net present value X probability sum total is positive.

3.

A	0	initial flows	(815.70)
C	1-6	Year Flows	+819.70
B	6	Terminal Flows	+132.19
			+136.19

Conclusion: The NPV is +ve. Hence electronics Ltd should under take the new project

Working notes:

Statement of cash flows:

A.Initial Flows

Year		₹in lakhs	
0	Investment	600	
	Work.capital	150	
	PV factor	750 x 1000	750.00
3	Additional working capital	100 x 0.657	65.70
			815.70

B.Terminal Flows:

Recovery of WC(150+100)	250x0.432	108.00

Sales of Equipment	56x0.432	24.19
		132.19

Yearly Flows:

Year	Production x cont/unit	Total-FC	PDB	Depn	PBT
1	4,00,000 x 80	320-240	80	200	-120
2.	8,00,000 x 80	640-360	280	134	+146
3	10,80,000 x 80	864-480	384	89	+295
4	12,00,000 x 80	960-480	480	59	+421
5	12,00,000 x 80	960-480	480	39	+441
6	12,00,000 x 80	960-480	480	26	+454

PBT	Tax	PAT	Deprn.	Inflow	
-120	-	-120	200	80 x 0.869	= 69.52
146	13	133	134	267 x 0.756	= 201.85 (carry forward loss adj)
295	148	148	89	237 x 0.657	= 155.71
421	210	210	59	269 x 0.571	= 153.60
441	221	220	39	261 x 0.497	= 129.72
454	227	227	26	253 x 0.432	= 109.30
					819.70

Depreciation schedule

Year	WDV	Deprn	Bal
1	600	200	400
2	400	134	266
3	266	89	177
4	177	59	118
5	118	39	79
6	79	26	52

Sale of equipment

10 % Rs.600	= 60
WDV	= 52
Profit	8
Tax 50%	4

Net sale value after tax = 60 – 4 = ₹56 lakhs

PRIME ACADEMY

32ND SESSION PROGRESS TEST – ADVANCED AUDITING & PROFESSIONAL ETHICS

No. of Pages: 2 **Total Marks: 75**

Time Allowed: 2Hrs

PART – A

Answer all Questions

1. As an auditor, How would you deal with the following?
   A private limited company reports the following position as on 31st March 2010
   Paid up capital ₹30 lacs
   Revaluation reserve ₹10 lacs
   Capital reserve ₹11 lacs
   P&L A/c (Dr.Bal) ₹2 lacs
   The management of the company contends that CARO 2003 is not applicable to it.

2. XYZ Ltd has obtained term loan from Nationalised Bank amounting to ₹ 20 crores for purchase of Research & Development Equipments. Out of this, the company has utilized ₹20 lakhs towards purchase of office furniture & car to be used by the chief executive officer of the company?

3. A Ltd having fixed assets in total valuing ₹ 5000 crores at 10 different locations, have been physically verifying the assets every third year. Auditor insists for yearly verification of the same-comment.

4. There is a sales-tax demand of ₹ 3 crores against PQR Ltd relating to prior years against which the company has gone on an appeal.

5. Under what circumstances, an auditor is required to submit a special report to the Registrar of Co-operative Societies?

(5x5=25 Marks)

PART - B

1.
   a. Mention the duties of Auditor of Co-operative Societies in regard to the following:
      i. Over-due interest
      ii. Compliance with provisions of Co-operative Act and Rules thereunder

(8 Marks)

   b. State the special features of Co-operative Societies Audit.

(7 Marks)

2.
   a. What are the special points in the audit of a Non-Banking Equipment Leasing Finance Company?

(8 Marks)

   b. List the matters to be included in the 'Auditors' report' in the case of Non Banking Financial Companies (NBFCs) accepting or holding public deposits.

(7 Marks)

3.
   a. You have been appointed Management Auditor of a large manufacturing company suffering from working capital crunch. Enlist and discuss the related areas which you would probe into to overcome the company's problem.

(8 Marks)

   b. 'Operational Auditing is no different from Internal Auditing' - Discuss

(7 Marks)

4. As a statutory auditor of a Public Limited Company, how would you deal with the following situations?
   a. The company has sold some old machinery for Rs. one crore. The details of the cost of such machinery are not available since the entire records relating to fixed assets have been destroyed in an earthquake.

(5 Marks)

PRIME ACADEMY
32ND SESSION PROGRESS TEST – ADVANCED AUDITING & PROFESSIONAL ETHICS
SUGGESTED ANSWERS

PART A

1. The CARO 2003 also exempts from its application a private limited company which fulfils all the following conditions:
    i. Its paid-up capital and reserves are rupees fifty lakhs or less;
    ii. It has no outstanding loan exceeding rupees twenty five lakhs from any bank or financial institution; and
    iii. Its turnover does not exceed rupees five crores at any point of time during the financial year.

   A private limited company, in order to be exempt from the applicability of the Order, must satisfy all the conditions mentioned above cumulatively. In other words, even if one of the conditions is not satisfied, a private limited company's auditor has to report on the matters specified in the Order.

   For determining the applicability of the Order to a private limited company, capital, revenue reserves, revaluation reserve, and credit balance in the profit and loss account should be taken into consideration while computing the limit of rupees fifty lakhs prescribed for paid-up capital and reserves.
   The debit balance of the profit and loss account, if any, should be reduced from the figure of revenue reserves.
   So the management contention is right because the sum of capital plus reserves comes to ₹38 lakhs, which is less than ₹50 lakhs.

2. **CARO Requirement**
   As per Paragraph 4 (xvi) of CARO, 2003, an auditor is required to comment whether the term loans were applied for the purpose for which the loans were obtained.

   The auditor should examine terms and conditions of the term loan with the actual utilization of the loans. If he finds that loan has not been used for the purpose for which they were obtained. The report should state the facts.

   In the instant case, LMN Ltd. has taken term loan from a nationalized bank amounting to ₹10 crores for the purchase of research and development equipments. Out of this amount, company has utilized ₹10 lakhs for purchase of office furniture and car, to be used by the Chief Executive Officer of the company. The furniture and car cannot be considered research and development equipments.

Accordingly, the auditor should state the facts in his report that out of the term loan for research and development equipment, ₹10 utilised by the purchase of furniture and car is not for the purpose for which the term loan was obtained.

3. **Physical Verification of Fixed Assets**
   a. Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Fixed Assets. (Paragraph 4(i)(a))
   b. Whether these Fixed Assets have been physically verified by the management at reasonable intervals: whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of accounts (paragraph 4(i)(b))
   c. If a substantial part of Fixed Assets have been disposed off during the year, whether it has affected the going concern (paragraph 4(i)(c))

   What constitutes "reasonable intervals" depends upon the circumstances of each case. The factors to be taken into consideration in this regard include the number of assets, the nature of assets, the relative value of assets, difficulty in verification, situation and spread of the assets, etc. The management may decide about the periodicity of physical verification may be reasonable, it may be impracticable to carry out the same in some cases. Even in such cases, the verification programme should be such that all assets are verified at least once in every three years. Where verification of all assets is not made during the year, it will be necessary for the auditor to report that fact, but if he is satisfied regarding the frequency of verification he should also make a suitable comment to that effect.

   In the instant case, A Ltd., having fixed assets at 10 different locations, in total valuing ₹5000 crores is physically verifying the assets every third year. As per CARO, 2003, verification of fixed assets should be done on reasonable intervals, and reasonable intervals may be, in some cases that all assets are verified at least once in every three years. Hence if the auditor is satisfied with the frequency, it is not necessary for A Ltd. to verify the fixed assets on an annual basis. However, a suitable comment to the effect has to be made by the auditor in his report.

4. As per Paragraph 10 of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", contingent liability is:
   a. A possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
   b. Present obligation that arises from past events but is not recognized because:
      i. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
      ii. A reliable estimate of the amount of the obligation cannot be made.

Accordingly in this case, when there is sales tax demand of ₹3 crores and the company has gone in an appeal, it needs considerations as to whether the entire demand is disputed, because it is difficult to presume that the demand by sales tax authority is without any basis. Therefore, partly to the extent the company considered that the demand is based on some logical basis, that amount may be provided for and the remaining may be disclosed as the contingent liability.

However as per Paragraph 4(ix)(b) CARO, 2003 "In case dues of Income Tax / Sales Tax / Service Tax / Customs Duty / Wealth Tax / Excise Duty / Cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. A mere representation to the Department shall not constitute the dispute." The auditor should also obtain a management representation about the disputed dues, the amounts involved and the forum where the dispute is pending. The auditor should carry out necessary audit procedures to verify the information provided by the management.

The information may be reported in the Statement of Disputed Dues as nature of the dues, amounts, period which the amount relates and forum where dispute is pending.

5. **Special Report by Auditor to Registrar of Co-operative Societies:**

During the course of audit of co-operative societies, if the auditor notices that there are some serious irregularities in the working of the society he may draw specific attention to these matters by a special report. In the following cases, a special report may become necessary:

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

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

iii) Mis-management and decision against co-operative principles.

iv) In the case of urban co-operative banks, disproportionate advances to vested interest groups and deliberate negligence about the recovery, thereof and cases of reckless advancing without adequate security and credit worthiness of the party.

PART B

1. a.
   i. **Overdue interest**:

   Overdue interest should be excluded from interest outstanding and accrued due, while calculating profit. Overdue interest is interest accrued or accruing to the accounts, the amount of which the principal is overdue. In practice an overdue interest reserve is created and the credit of overdue interest credited to interest account is reduced.

   ii. **Compliance with provisions of the Co-operative Act and Rules:**

   An auditor of a co-operative society is required to point out the infringement with the provisions of the relevant Co-operative Act Rules and bye-laws. The auditor of a co-operative society is also required to point out various irregularities, improprieties, and departure from the provision of the Act, rules framed thereunder and the bye-laws of the society. The financial implications of such infringements should be properly assessed and quantified by the auditor and they should be reported. Some of the State laws contain restrictions on the payment of dividends, which should be noted by the auditor and if dividend is declared in excess of the prescribed percentage, the fact should be reported by the auditor. Auditor should also ensure that various provisions in the Co-operative Societies Act, such as, restriction on borrowings, investment of funds, contribution to education funds, restriction on loans, etc are also complied with.

   b. **Special features of Co-operative Societies Audit:**

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

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

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

3. **Valuation of Assets and Liabilities:** Regarding valuation of assets there are no specific provisions or instructions under the Act and Rules and as such due regard shall be had to the general principles of accounting and auditing conventions and standards adopted. The auditor will have to ascertain existence, ownership and valuation of assets. Fixed assets should be valued at cost less adequate provision for depreciation. The incidental expenses incurred in the acquisition and the installation expenses of assets should be properly capitalised. If the difference in the original cost of acquisition and the present market price is of far reaching significance, a note regarding the present market value may be appended; so as to have a proper disclosure in the light of present inflationary conditions. The current assets be valued at cost or market price, whichever is lower. Regarding the liabilities, the auditor should see that all the known liabilities are brought into the account, and the contingent liabilities are stated by way of a note.

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

5. **Observations of the Provisions of the Act and Rules**: An auditor of a cooperative society is required to point out the infringement with the provisions of Cooperative Societies Act and Rules and bye-laws. The financial implications of such infringements should be properly assessed by the auditor and they should be reported. Some of the State Acts contain restrictions on payment of dividends, which should be noted by the auditor.
6. **Verification of Members' Register and examination of their pass books**: Examination of entries in members, pass books regarding the loan given and its repayments, and confirmation of loan balances in person is very much important in a co-operative organisation to assure that the entries in the books of accounts are free from manipulation.

7. **Special report to the Registrar**: During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society, he may report these special matters to the Registrar, drawing his specific attention such irregularities. The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance a special report may become necessary:
   (i) Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.

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

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

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

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

2. a. **Special Points in the Audit of Non-Banking Equipment Leasing Finance (NBELF) Company**
   i. Ascertain whether the NBFC has an adequate appraisal system for extending equipment leasing finance.
   ii. Verify whether there is an adequate system in place for ensuring installation of assets and their periodic physical verification. In respect of some major transactions, an auditor should arrange for physical verification of the leased assets so as to dispel any doubts that equipment leasing finance was not extended without the corresponding assets being created.
   iii. Ascertain whether the NBFC has an adequate system for monitoring whether the assets have been adequately insured against and regular maintenance of the leased assets is being carried out by the lessee.

iv. Verify the lease agreement entered into with the lessee in respect of the equipment given on lease.
v. Verify whether the AS 13 issued by the Institute of Chartered Accountants of India in respect of "Accounting for Investments" has been complied with.

b. **Matters to be included in the Auditor's report in case of NBFCs accepting or holding public deposits:**

The auditors are required to make a separate report to the Board of Directors and the RBI for every financial year as per the Non Banking Companies Auditors' Report (RBI) Direction 1998, in addition to the reporting obligations u/s 227 of the Companies Act 1956.

1. **Reporting Requirements**: The auditor shall make –a statement on the following matters, together with reasons in case of any unfavourable or qualified statement:
   a. Registration: Whether the NBFC has obtained certificate of Registration or applied for registration.
   b. Communication from RBI: Whether the NBFC has received any communication from RBI refusing grant of Certificate of Registration.

2. **NBFCs accepting/holding public deposits**
   i. **Limit on Public Deposits**: Whether the public deposits and the following borrowings are within the permissible limits:
      a. Borrowing from public by issue of unsecured non-convertible Debentures/Bonds.
      b. Borrowing from its share holders by a public limited company and
      c. Other deposits within the definition of "Public Deposit" in the NBFC (Reserve Bank) Direction, 1998.
   ii. **Credit Rating**: Whether Credit rating for fixed Deposits, assigned by the credit rating agency is in force.
   iii. **Limit on Fixed Deposits**: Whether aggregate amount of Deposit outstanding at any point during the year has exceeded the limit specified by the Credit Rating Agency.
   iv. **Default:** Whether the NBFC has defaulted in paying to its Depositors the interest and/or principal amount of the deposits after such interest and/or principal became due.
   v. **Prudential Norms**: Whether the NBFC has complied with NBFC Prudential Norms (Reserve Bank) Direction, 1998 in relation to Income Recognition. According standards, classification, Provisioning for bad and doubtful debts and concentration of Credit/Investment.
   vi. **Capital Adequacy**: Whether the capital Adequacy Ratio disclosed in the return submitted to the RBI is correctly determined and whether such ratio is in compliance with the minimum capital to Risk Asset Ratio prescribed by the RBI.

vii. **Liquidity:** Whether the NBFC has complied with the prescribed liquidity requirement and kept the approved securities with designated Bank.

viii. **Return of Deposits:** Whether the NBFC has furnished the return of deposits to the RBI within the stipulated period as required under

3.

a. Adequate working capital is required for liquidity and smooth operations of the company. To ensure an adequate flow of working capital to the manufacturing company, the following action plan may be considered:

i. **Working Capital Estimation:** The company should start by preparing a statement of the projected working capital requirements. This should be based on the functional budgets in sales, production, expenses, capital expenditure and the master budget consisting of projected profit and loss and the balance sheet.

ii. **Cash Flow Statement / Cash Budget:** Month-wise cash budgets showing inflows and outflows of cash heading-wise should be prepared to analyse the major inflows and outflows affecting the entity. At this stage any wasteful outflow can be traced and eliminated. Bank reconciliation should be undertaken periodically so that outstandings can be traced and acted upon. This is also necessary to reduce the float time.

iii. **Inventory / Stock Management**: Raw materials and inventories should be classified properly to determine the level of stock of materials. The method of costing also needs to be looked at minutely. There is a need to establish linkage with the production pattern and work backwards accounting for time factor in receipt of material. This needs to be worked out carefully since at no cost, production schedule should be hampered. The caution also need to be exercised that there is no unused/obsolete inventory. The system of inventory management needs to be looked at so as to check the avoidable wastes/scraps generated during storage and handling. Just in time philosophy will enable the company to reduce processing time, stocks and related costs. The adoption of such a mechanism would bring down the cost to a considerable extent.

iv. **Credit Management:** The company should lay down a proper policy for evaluating customers, determining the credit period and offering discounts for early payment. An age-wise analysis of debtors should also be prepared so as to avoid credit to defaulters. The sale department need to be geared up so that realisation can be made in time. A careful analysis should be done of various customers according to pattern of sales so as to exercise control on their respective debit balances. The company should through its purchase department endeavour to avail the maximum credit period from its creditors. This would enhance the working capital of the company.

v. **Funds Flow Analysis**: The company should prepare a funds flow analysis, distinguishing between long-term and short-term sources and applications.

vi. **Investment Management*:*** The idle funds of the company, if any, should be invested in short-term securities to augment the income.

vii. **WIP Analysis**: Minimum WIP should be monitored and for the purpose it is necessary Internal auditing is an activity carried out by the internal staff of the organisation to meet the management requirements of information.

b. **Operational audit Vs Internal Audit:**

The definition of internal auditing as given by the Institute of Internal Auditors of New York, in fact, is so wide in its scope that it covers both operational and management auditing. According to the Institute of Internal Auditors, "the overall objective of internal auditing is to assist all members of management in the objective discharge of their responsibilities, by furnishing them with objective analysis, appraisals, recommendations and pertinent comments concerning the activities reviewed. The internal auditor, therefore, should be concerned with any phase of business activity wherein he can be of service to organisation".

According to the definition, the overall objective of internal auditing is to assist all members of management in the objective discharge of their responsibilities, by furnishing them with objective analysis, appraisals, recommendations and relevant comments concerning the activities reviewed. The internal auditor, therefore, should be concerned with any phase of business activity wherein he can be of service to the organisation. Naturally, when an auditor is concerned with the appraisal of operations, he would be performing the role of an operational auditor. Another important point that this definition throws up is that operational auditing is essentially a function of internal auditing staff.

Traditionally, the internal auditing was concerned with the financial transactions only. It was during early 1940's, the concept of operational auditing came into existence. According to Cadmus "operational auditing is not different from internal auditing, it is merely an extension of internal auditing into operational areas. It is characterised in both financial and operational areas – by the auditor's approach and state of mind". The main objective of operational auditing is to verify the fulfilment of plans and sound business requirements as also to focus on objectives and their achievement as against the performance yardsticks evident from in the management objectives, goals and plans, budgets records of past performance, policies and procedures.

Industry standards can be obtained from the statistics provided by industry, associations and government sources. It should be appreciated that the standards may be relative depending upon the situation and circumstances; the operational auditor may have to apply them with suitable adjustments. It might appear from the above that an internal auditor is not concerned with operational aspects and operational auditor is, not concerned with financial aspects which is not so . Because traditionally, internal auditors had been engaged in a sort of protective function, deriving their authority from the management. They examined internal controls in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are not there; they checked the accounting books and records to see, whether the internal checks are properly working and the resulting accounting data are reliable. They also looked into the aspect of safety of the assets and properties of the company. Some element of operational auditing could be found even in these traditional functions of internal auditors, specially in the context of fraud, wastage and loss. Internal auditors emboldened by their ability to appraise financial and accounting control gradually started extending their field to cover non-accounting control as well.

On the other hand, it should not be assumed, that, since an operational auditor is concerned with the audit of operations and review of operating conditions, he is not concerned with the financial aspects of transaction and controls. A point has already been
made that the special expertise acquired by the operational auditor, that enables him to view the controls and operations from the management point of view, can be carried back to his review of the financial areas. In the matter of cash transactions, the operational auditor will look into such aspects as the quantum of cash in hand (by relating it to the requirement of cash to be held) carried generally or the use of cash not immediately required. Also he will review the operational control on cash to determine whether maximum possible protection has been given to cash. Similarly, in the audit of stocks, he would have management policy. In pure administrative areas on stock, he will see whether adequate security and insurance arrangements exist for protection of stocks.

Thus, over a period of time, the scope of internal auditing was widened to cover not only accounting and financial operations but other operations such as marketing, personnel, production, etc. As per the modern definition of internal auditing, there is no difference between the two. However, still some auditors believe that there might exist difference between the two on account of perception as far as scope of the two is concerned which in fact is not true as evident from the foregoing analysis.

4. **Sale of Machinery**: AS 10 on "Accounting for Fixed Assets", gains or losses arising on disposal are generally recognised in the profit and loss statement. Therefore, when the company sells old machinery, profit/loss on sale thereof has to be determined. Such profit or loss can be determined provided the cost and written down value of the said machinery is available. In the instant case, since the entire records of fixed assets have been destroyed, the cost and the WDV of the machinery sold could not be arrived at. The company may therefore, have to determine the same on some estimated basis provided all reasonable efforts to determine the cost/WDVs of the machinery do not yield any better result. An all out attempt should be made by the management to reconstruct the old records. Such

records may be constructed by obtaining old copies of annual reports distributed amongst shareholders, annual accounts filed with ROC, etc. In fact, through this process, the company shall be able to determine the WDV of the asset because the machinery sold seems to be quite big and must have been recorded on stand alone basis.

The auditor will have to see whether the estimate of cost and WDV arrived at in the above manner by the company is reasonable and whether the profit/loss is determined accordingly. A note to that effect would also have to be given by the management in the accounts. If the auditor is of the opinion that the said estimates are satisfactory based on available records and the note given by management explains the said fact, he may not qualify his report. If he is not so satisfied, he would have to give disclaimer in the audit report that in the absence of proper records, the said profit/loss has been arrived on an estimated basis and in that view he has been unable to form an opinion. As far as the report under the CARO, 2003 order is concerned, the auditor would have to point out that proper records of fixed assets showing full particulars as required by that clause are not available.

PRIME ACADEMY
32ND SESSION PROGRESS TEST – CORPORATE & ALLIED LAWS

No. of Pages: 8 **Total Marks: 75**
Time Allowed: 2Hrs

PART – A

1. A public company shall also have a director elected by
   (a) 500 small shareholders
   (b) 800 small shareholders
   (c) 900 small shareholders
   (d) 1000 or more small shareholders

2. For the purpose of calculation of maximum number of directors the following shall not be considered.
   (a) Private company
   (b) An unlimited liability company
   (c) Section 25 company
   (d) All of the above

3. First Directors are appointed by
   (a) Shareholders
   (b) Government
   (c) Subscribers to the memorandum
   (d) Company Law Board

4. Additional director may be appointed provided
   (a) Articles of a company confer power on the Board
   (b) Provision in the memorandum of Association
   (c) Approved by the shareholders at the extraordinary general meeting
   (d) Approved by the central Government

5. Appointment of alternate director can be made if original director is absent from the state for a period not less than
   (a) One month
   (b) Two months
   (c) Three months
   (d) None of the above

6. A director can be appointed by central Government under section
   (a) 260
   (b) 262
   (c) 313
   (d) 408

7. Which of the following power can be exercised only at the Board meeting
   (a) Power to issue debentures
   (b) Power to appoint general manager
   (c) Power to sell the products of the company
   (d) Power to open branch of the company

8. Section 297 requires board sanction for entering into certain contracts with the following persons
   (a) Public limited company with another public limited company
   (b) Shareholder of the company
   (c) Any director of the company
   (d) Managing Director of the company

9. Provisions of Section 297 are not applicable to the following contracts
   (a) Contracts for purchase of goods, materials or services
   (b) Underwriting the subscription of any shares in or debentures of the company
   (c) Contracts for sale, purchase or supply of goods where the value of goods or services rendered does exceed ₹ 5000 in a year
   (d) In case of banking or insurance company any transaction in ordinary course of business of such company with the Directors.

10. Every director of the company who is interested directly or indirectly in a contract or arrangement shall disclose his nature of concern or interest at a
   (a) General meeting
   (b) Committee meeting of the Board
   (c) Board meeting
   (d) Creditors meeting

11. Minutes of the Board meeting may be signed by
   (a) The chairman of the said meeting
   (b) Any one of the Directors of the meeting
   (c) Any director authorised by the Board
   (d) Any director who presented at the meeting

12. A managing director means a director who by virtue of
   (a) An agreement with the company
   (b) A resolution passed by the company in general meeting
   (c) The memorandum of Association or Articles of Association
   (d) All the above

13. Appointment of Managing Director does not require the permission of central Government if the appointment is made conforming to the provision of
    (a) Schedule XIII
    (b) Schedule V
    (c) Schedule 198
    (d) Section 309 read with Schedule XIII

14. The limits mentioned in Section 372A for the purpose of Investment / Lending funds is
    (a) 30% of the paid capital and free reserves
    (b) 60% of the paid up capital and free reserves
    (c) 100% of free reserves of lending/ investing company
    (d) (b) and (c) whichever is more

15. Section 372A applicable to
    (a) Banking company insurance company
    (b) Investment company
    (c) Private company which is not a subsidiary of a public company
    (d) None of the above

16. Nominee directors are appointed by
    (a) Financial institutions
    (b) Debenture trust deed
    (c) Loan agreement
    (d) All of the above

17. The following persons shall be disqualified as director
    (a) A person who is un discharged insolvent
    (b) A person who has applied to be adjudicated as an insolvent and his application is pending
    (c) A person who has been disqualified by any court
    (d) All of the above

18. Powers to be exercised by the Board of directors by unanimous consent in respect of the following
    (a) To appoint a Director as managing Director of the company
    (b) To appoint a person as managing Director who is already a manager or Managing Director of another company
    (c) To appoint a person as Manager who is already a manager or Managing Director of another company.
    (d) (b) and (c) above

19. Powers which can be exercised by the Board of Directors with the approved of General Meeting in respect of the following ;
    (a) Sell, lease or otherwise dispose of the whole or substantially the whole of the undertakings of the company
    (b) Remit or give time for the repayment of any debt by a director.
    (c) Borrow moneys not exceeding the aggregate of the paid up capital and free reserves
    (d) (a) and (b)

20. Companies can make political contributions provided
    (a) Contribution shall not exceed 10% of the average net profits of preceding three years.
    (b) Resolution passed at the Board Meeting
    (c) Resolution passed at the general meeting
    (d) None of the above

21. In Audit Committee the following are compulsory as per the provisions of the Companies Act, 1956
    (a) Every private company having not less than paid up capital of ₹10 Lakhs shall constitute Audit committee
    (b) Every public company having not less than paid up capital of ₹5 Lakhs shall constitute Audit committee
    (c) The chairman of the Audit committee to attend the annual general meetings of the company
    (d) (b) and (c)

22. The following persons shall have right to attend the Audit committee
    (a) Auditors
    (b) Shareholders
    (c) Employees
    (d) All of the above

23. A Director of the company who is interested in any contract can participate and vote in the Board Meeting in respect of the following companies
    (a) Private company which is subsidiary of public company
    (b) Private company which is holding company of subsidiary company
    (c) Contract entered by a public limited company with its subsidiary company which is a private limited company
    (d) Private limited company which is neither a subsidiary nor a holding company of a public company.

24. Compensation for loss of office can be paid to the following managerial persons
(a) Non- Wholetime Director
(b) Managing Director
(c) Manager
(d) (b) and (c)

25. A limited company can altered its memorandum so as to make the liability of any of its directors unlimited through
(a) Unanimous Board Resolution
(b) Ordinary resolution passed at the general meeting
(c) Special resolution passed at the General meeting
(d) (a) and (b)

(25x1=25 Marks)

PART B

Answer all the questions

1. The Board of Directors of M/s ABC Motors Ltd. made the following appointments at its meeting held on 1^{st} January, 2004:
   (i) Mr. X, a Director of its subsidiary company, namely, M/s ABC Forgings Ltd., was appointed as purchase Manager on a consolidated salary of ₹11, 000 per month with effect from 1st January, 2004.
   (ii) Mr. Y was appointed as the Sales Manager on a consolidated salary of ₹11,000 per month with effect from 1^{st} January, 2004.Answer the following explaining the relevant provisions of the Companies Act :
      (i) Does the appointment of Mr. X require the approval of the members in a general meeting of any company? Will your answer be different if M/s ABC Motors Ltd. is the subsidiary of M/s ABC Forgings Ltd?
      (ii) Mr. P, a relative of Mr. Y was appointed as a Director of M/s ABC Motors Ltd. on 1^{st} January, 2005. Does it affect the continuation of Mr. Y as the Sales Manager?

(8 Marks)

2. State briefly the legal requirements to be complied with by a public company to give effect to the following proposals:
   (i) Payment of ₹50,000 as minimum remuneration to the ordinary directors in a financial year when the company has suffered a loss. The directors have been receiving remuneration by way of commission on net profits within the prescribed limits.
   (ii) Payment of minimum remuneration to a whole-time director in a financial year when the company has suffered a loss. The appointment has been in accordance with the conditions specified in Schedule XIII to the Companies Act and he is being remunerated by way of commission on net profits.
   (iii) Appointment of a person as Managing Director without remuneration in accordance with the conditions specified in Sch. XIII to the Companies Act, when he is already holding position of a Managing Director in a Private Company.

(6 Marks)

3.

a. ‘X’ was appointed as Managing Director for life by the Articles of Association of a private company incorporated on 1st June, 1970. The articles also empowered ‘X’ to appoint a successor, ‘X’ appointed, by will, ’G’ to succeed him after his death. Answer the following:
   (i) Can ‘G’ succeed ‘X’ as Managing Director after the death of ‘X’?
   (ii) Is it possible for the company in general meeting to remove ‘X’ from his office of directorship during his lifetime?

(4 Marks)

b. What is maximum percentage of net profits permitted in any financial year as total managerial remuneration under the provisions of the Companies Act, 1956 for public company? Whether sitting fees shall be included for the calculation of such maximum ceiling of remuneration?

(3 Marks)

4. M/s XYZ Ltd., with a paid-up capital of ₹5 crores, has nine Directors on its Board and as per its Articles, the quorum for a Board meeting is 3(three). A meeting of the Board was called to consider a contract relating to purchase of raw materials from another company ABC (P.) Ltd., in which A and B, the Directors of XYZ Ltd., are also major shareholders. In the board meeting of XYZ Ltd. three Directors including ‘A’ and ‘B’ attended. The matter was discussed and the three Directors voted for the contract. ABC (P.) Ltd. wants to enforce the contract. Will it succeed? Would it make any difference if ABC Ltd., is a public company? Discuss.

(7 Marks)

5. State with reference to the provisions of the Companies Act, 1956 whether the following companies can make donations to political parties and if so the conditions to be complied with in this regard :
   (i) ABCD Ltd., a Government company registered in 1991, wants to donate a sum of ₹10 lakhs.
   (ii) EFG Ltd., a public company registered in 1990, wishes to contribute a sum of ₹5 lakhs.
   (iii) RST Ltd., a company incorporated in the year 1996, decides to contribute a sum of ₹3 Lakhs.

(7 Marks)

6. Decide in the light of the provisions of the companies Act, 1956 the validity and extent of powers of Board of Directors and the procedure to be complied with in the following matters :
   (i) Delegation of power of the Managing Director of the company to invest surplus funds of the company in the shares of some companies.
   (ii) Donation of ₹5 lakhs to a hospital established exclusively for the benefit of employees and a donation of ₹5 lakhs to a charitable trust registered under section 12A and exempted under Section 80G of the Income-tax Act, 1961.
   (iii) Donation of ₹5 Lakhs to a political party registered with the appropriate authority.

(7 Marks)

7. The following information is available from the audited Balance Sheet of DO WELL LTD:

	₹ in Lakhs
Equity Share Capital	60
Calls outstanding	01
Preference Share Capital	21
Share Application Money	10
Securities Premium Account	15
Capital Redemption Reserve	18
Fixed Assets Revaluation Reserve	09
General Reserve	30
Profit and Loss Account (credit balance)	17
Dividend Equalization Reserve	05

The Company Proposes to acquire ₹3 lakh equity shares of ₹10 each of RSQ LTD. It also intends to execute a corporate guarantee for ₹25 lakhs in favour of Goodwill Ltd a wholly owned subsidiary company and a corporate loan of ₹50 lakhs to XYZ Ltd. State the legal requirements to be complied with to give effect to the above proposals.

(8 Marks)

PRIME ACADEMY
32ND SESSION PROGRESS TEST – CORPORATE & ALLIED LAWS
SUGGESTED ANSWERS

PART A

Qn. No	Answer
1	d
2	d
3	c
4	a
5	c
6	d
7	a
8	c
9	d
10	c
11	a
12	d
13	a
14	d
15	d
16	d
17	d
18	d
19	d
20	b
21	d
22	a
23	d
24	d
25	c

PART B

1.

i. No, the appointment of Mr. X is not hit by section 314(1) and therefore shall not require the approval of general meeting by way of special resolution. Section 314(1) forbids the specified persons to be appointed to an offence or place of profit: (a) under the company, or (b) under any of its subsidiaries. Since Mr. X is not a director of ABC Motors Ltd., his appointment is not affected by the section. Section 314(1) does not prohibit a director of a subsidiary company from holding an office or place of profit in its holding company. However, it will require the aforesaid approval if M/s ABC Motors Ltd. is the Subsidiary of M/s ABC Forgings Ltd.

ii. Section 314(1) does not apply since at the time of appointment of 'Y' as the sales manager, his relative 'P' was not the director of the company (Section 314 (1A))

2.

i. Remuneration by way of commission can be paid to an ordinary director only with the sanction of a special resolution (Sec. 309(4)) Fresh special resolution is required to be passed after every five years (section 309(7)) The concept of minimum remuneration, however, has no relevance with reference to ordinary directors.

1. Depending upon the effective capital of the company, a whole-time director can be paid @ ₹75,000 p.m. to ₹2, 00,000 p.m. as per Sch. XIII.
2. According to Sec. 316 read along with Sch. XIII, the following shall be necessary:
    (a) Unanimous resolution of the Board of Directors passed at its meeting.
    (b) Approval of the Central Government (clause (d) Sch. XIII).

3. a.

i. 'G' can succeed 'X', Appointing a successor under a power conferred under the Articles is not considered as 'assignment of office' which is prohibited under section 312 (Oriental Metal Pressing v. Bhasker Kashinath Thakoor (1961) 3) Comp. Cas. 143(SC)).

ii. In case of private companies only, directors appointed for life upto 1st April, 1952 cannot be removed. Any other director can be removed under section 284 i.e., by passing an ordinary resolution of which special notice had been given.

a. In case of a public company or a private company which is a subsidiary of a public company total managerial remuneration payable to its directors and manager in any financial year shall not exceed 11%(Eleven per cent) of net profits (Sec. 198(1)). The above maximum ceiling remuneration of 11% shall be exclusive of sitting fees payable to directors (Sec.198(2)).

4. The problem relates to interested directors. In this case, A and B are interested directors and accordingly must disclose their interest as per section 299.

   Further, interested director under section 300 is forbidden to take part in the discussion or vote on any contract or arrangement entered into by or on behalf of the company where he is directly or indirectly interested in it.

   Still further, interested director is not to be counted for quorum and the quorum for a Board's meeting is, as per Articles, fixed at minimum 3 directors (Section 287). Any resolution passed without quorum would be void and incapable of even subsequent ratification (Firestone Tyre & Rubber Co. v. Synthetic and Chemicals (1970) 2 Comp. L. J. 200).

   Thus, in the instant case, the ABC (P) Ltd cannot enforce the contract.

   If ABC (P.) Ltd were a public Company, then also the situation would have remained unchanged because the directors A and B are its major shareholders. Exemption of section 300(2)(d) is not available in such a case.

5. Sections 293A of the Companies Act, 1956 contain law relating to political donations by companies.
   Accordingly,
   a. No political donation can be made by ABCD Ltd., being a Government company.
   b. Company EFG Ltd. having been in existence for more than three years can contribute ₹5 lakhs provided the aggregate of the amount contributed in the financial year including the proposed amount is within 5 per cent of the average net profits for the last- three immediately preceding financial years.
   c. RST Ltd. having not been in existence for three years is not allowed to make political contributions.

6.

i. Section 292 of the Companies Act, 1956 empowers the Board of Directors to delegate to the Managing Director the power to invest in general terms. But section 372A (2) of the said act provides that no investment shall be made, unless it is sanctioned by a resolution passed at a meeting of the Board with the consent of all the directors present. Section 372 A does not provide for delegation. Hence the proposed delegation of power to the Managing Director to invest is not in order.

ii. Donation to a hospital run exclusively for the benefit of employees of the company is in order. The limit of 5 % of average net profits during the last three financial years is applicable only to contributions to charitable and other funds not directly relating to the business of the company or the welfare of its employees. Thus, under section 293(1)(e) of the Companies Act,1956, the Board is empowered to make the proposed donation to the hospital.

    However the donation of ₹5 Lakhs to a charitable trust is subject to the limit laid down in section 293 (1) i.e. ₹50,000 or 5% of the average net profits of the company during the last three financial years whichever is higher. Thus to contribute ₹5 Lakhs the average net profits for last three financial years should be ₹100 Lakhs.

iii. Donation of ₹5 Lakhs to a political party can be made if the company is in existence for more than 3 years and the donation amount cannot exceed 5 % of the average net profit for the preceding three years. Further the procedure laid down in Section 293 A should also be complied with.

7. As per section 372 A a company cannot directly or indirectly

1. Make any loan to any other body corporate
2. Give any guarantee, or Provide security, in connection with a loan made by any other person to, or to any other person by, any body corporate; and
3. Acquire, by way of subscription, purchase or otherwise the securities of any other body corporate line, exceeding 60% of its paid-up share capital and free reserve or 100% of its free reserves whichever is more.

In case the aggregate of loan and advances so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceeds the aforesaid limits, no investment or loans shall be made or guarantee shall be given or security shall be provided unless previously authorised by a special resolution passed in the general meeting.

Here the term loan includes debentures, or any deposit of money made by one company with another company, not being a banking company, and free reserves means those reserves which, as per latest audited balance sheet of the company, are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money.

Again as per section 372A (8) any guarantee made by a holding company to its wholly owned subsidiary is not within the purview of section 372A.

Now in the given case the total amount of investment proposed is as under

	₹
Investment proposed in shares of RSQ limited	30, 00,000
Corporate loan to XYZ Ltd.,	50, 00,000
Total	80, 00,000

Corporate guarantee of ₹25, 00,000 in favour of wholly owned subsidiary is exempted (u/s372 A (8) (c))

Paid up share capital	₹
Equity share capital	60, 00,000
Less: Call outstanding	1, 00,000
Balance	59, 00,000
Add: Preference share capital	21, 00,000
Paid up share capital	80, 00,000

Free reserve	
Security premium a/c	15, 00,000
General reserve	30, 00,000
Profit and loss a/c	17, 00,000
Dividend equalization reserve	5, 00,000
	67, 00,000

Share application is not included as per explanation given in the Act. Capital redemption reserve and fixed assets revaluation reserve are not free for distribution as dividend and hence are not included in free reserve

Therefore the limit for inter corporate loan and investment will be higher of the following two

60% of (80, 00,000 + 67, 00,000)	= ₹ 88, 20,000
100% of 67, 00,000	= ₹ 67, 00,000

₹ 88, 20,000 being the higher of these two amounts, will be the limit for loan and investment.

As the investment proposed is below the limit the company can go ahead with the investment. For this purpose, the company has to convene a Board meeting whereat the above said loan and investments including corporate guarantee can be approved by means of a resolutions. As per section 372(2) the resolutions should be passed at the meeting of the Board with the consent of all the directors present at the meeting. Particulars of investment and loans shall be entered in the register maintained under section 372 A (5).