PRIME ACADEMY
35TH SESSION PROGRESS TEST – FINANCIAL REPORTING

No. of Pages: 11

Total Marks: 75
Time Allowed: 2Hrs

PART-A

a) Which of the following is an SMC according to Companies (Accounting Standards) Rules 2006?
   i) Banking company
   ii) Subsidiary of a SMC
   iii) Company with turnover in excess of ` 50 Crores
   iv) Company with borrowing exceeding ` 10 Crores

b) For financial statements to achieve "true and fair view" which of the following is not a major consideration?
   i) Prudence
   ii) Going concern
   iii) Substance over form
   iv) Materiality

c) A company engaged in manufacture of agricultural and forest products wants to know which of the following method of valuation of inventory is suggested for their industry?
   i) Cost
   ii) Cost or Net Realisable Value whichever is lower
   iii) Net Realisable Value
   iv) None of the above

d) Production overheads of joint products are valued based on
   i) Normal Capacity
   ii) NRV at Split off Point
   iii) Final Sales Value
   iv) None of the above

e) Which of the following costs of conversion cannot be included in cost of inventory?
   i) Salaries of sales staff (sales department shares the building with factory supervisor).
   ii) Cost of direct labor.
   iii) Factory rent and utilities.
   iv) Factory overheads based on normal capacity.

f) ABC Ltd manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of March 31, 2012, at a cost of ` 50 each per pack. During the final audit, the auditors noted that the subsequent sale price for the inventory at April 15, 2012, was ` 40 each per pack. Furthermore, inquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd spent a total of ` 15 per pack for repairing and reapplying glue to the envelopes. The net realizable value and inventory write-down (loss) amount to

i) ` 25 and ` 25 respectively.
ii) ` 40 and ` 10 respectively.
iii) ` 45 and ` 10 respectively.
iv) ` 35 and ` 25 respectively.

g) An entity purchases a building and the seller accepts payment partly in equity shares and partly in debentures of the entity. This transaction should be treated in the cash flow statement as follows:

i) This does not belong in a cash flow statement and should be disclosed only in the footnotes to the financial statements.
ii) The purchase of the building should be investing cash outflow and the issuance of shares and the debentures financing cash outflows.
iii) The purchase of the building should be investing cash outflow and the issuance of debentures financing cash outflows while the issuance of shares investing cash outflow.
iv) Ignore the transaction totally since it is a noncash transaction. No mention is required in either the cash flow statement or anywhere else in the financial statements.

h) ABC Ltd. decided to operate a new amusement park that will cost ` 10 Lakhs to build in the year 2011-12. Its financial year-end is March 31, 2012. ABC Ltd. has applied for a letter of guarantee for . ` 700,000. The letter of guarantee was issued on June 30, 2012. The audited financial statements have been signed on April 18, 2012. The adjustment required to be made to the financial statement for the year ended March 31, 2012, should be

i) Do nothing.
ii) Booking a ` 700,000 long-term payable.
iii) Disclosing ` 700,000 as a contingent liability in 2010 financial statement.
iv) Increasing the contingency reserve by ` 700,000.

i) Lazy Builders Ltd. has incurred the following contract costs in the first year on a two-year fixed price contract for ` 40 Lakhs to construct a bridge:

- Material cost = ` 20 Lakhs
- Other contract costs (including site labor costs) = ` 10 Lakhs
- Cost to complete = ` 20 Lakhs

How much profit or loss should Lazy Ltd. recognize in the first year of the three-year construction contract?

i) Loss of` 10 Lakhs (expensed immediately).
ii) Loss of ` 5 Lakhs prorated over two years.

iii) No profit or loss in the first year and deferring it to second year.
iv) Since 60% is the percentage of completion, recognize 60% of loss (i.e. ` 6 Lakhs).

j) XYZ Ltd. owns a fleet of over 100 cars and 20 ships. It operates in a capital-intensive industry and thus has significant other fixed assets that it carries in its books. It decided to revalue its fixed assets. The company's accountant has suggested the alternatives that follow. Which one of the options should XYZ Ltd select in order to be in line with the provisions of AS 10?
   i) Revalue an entire class of fixed assets.
   ii) Revalue only one-half of each class of fixed assets, as that method is less cumbersome and easy compared to revaluing all assets together.
   iii) Revalue one ship at a time, as it is easier than revaluing all ships together.
   iv) Since assets are being revalued regularly, there is no need to depreciate.

k) An entity installed a new production facility and incurred a number of expenses at the point of installation. The entity's accountant is arguing that most expenses do not qualify for capitalization. Included in those expenses are initial operating losses. These should be
   i) Expensed and charged to the income statement.
   ii) Deferred and amortized over a reasonable period of time.
   iii) Capitalized as part of the cost of the plant as a directly attributable cost.
   iv) Taken to retained earnings since it is unreasonable to present it as part of the current year's income statement.

l) A company imported machinery worth 500,000 $ on 4^{th} January 2012. The company paid customs duty and cleared the goods on 7^{th} January 2012 and reached the factory on 8^{th} January 2012. However due to non-availability of space at the factory, the machinery was installed and put to use on 14^{th} February 2012. The exchange rates on 4^{th} January 2012 was ` 47, on $7^{th}$ January was ` 48 and on 14^{th} February 2012 was `46. The company had taken a foreign currency loan to purchase the machinery. In the preparation of financial statements for year ending 31^{st} March 2012, the exchange difference on loan should be
   i) Expensed and charged to income statements
   ii) Capitalized and amortised over the term of loan
   iii) Capitalized and amortised over the life of the asset

m) Which of the following is not a condition for qualifying as a reportable segment?
   i) Profit or loss of the segment is 10 percent or more of profit or loss of all segments
   ii) Revenue from sale to external customers and other segments is 10 percent or more of total revenues, internal and external
   iii) Segment assets are 10 percent or more of total assets of the company

n) Which of the following relationships should be compulsorily disclosed irrespective of transaction during the year
   i) An associate

ii) A parent
iii) A joint venture
iv) Promoter of Parent company, who also holds 5% of voting rights

o) A company falls under the category SMC as per the conditions prescribed in Companies (Accounting Standards) Rules 2006. But the company does not want to utilize the exemptions available to an SMC in the application of Accounting Standards. What are the options available for the company?
i) Cannot decide to adopt exempted standards
ii) Can adopt and it is necessary to make specific disclosure regarding this in the financial statements
iii) Can adopt and need not disclose, as all accounting standards are applied in full
iv) Can leave it to the auditors to make the decision

p) Z.Ltd has 4 segments – A,B,C, and D. The total assets of the company is ` 21 crs, split up into A-10crs, B- 6 crs, C – 3 crs and D – 2 crs. Deferred tax assets included in above are A – 1cr, B -0.8 cr, C – 1.5 cr and D – 0.2 cr. Which of these segments are not reportable segments as per AS -17?
i) A
ii) B
iii) C
iv) D
v) None of the above

q) Which of the following enterprise is excluded from preparing consolidated financial statements, as per AS-21, though a parent-subsidiary relationship exists?
i) Investment in subsidiary, where activities are dissimilar
ii) Investment in subsidiary with an intention to dispose off in near future
iii) Investment in subsidiary which is subsequently decided to be disposed
iv) Investment in subsidiary with intention to dispose off in near future, not disposed off

r) Where the loss attributable to the minority exceeds the minority interest in the equity of the company, the same has to be:
i) Shown separately as minority interest on the assets side
ii) Adjusted with the majority interest
iii) Nothing

s) XYZ Ltd acquired shares of A Ltd on the following dates, 25th October 2010 – 40%, 24th April 2011 – 4%, 15th June 2011 – 3%, 21th November 2011 – 7% and 2nd January 2012 – 10%. XYZ Ltd is required to prepare consolidated Financial statements from :
i) 25thOctober 2010
ii) 15th June 2011
iii) 21st November 2011
iv) 2nd January 2012

t) A Ltd, owns 35% of the equity capital of B Ltd. B Ltd. in turn owns 30% of equity capital C Ltd., and 35% of equity capital in D Ltd. Which of the combinations are not related parties?

i) A and B
ii) B and C
iii) C and D
iv) B and D
v) A and C

u) Which of the following is not a "Joint Venture"?

i) Jointly controlled operations
ii) Jointly controlled assets
iii) Jointly controlled entities
iv) Joint Partnership

v) Assets and Liabilities in a joint venture is recognised in separate financial statements of the venturer in which of the following kind of joint venture

i) Jointly controlled operations
ii) Jointly controlled assets
iii) Jointly controlled entities
iv) Joint Partnership

w) In Equity Method of accounting, goodwill or capital reserve is recognised in the financial statements is amortised

i) Over a period of five years
ii) Over a period of ten years
iii) No amortization, but tested for impairment
iv) No amortization at all

x) Z Ltd invested to the extent of 30% in ABC Ltd. The share of losses in associate entity (ABC Ltd) of Z Ltd exceeds the investment carrying amount, and results of ABC Ltd show loss for the current year. What should be the treatment for Z Ltd as per AS 23?

i) Recognise the loss for the current year
ii) Do not recognise the loss and carry investment at cost
iii) Do not recognise the loss and carry investment at NIL value

y) Zen Ltd acquired 25% shares of B Ltd for` 5,00,000. The Balance Sheet of B Ltd as on 31^{st} March 2011 is given below:

Share Capital	8,00,000
Reserves and Surplus	5,00,000
	13,00,000
Fixed Assets	6,00,000
Investment	3,00,000
Current Assets	4,00,000
	13,00,000

- Zen Ltd received dividend from B Ltd for the year ended 31^{st} March 2011 at 40% from reserves
- B. Ltd profit for the year ended 31^{st} March 2012 was ` 8,00,000
- Dividend for current year was declared at 35% on 30^{th} April 2012

What is the value of Goodwill and carrying amount of Investment in Consolidated financials of Zen Ltd?

i) ` 2,00,000 and ` 2,00,000
ii) ` 50,000 and ` 1,50,000
iii) ` 50,000 and ` 1,30,000
iv) ` 50,000 and ` 80,000

(25X1=25 Marks)

PART-B **50 Marks**

Question no.1 is compulsory.
Answer any three from the rest

1. RCB Ltd., a listed company, entered into an expansion programme on 1st October 2011. On that date the company purchased from LM Ltd its investments in two private limited companies. The purchase of
   - The entire share capital of RR P Ltd
   - 50% share capital of KXIP P Ltd

   Both investments were previously owned by LM Ltd. After acquisition by RCB, KXIP P Ltd is to be run by RCB Ltd and LM Ltd as a jointly controlled entity.

   RCB Ltd makes its financial statements upto 30th September each year. The terms of acquisition were:

   RR P Ltd
   The total consideration was based on Price Earnings Ratio (P/E) of 12 applied to the reported profit of ` 20 Lakhs of RR Ltd for the year ended 30 September 2011. The consideration was settled by RCB Ltd issuing 8% debentures for ` 140 Lakhs (at par) and the balance by a new issue of Re. 1 equity shares based on its market value of ` 2.50 each.

   KXIP P Ltd
   The market value of KXIP P Ltd on 1st October 2011 was mutually agreed as ` 375 lakhs. RCB Ltd satisfied its share of 50% of this amount by issuing ` 75 lakhs Re. 1 equity shares (market value of ` 2.50 each) to LM Ltd.

   RCB Ltd has not recorded in its books the acquisition of the above investments or discharge of the consideration

   The summarized financial statements of the three entities at 30th September 2012 are
   (in. ` '000)

	RCB Ltd	RR P Ltd	KXIP P Ltd
Assets			
Tangible Assets	34,260	27,000	21,060
Inventories	9,640	7,200	18,640
Debtors	11,200	5,060	4,620
Cash	-	3,410	40
Total Assets	**55,100**	**42,670**	**44,360**
Liabilities			
Equity Share Capital			
`1 each	10,000	20,000	25,000

Retained earnings	20,800	15,000	4,500
Trade and other payables	17,120	5,270	14,100
Overdraft	1,540	-	-
Provision for taxes	5,640	2,400	760
	55,100	**42,670**	**44,360**

The following information is relevant:

- The book values of the net assets of RR P Ltd and KXIP P Ltd on the date of acquisition were considered to be a reasonable approximation to their fair values
- The current profits of RR P Ltd and KXIP P Ltd for the year ended 30th September 2012 were ` 80 lakhs and ` 20 Lakhs respectively. No dividends were paid by any of the companies during the year
- KXIP P Ltd the jointly controlled entity, is to be accounted for using proportional consolidation method in accordance with AS 27 “Interests in Joint Venture”
- Goodwill in respect of the acquisition of KXIP P Ltd has been impaired by ` 10 Lakhs at 30th September 2012. Gain on acquisition, if any, will be separately accounted

Prepare the consolidated Balance Sheet of RCB Ltd and its subsidiaries as at 30th September 2012.

(20 Marks)

2. XYZ & Company has acquired 100% of the equity shares of Company X during 2009. Company X is a defunct company. The net worth of the Company X is represented by land and building it owns. XYZ & Co acquired the shares of the Company X only for the land and building it owns. XYZ & Co has proposed to start a software development facility at this site at the time of share purchase. The software development facility has not yet been set up, as company’s existing facility itself is under utilized.

In the financials of the year 2010, the above instrument was classified as fixed assets under the head ‘land and buildings’ to reflect the substance of the transaction, as the intention to acquire shares was to use the land and buildings owned by Company X.

During the year 2012, the company has decided to sell these shares and has passed a resolution authorizing the chairman to negotiate and settle the price. As of March 2012, this investment is reflected as fixed assets in the books. The property is prime one and is an ideal one for setting up new software units, warehouses etc.

a) Should the above shares be classified under investments or is the current treatment of grouping it under fixed assets correct?
b) If the current treatment of disclosing shares as land and building is correct, should we disclose the same as assets held for disposal, with appropriate classification and disclosure?

(10 Marks)

3. A company is engaged in the business of ship building and ship repair. On completion of the repair work, a work completion certificate is prepared and countersigned by ship owner (customer). Subsequently, invoice is prepared based on the work completion certificate describing the nature of work done together with the rate and amount. Customer scrutinizes the invoice and any variation is informed to the company. Negotiations take place between the company and the customer. Negotiations may result in a deduction being allowed from the invoiced amount either as a lump sum or as a percentage of the invoiced amount. The accounting treatment followed by the company is as follows:

   a) When the invoice is raised, the customer's account is debited and ship repair income account is credited with the invoiced amount
   b) Deduction, if any, arrived after negotiation is treated as trade discount by debiting the ship repaid income account
   c) At the close of the year, negotiation in respect of certain invoices had not been completed. In such cases, based on past experience, a provision for anticipated loss is created by debiting the profit and loss account. The provision is disclosed in the Balance Sheet.

   Following two aspects are settled in the negotiations:

   a) Errors in billing arising on account of variation between the quantities as per work completion certificate and invoice and other clerical errors in preparing the invoice
   b) Disagreement between the company and customer about the rate/cost on which prior agreement has not been reached between them

   Comment, whether the accounting treatment is correct?

(10 Marks)

4.

a) A Company on 1.1.2008 purchased a fixed asset costing ` 250 Lacks. The company charges WDV depreciation on the asset. The asset has an estimated life of 15 years with a scrap value of ` 25 Lacks. The company received government grants to the extent of 50% of the cost of the asset. As per term and conditions of the grants 50% of the products of the company are to be supplied to the Government Agencies at a price of 20% below average market price. Average market price of the product price per unit was as follows:

2002	2003	2004	2005	2006
`300	` 320	` 340	`360	` 380

Production capacity was 1-lacks units per annum. Capacity utilization was

2002	2003	2004	2005	2006
50%	60%	60%	70%	80%

How do you allocate the government grants systematically if the company decides to treat the grant as deferred income?

b) A construction contractor has a fixed price contract for ` 9,000 to build a bridge. The initial amount of revenue agreed in the contract is ` 9,000. The contractor's initial estimate of contract costs is ` 8,000. It will take 3 years to build the bridge.

By the end of year 1, the contractor's estimate of contract costs has increased to ` 8,050. In year 2, the customer approves a variation resulting in an increase in contract revenue of ` 200 and estimated additional contract costs of ` 150. At the end of year 2, costs incurred include ` 100 for standard materials stored at the site to be used in year 3 to complete the project.

The contractor determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed upto the reporting date bear to the latest estimated total contract costs. A summary of the financial data during the construction period is as follows:

(Amount in ` lakhs)

	Year 1	Year 2	Year 3
Initial amount of revenue agreed in contract	9000	9000	9000
Variation	—	200	200
Total contract revenue	9000	9200	9200
Contract costs incurred upto the reporting date	2093	6168	8200
Contract costs to complete	5957	2032	-
Total estimated contract costs	8050	8200	8200
Estimated Profit	950	1000	1000
Stage of completion	26%	74%	100%

The stage of completion for year 2 (74%) is determined by excluding from contract costs incurred for work performed upto the reporting date, ` 100 of standard materials stored at the site for use in year

Compute Contract Revenue, Expenses and the Profit to be recognised in the Books of contractor

(10 Marks)

5.

a) A Ltd acquired 60,000 equity shares of ` 10 each in B Ltd on 1-1-2012 at ` 30 per share. The total issued equity share capital of B Ltd was ` 30,00,000 divided into 3,00,000 equity shares of ` 10 each. During the year 2012, the fixed assets of B Ltd was revalued up by ` 5,00,000. On the date of acquisition of shares, reserves and surplus of B Ltd was `. 10,00,000. B Ltd earned a profit after tax of ` 3,37,500 for the year 2012. During 2012, B Ltd paid an interim dividend of 5%.

Show in the books of A Ltd the value of investments in shares of B Ltd that would appear at 31st March 2012:

- In separate Balance Sheet of A Ltd
- In consolidated Balance Sheet of A Ltd and its subsidiaries

b) Following details are given for S Ltd for the year ended 31st March 2012:

	(` in lakhs)	(` in lakhs)
Sales (including inter-segment sales)		
Food products	10,000	
Plastic and packaging	1,240	
Health and Scientific	690	
Others	364	12,294
Expenses		
Food Products	7,170	
Plastic and Packaging	800	
Health and Scientific	444	
Others	400	8814
Other items		
General corporate expenses		1,096
Income from investments		252
Interest expenses		126
Identifiable Assets		
Food Products	15,096	
Plastic and Packaging	4,000	
Health and Scientific	1,400	
Others	1,364	21,860
General Corporate Assets		1,664
a) Inter segment sales are as below:		
Food Products		120
Plastic and Packaging		168
Health and Scientific		36
b) Operating profit includes ` 66 on inter segment sales		

You are requested to identify reportable segments

(10 Marks)

PRIME ACADEMY

35TH SESSION PROGRESS TEST- FINANCIAL REPORTING

SUGGESTED ANSWERS

PART- A

a) ii) Subsidiary of a SMC
b) ii) Going concern
c) iv) None of the above
d) ii) NRV at Split off Point or iii) Final Sales Value
e) i) Salaries of sales staff (sales department shares the building with factory supervisor).
f) i) ` 25 and ` 25 respectively.
g) i) This does not belong in a cash flow statement and should be disclosed only in the footnotes to the financial statements.
h) i) Do nothing.
i) i) Loss of ` 10 Lakhs (expensed immediately).
j) i) Revalue an entire class of fixed assets.
k) i) Expensed and charged to the income statement.
l) iii) Capitalized and amortised over the life of the asset
m) i) Profit or loss of the segment is 10 percent or more of profit or loss of all segments
n) ii) A parent
o) ii) Can adopt and it is necessary to make specific disclosure regarding this in the financial statements
p) iii) C
q) ii) Investment in subsidiary with an intention to dispose off in near future
r) iii)
s) iii) 21st November 2011
t) iii) C and D and v) A and C
u) iv) Joint Partnership
v) i) Jointly controlled operations
w) iv) No amortization at all
x) iii) Do not recognise the loss and carry investment at NIL value
y) ii) ` 50,000 and `1,50,000

PART B

1.

Consolidated Balance Sheet of RCB Ltd and its Subsidiaries as at 30th September 2012

Particulars	Note	` '000
I. Equity and Liabilities		
1. Shareholders' funds		
a. Share Capital	1	21,500
b. Reserves and Surplus	2	49,050
2. Non-current liabilities		
a. Long term borrowings (Bonds and debentures – 8% debentures)		14,000
3. Current Liabilities		
a. Short-term Borrowings (Overdraft)		1,540
b. Trade and other payables (17,120+5,270+50% of 14,100)		29,440
c. Short-term provisions (Provision for tax) (5,640+2,400+50% of 760)		8,420
Total		1,23,950
II. Assets		
1. Non-current Assets		
a. Fixed Assets		
i. Tangible Assets (34,260+27,000+50% of 21,060)		71,790
ii. Intangible Assets (Goodwill) (WN #8)		4,000
2. Current Assets		
a. Inventories (9,640+7,200+50% of 18,640)		26,160
b. Trade Receivables (Debtors) (11,200+5,060+50% of 4,620)		18,570
c. Cash and Cash Equivalents (Cash on hand) (0+3,410+50% of 40)		3,430
Total		1,23,950

Notes to the financial statements

1) Share Capital

Particulars	`
a. Authorised	.....
b. Issued, Subscribed and fully paid up 21,500 thousand equity shares of ` 1 each (Of the above, 11,500 thousand equity shares have been issued as fully paid up for consideration other than cash)	21,500

2) Reserves and Surplus

Particulars	`
a. Capital Reserve (WN #8)	3,000
b. Securities Premium (11,500 thousand * (2.50-1.00)	17,250
c. Surplus (WN #10)	28,800
Total	49,050

Working Notes

Particulars	RR P Ltd	KKXIP P Ltd
1. Accounting Standard applicable	21	27
2. Accounting Method	Full Consolidation	Proportionate Consolidation
3. Date of Acquisition	01-10-2011	01-10-2011
4. Shareholding pattern	• RCB Ltd – 100% • Minority interest – Nil	• Extent of financial interest – 50%
5. Analysis of Profits	• Opening Balance ` 15,000 – ` 8,000 = ` 7000 (PRE-acquisition) • Current year profits – `8,000 (POST-acquisition)	• Opening Balance `4,500 – ` 2000 = `2,500 (PRE-acquisition) • Current year profits – `2000 (POST-acquisition)
6. Apportionment of profits	PRE-acquisition • RCB Ltd – `7,000 • Minority interest – Nil POST-acquisition • RCB Ltd – ` 8,000 • Minority interest – Nil	PRE-acquisition • RCB Ltd – `1,250 (venturer's interest 50%) POST acquisition • RCB Ltd – `1,000 (venturer's interest 50%)
7. Minority interest	Nil	Not Applicable
8. Goodwill/Capital Reserve	• Cost of investment (2,000*12) = ` 24,000 • Share of net assets on the date of investment: Share capital – ` 20,000 Capital Profits – ` 7,000 Total - ` 27,000 • Capital Reserve– `3,000	• Cost of investment (37,500*50%)= ` 18,750 • Share of net assets on the date of investment: Share capital– ` 12,500 Capital Profits – ` 1,250 Total -` 13,750 • Goodwill – `5,000 Less: Impaired =

		` 1,000 Net for CBS = ` 4,000
9. Inter-company transactions	Nil	Nil

WN #10 Reserves

Particulars	` '000
a. RCB Ltd Balance	20,800
b. Add: Share of post-acquisition profits of RR P Ltd (WN #6) KXIP P Ltd (WN #6)	 8,000 1,000
c. Impairment of goodwill	(1,000)
d. Net for CBS	28,800

2. As per AS 13, "Accounting for Investments", the cost of any shares in a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property as long term investment.

   In this case, the acquisition of shares in company X was with the sole motive of using the land and buildings and not for earnings income by way of dividends. The substance of the transaction is an investment in fixed assets, though 'form' may be acquisition of shares.

   Hence, the accounting treatment so far done by the company is correct

   Since the original intention has undergone a change, on decision to "dispose of the shares" in company X, the reclassification should be to current investments and not "assets held for disposal" because it is based on the original intention to use the property, the investment was classified as 'fixed assets'.

   When the transfer from long term investment to current investment is made, transfer should be at lower of cost or carrying amount whichever is lower on the date of transfer. Similarly, this transfer should also be recorded at lower of cost and carrying amount.

3. As per AS 9 on "Revenue Recognition" revenue is recognised at the time when the significant risks and rewards of ownership is transferred i.e., when the invoice is raised to the customers. However, the treatment of deduction as trade discount is not as per AS 9.

   According to AS 4, "Contingencies and Events occurring after Balance Sheet", the adjustment of provision for anticipated loss in the profit and loss account is not appropriate. This is not an adjusting event in accordance with the standard.

The outcome of negotiations, i.e., any adjustment on account of errors on account of variation and other clerical errors and agreements where prior rates are not agreed should be debited to Ship income repair account with corresponding credit to sundry debtors account in the period when the negotiations are complete.

4.

a) As per AS 12 Accounting for Government Grants – the grant should be recognised as deferred income over the period in which the costs related to the grant is incurred. In this case, the costs related to the grant is the concession of 20% below market price for the products produced by the company that is supplied to government agencies

	2002	2003	2004	2005	2006
Production in units	50,000	60,000	60,000	70,000	80,000
Units supplied to Government agencies	25,000	30,000	30,000	35,000	40,000
Market Price	` 300	`320	` 340	` **360**	` 380
Price at which supplied to government	`240	` 256	`272	` 288	`304
Revenue foregone to government agencies	` 60	` 64	`68	`72	`76
Total grant received amortised in the above ratio (` 250 lacs)	` 44.12	` 47.05	` 50	` 52.95	`55.88

b)

As per AS 7 on Construction Contracts - Contract revenue and Contract costs should be recognised based on the percentage of completion.

Computation of Contract Revenue, Contract Expense and Profit

(Amount in ` lakhs)

	Year 1	Year 2	Year 3
Contract Revenue (Based on % of completion)	2160 (9000*24%)	6808 (9200*74%)	9000 (9200*100 %)
Contract Costs to be recognised	2093	6168	8200
Estimated Profit	167	760	800
Stage of completion	26%	74%	100%

5.

a) Separate Financial Statements of A Ltd (Extract)

	`
Equity and Liabilities	
Assets	
Non-current Assets	
Investments in B Ltd	9,00,000

Consolidated Financial Statements of A Ltd with B Ltd (Extract)

	`
Equity and Liabilities	
Assets	
Non-current Assets	
Investments at Cost (including goodwill `1,00,000)	9,00,000
Add: Share of revenue profit (` 3,37,500 * 40%) – (`75,000 * 40%) (to be credited to profit and loss account)	1,05,000
Share of revaluation reserve (` 2,50,000 * 40%) (to be credited to revaluation reserve of A Ltd)	1,00,000
Investments in B Ltd under Equity method	11,05,000

Working Notes:

1. Reserves & Surplus of B Ltd

Profit and Loss of B Ltd	`
Opening Balance	5,00,000
Add: Current year earnings	3.37,500
Less: Interim dividend capital	(75,000)
Closing balance	7,62,500
Revaluation reserve	2,50,000

2. Analysis of Reserves and Surplus of B Ltd

	100%	40%
Reserves and Surplus (Capital Profit)	5,00,000	2,00,000
Revenue Profit	2,62,500	1,05,000
Equity Share Capital	15,00,000	6,00,000

3. Goodwill/Capital Reserve

		`
Investments		9,00,000
Less: Nominal Value	6,00,000	
Capital Profit	2,00,000	8,00,000
Goodwill		1,00,000

If the net equity of an associate is increase on account of revaluation of fixed assets then the investments in associates should also be increased for the investor's share on such increase with a corresponding increase in the revaluation reserve of the investor

b) Calculation of segment result

	Sales `	Expenses `	Segment result `
Food products	10,000	7,170	2,830
Plastic & Packaging	1,240	800	440
Health & Scientific	690	444	246
Other	364	400	(36)

The conditions for reportable segments are

i. Revenue from sales to external customers and from transactions with other segments is 10% or more of the total revenue, external and internal of all segments
ii. Segment result whether profit or loss is 10% or more of (a) the combined result of all segments in profit or (b) the combined result of all segments in loss, whichever is greater in absolute amount
iii. Segment assets are 10% or more of the total assets of all segments
iv. Total external revenue attributable to reportable segments constitutes less than 75% of the total enterprise revenue, additional segments should be identified as reportable segments even if they do not meet the 10% threshold until atleast 75% of total enterprise revenue is included in reportable segments

The relevant information about the segments is given in the following table:

	Food and Products `	Plastic and Packaging `	Health and Scientific `	Others `	Total `
Segment Assets	15,096	4,000	1,400	1,364	21,860
Segment assets as a % of total assets of all segments	69.06%	18.3%	6.4%	6.24%	
Segment Results	2,830	440	246	(36)	3,480
Combined result of all segments in profits	2,830	440	246		3,516
Combined result of all segments in loss				36	
Segment result as a % of the higher of profit or losses in absolute amount (3,516)	80.49%	12.51%	7%	1.02%	
Segment Revenue	10,000	1,240	690	365	12,294
Segment revenue as a % of total revenue of all segments	81.34%	10.09%	5.61%	2.96%	

On the basis of assets, results and revenue criteria, “food products” and “plastic and packaging” divisions are reportable segment

PRIME ACADEMY

35TH SESSION PROGRESS TEST – STRATEGIC FINANCIAL MANAGEMENT

No. of pages – 4 | Total Marks – 75
Time allowed – 2 Hrs

PART -A

1. A company has obtained quotes from two different manufacturers for equipment. The details are as follows :

Product	Cost (` Million)	Estimated life (years)
Make A	4.50	10
Make B	6.00	15

Ignoring operation and maintenance cost, which one would be cheaper? The company's cost of capital is 10%. [Given: PVIFA (10%, 10 years) = 6.1446 and PVIFA (10%, 15 years) = 7.6061]
   a) Make A will be cheaper
   b) Make B will be cheaper
   c) Cost will be the same
   d) None of the above. (3 Marks)

2. An Indian company is planning to invest in US. The US inflation rate is expected to be 3% and that of India is expected to be 8% annually. If the spot rate currently is `45/ US$, what spot rate can you expect after 5 years?
   a) `59.09/US$
   b) `57.00/US$
   c) `57.04/US$
   d) `57.13/US$ (2 Marks)

3. The following various currency quotes are available from a leading bank :
   ` /£ 75.31/75.33 ; £ / $ 0.6391/0.6398; $ /¥ 0.01048/0.01052
   The rate at which yen (¥) can be purchased with rupees will be—
   a) ` 0.5070
   b) `1.5030
   c) `1.7230
   d) None of the above.
   (2 Marks)

4. Concept of joint probability is used in case of:
   a) Independent Cash flows
   b) Uncertain Cash flows
   c) Dependent Cash flows
   d) Certain Cash flows (1 Mark)

5. Money market hedge involves
   a) Borrowing in foreign currency in case of exports;
   b) Investing in foreign currency in case of imports;
   c) Both A and B.
   d) Neither of the above (1 Mark)

6. The aim of foreign exchange risk management is :
   a) To maximize profits.

b) To know with certainty the quantum of future cash flows.
c) To minimize losses.
d) To earn a minimum level of profit. (1 Mark)

7. Eurodollar deposit means
   a) Dollar deposit outside USA
   b) Dollar deposit beyond the control of monetary authority
   c) Dollar deposit in the US and outside US
   d) None of the above.
   (1 Mark)

8. In theory, when making capital budgeting decisions, all projects with positive NPVs should be
   a) rejected
   b) recalculated
   c) avoided
   d) accepted (1 Mark)

9. Subsidiary A of Mega plc has net inflows in Australian dollars of A$1,000,000, while Subsidiary B has net outflows in Australian dollars of A$1,500,000. The expected exchange rate of the Australian dollar is £0.30. What is the net inflow or outflow as measured in pounds?
   a) £150,000 outflow.
   b) £1,666,000 inflow.
   c) £150,000 inflow.
   d) £1,666,000 outflow. (3 Marks)

10. If interest rate parity holds, then the one-year forward rate of a currency will ______ the predicted spot rate of the currency in one year according to the international Fisher effect.
    a) greater than
    b) less than
    c) equal to
    d) answer is dependent on whether the forward rate has a discount or premium (1 Mark)

11. You have an opportunity to invest in Australia at an interest rate of 8%. Moreover, you expect the Australian dollar (A$) to appreciate by 2%. Your effective return from this investment is:
    a) 8.00%. b) 10.16%.
    c) 6.00%. d) 5.88%. (2 Marks)

12. Assume the bid rate of a Swiss franc is £0.42 while the ask rate is £0.45 at Bank X. Assume the bid rate of the Swiss franc is £0.40 while the ask rate is £0.41 at Bank Y. Given this information, what would be your gain if you use £1,000,000 and execute location arbitrage? That is, how much will you end up with over and above the £1,000,000 you started with?
    a) £24,340. b) £150,000.
    b) £125,000. c) £12,550. (3 Marks)

13. The value of the Australian dollar (A$) today is £0.41. Yesterday, the value of the Australian dollar was £0.38. The Australian dollar by _______%.
    a) depreciated; 7.90 b) appreciated; 7.90
    c) depreciated; 7.30 d) appreciated; 7.30 (2 Marks)

14. An Indian importer has purchased capital goods worth \$6,50,000 from US which is payable in 3 months time. The Importer expects that frame will weaken over a period. He has asked for forward exchange cover to the banker. The rates are Spot 1USD = `46.98; Forward discount rate for 3 months is `0.48.The rupee exposure is
    a) `27,937,000    b) `3,12000
    c) `27,625,000    d) `28,249,000   (2 Marks)

PART B

Question no.1 is compulsory. Answer any TWO from the rest.
Working notes should form part of your answer

1. Following are the estimates of the net cash flows and probability of a new project of M/s X Ltd.:

	Year	P=0.3	P=0.5	P=0.2
Initial investment	0	`4,00,000	`4,00,000	`4,00,000
Estimated net after tax cash inflows per year	1 to 5	`1,00,000	`1,10,000	`1,20,000
Estimated salvage value (after tax)	5	`20,000	`50,000	`60,000

Required rate of return from the project is 10%. Find:

(i) The expected NPV of the project.
(ii) The best case and the worst case NPVs.
(iii) The probability of occurrence of the worst case if the cash flows are perfectly dependent overtime and independent overtime.
(iv) Standard deviation and coefficient of variation assuming that there are only three streams of cash flow, which are represented by each column of the table with the given probabilities.
(v) Coefficient of variation of X Ltd. on its average project which is in the range of 0.95 to 1.0. If the coefficient of variation of the project is found to be less risky than average, 100 basis points are deducted from the Company's cost of Capital.

Should the project be accepted by X Ltd? (20 Marks)

2. S Ltd has to make a US $5 million payment in three month's time. The required amount in dollars is available with S ltd. The management of the company decided to invest them for three months and following information is available in this context.

US $ deposit rate – 9% p.a
Sterling pound deposit rate – 11% p.a
Spot exchange rate is $1.82/pound
3months forward rate is $1.80/pound

Required:

a) Where should the company invest for better returns?
b) Assuming that the interest rates and the spot exchange rate remain as above, what forward rate would yield an equilibrium situation?
c) Assuming that the US interest rate and the spot and the forward rates remain as above, where should the company invest if the sterling pound deposit rate were 15% p.a?

(15 Marks)

3. (a) The finance director of P ltd has been studying exchange rates and interest rates relevant in India and USA. P Ltd has purchased goods from a company in US at a cost of $51 lakhs payable in $ in 3 months time. In order to maintain profit margins the finance director wishes to adopt, if possible a risk free strategy that will ensure that the cost of goods to P ltd is no more than `22crores.

`/$ (Spot)	40/42
`/$ (1m forward)	41/43
`/$ (3m forward)	42/45

Interest rates available to P ltd:

	India		USA	
	Deposit	Borrowing	Deposit	Borrowing
1 month	13%	15%	7%	10%
3 months	13%	16%	8%	11%

Calculate whether it is possible for P ltd. to achieve a cost directly associated with transaction no more than `22 crores, by means of a forward market hedge or money market hedge. Transaction costs may be ignored. (8 Marks)

(b) From the following project details calculate the sensitivity of the (i) project cost, (ii) Annual cash flow, (iii) Cost of capital. Which variable is the most sensitive?

Project cost	`12,000
Annual cash flow	`4,500
Life of the project	4 years
Cost of capital	14%

The annuity factor at 14% for 4 years is 2.9137 and at 18% for 4 years is 2.667 (7 Marks)

4. A UK Company expects to receive 500,000 Canadian Dollars. The actual due date, falls exactly six Months from now. The finance manager decides to hedge the transaction, using forward contracts. Interest rate in Canada is 15%, while that in UK is 12%. Current spot rate is Pd. Sterling 1 = Can $ 2.5. Evaluate the situation after UK Company hedged its transaction, and if sterling was to:
   (i) Gain 4%
   (ii) Lose 2% or
   (iii) Remain stable at present level

   Assume that the forward exchange rate differential reflects the Interest Rate Parity analysis of forward rates. (15 Marks)

PRIME ACADEMY
35TH SESSION PROGRESS TEST-STRATEGIC FINANCIAL MANAGEMENT
SUGGESTED ANSWERS

PART-A

1. **OPTION A - Make A will be cheaper**
   Make A - Purchase cost = `. 4.50 million
   Equivalent annual cost = 4.50/6.1446 = ` 0.73235 million
   Make B - Purchase cost = ` 6.00 million
   Equivalent annual cost = 6.00/7.6061 = 0.78884 million
   Therefore, equivalent annual cost of make A is lower than make B, make A is suggested to purchase.

2. **OPTION C. — ` 57.04/US $**
   According to Purchase Power Parity, spot rate after 5 years = ` 45 × [(1 + 0.08)/ (1 + 0.03)]5 = 45 × 1.2675 = ' 57.04
3. **A. ` 0.5070 -** To purchase (¥) we need to have a quote of (¥ ) in terms of `. We need only the ASK
   quote. ASK (` / ¥ ) = ASK (` / £) × ASK (£ /$) × ASK($/ ¥) = 75.33 × 0.6398 × 0. 01052 = `
   0.5070 (approx.)
4. **OPTION C Dependent Cash flows**
5. **OPTION C. Both A and B are correct.**
   Importer will have FC liability and settle the same with maturity proceeds of FC asset created.
   Exporter will get the asset value from overseas customer and settle FC liability there itself.
6. **OPTION B. To know with certainty the quantum of future cash flows.**
7. **OPTION B. Dollar deposit beyond the control of monetary authority.**
8. **OPTION D - accepted**
9. **OPTION D -** A$1,000,000 – A$1,500,000 = –A$500,000 × $.55 = –$275,000
10. OPTION C - equal to
11. **OPTION B -** (1.08 × 1.02) – 1 = 10.16%
12. **OPTION A -** Buy from Bank Y and sell to Bank X so 1,000,000 / 0.41 = SFr 2,439,024 and sell to X at
    £0.42 = £1,024,340, so £24,340
13. **OPTION C -** (£0.41 - £0.38)/£0.38 = 7.90%
14. **OPTION A**

PART-B

1. (i) Expected cash flows

Year		Net cashflows	P.V	P.V @ 10%
0	(4,00,000 x 1)	-4,00,000	1.0000	-4,00,000
1 to 4	(1,00,000x0.3 + 1,10,000x0.5+1,20,000x0.2)	1,09,000	3.1700	3,45,530
5	[1,09,000+(20,000x0.3+50,000x0.5+60,000x0.2)]	1,52,000	0.6210	94,392
NPV				39,922

(ii) ENPV of the worst case

1,00,000 x 3.790 = `3,79,000
20,000 x 0.621 = `12,420/-
ENPV = (-)4,00,000 + 3,79,000 + 12,420 = (-)`8,580/-

ENPV of the best case
ENPV = (-)4,00,000 + 1,20,000 x 3.790 + 60,000 x 0.621 = `92,060/-.

(iii) (a) Required probability = 0.3
(b) Required probability = (0.3)5 = 0.00243

(iv) The base case NPV = (-)4,00,000 + (1,10,000 x 3.79) + (50,000 x 0.621) = `47,950/-
ENPV = 0.30 x (-) 8580 + 0.5 x 47950 + 92060 x 0.20 = `39,813/- Therefore, σENPV = √0.3(-8580-39,813)$^2$ + 0.5(47950- 39813)$^2$ + 0.2(92,060- 39,813)$^2$ = `35,800/-Therefore, CV = 35,800/39,813 = 0.90

(v) Risk adjusted out of cost of capital of X Ltd. = 10% - 1% = 9%.
ENPV

Year	Net cashflows	P.V @ 9%	P.V @ 10%
0	-4,00,000	1.0000	-4,00,000
1 to 4	1,09,000	3.2400	3,53,160
5	1,52,000	0.6500	98,800
ENPV			51,960

Therefore the project should be accepted

2. Interest rate parity $(1+r_h) = (f/S) \times (1+r_f)$

a) 1.0225 = (1.0275)(1.80/1.82)
LHS = 1.0225
RHS = 1.0162
Since LHS ≠ RHS, interest rate parity is not holding exactly.
The company needs to invest in dollars for better returns

b) For equilibrium, the interest rate parity equation should match i.e. $F/S = (1+r_h) \div (1+r_f)$
i.e. $F = S \times [(1+r_h) \div (1+r_f)]$ 1.82 x(1.0225/1.0275) = 1.8111
Only if the forward rate, F = 1.8111, we have an equilibrium situation

c) If spot = \$1.82/£; 3m forward = \$1.80/£; r_h = 9%; r_f = 15%;
LHS = 1.0225 RHS = (1.0375)(1.80/1.82) = 1.0261
Since LHS ≠ RHS, interest rate parity is not holding exactly.
The company needs to invest in pounds since RHS > LHS.

3 (a) *Forward cover:* P ltd has to pay \$51 lakhs in 3 months time. Thus the company would hedge forward
for 3 months. Since they need \$, the rate applicable will be `45/\$.

Outflow `51 lakhs x 45 = `22.95crores

Money market hedge

- Exposure – Payables \$
- Strategy:
- Borrow INR @16%
- Convert to \$ at Spot
- Deposit @ 8%
- Use the \$ maturity to pay purchase of goods

Here \$51 lakhs is required after 3 months, thereby the amount deposited + interest should equal \$ 51 lakhs. Therefore, it would deposit: =(51 L)/(1+0.08/4) = \$ 50 lakhs
Borrow 50 lakhs x 42(spot) = `21crores
Total payment = `21crores + interest @16% for 3 m = `21.84 crores

Conclusion: Since amount under option II is lower and less than `22crores, it is advisable to go for Money
market hedge

3 (b) Annual cash flow `(4500 x 2.9137) = `13,112

Annual cash flow `(4500 x 2.9137)	=	`13,112
Less: Project cost		`12,000
NPV		1,112

a) *Sensitivity for project cost:*
If the project cost is increased by Rs 1,112 the NPV of the project will become zero. Therefore, the sensitivity for the project cost is 1112 / 12000 = 9.27%

b) *Sensitivity for annual cash inflow:*
If the present value of annual cash inflow is lower by `1112, the NPV of the project will become zero. Therefore, the sensitivity for annual cash flow is: 1112/13112 = 8.48%

c) *Sensitivity for cost of capital:*
Let 'p' be the annuity factor which gives a zero NPV.Therefore we can say -12000 + 4500p = 0
[where p = PVIFA(x,4), where, x is that rate when NPV = 0 i.e. x is the IRR] 4500p = 12000
P = 12000/4500 = 2.667. Therefore PVIFA(x,4) = 2.667. x = 18%.
Sensitivity of cost of capital = 18%-14%/14% = 28.57%.

Analysis – the cash inflow is more sensitive, since only 8.5% change is cash inflow will make the NPV of the project zero.

4. From Interest Rate Parity theory we have,£ 1 = CD 2.5. Therefore Home currency is CD (interest rate =
R_h = 15%) & R_f = 12%.Therefore we have Forward Exchange Rate F =2.5x[(1+0.15/2)/(1+0.12/2)] =
2.5354

Thus the company would get £ = 5,00,000/2.5354 = £ 1,97,207.54

(i) If the pound gains 4%, the exchange rate will be CD 2.5 * 1.04 = CD 2.60 Originally £ 1 = CD 2.50 and now £ 1 = CD 2.60. At this rate the firm would be able to buy 5,00,000 / 2.6 = £ 1,92,307.69. i.e., it would have received £ 1,97,207.54 - £ 1,92,307.69 = £ 4,900 less. Therefore, hedging has saved the company £ 4,900 approximately.

(ii) If the pound loses 2%, the exchange rate will be CD 2.5 * 0.98 = CD 2.45. Originally £ 1 = CD 2.50 and now £ 1 = CD 2.45. At this rate the firm would be able to buy 5,00,000/-. 2.45 = £ 2,04,081.63 i.e., it would have received £ 2,04,081.63 – £ 1,97,207.54 = £ 6,874.09 more. Therefore, hedging has cost the company £ 6,874.09.

(iii) If the pound remains at 2.5%. Originally £ 1 = CD 2.50 and now £ 1 = CD 2.50. At this rate the firm would be able to buy 5,00,000/-. 2.5 = £ 2,00,000. i.e., it would have received £ 2,00,000 – £ 1,97,207.54 = £ 2,792.46 more. Therefore, hedging has cost the company £ 2,792.46

PRIME ACADEMY

35TH SESSION PROGRESS TEST – ADVANCED AUDITING & PROFESSIONAL ETHICS

No. of pages –6

Total Marks – 75
Time allowed – 2 Hours

PART – A

1. A person who is indebted to a company X for an amount of ` 1000/- is:
   a. Disqualified from appointing as auditor of Company X.
   b. Not disqualified from appointing as auditor of company X.
   c. Disqualified from appointing as auditor of Company X and its subsidiaries and Holding Companies.
   d. Not disqualified from appointing as auditor of Company X and its subsidiaries and Holding Companies.

2. A vacancy arouse in the office of the auditors due to disqualifications specified under section 226 of the Companies Act may be filled in by:
   a. Board of Directors.
   b. Shareholders in General Meetings.
   c. Either a or b above.
   d. Central government.

3. To which of the following companies CARO is applicable:
   a. A Private company whose authorised capital is `40 lakhs and paid up share capital is ` 10 lakhs and Reserves are Nil.
   b. A Private company whose loan outstanding from its directors is `30 lakhs.
   c. A Private company whose paid up capital is `35 lakhs and share application money pending allotment is `25 lakhs.
   d. A private company whose authorised share capital is ` 10 lakhs, paid up capital is ` 10 lakhs and reserves are at 40 lakhs.

4. In an audit of a listed entity the difference of opinion arising between the engagement partner and engagement quality reviewer may be resolved:
   a. By following the firm's policies and procedures.
   b. By following the instructions of the quality reviewer.
   c. By following the instructions of the engagement partner.
   d. By following the instructions of the management.

5. The objective of the auditor in preparing the documentation is to ensure that those documentation provides:
   a. Sufficient and appropriate records of the basis for the auditor's report.
   b. Sufficient and appropriate record to establish that the firms policies and procedures are followed.
   c. Sufficient evidence to safeguard the interest of the auditor.
   d. Sufficient and appropriate evidence for the work carried out by the assistants.

6. In respect of the work entrusted to the other auditors, the level of responsibility of the principal auditor would be:
   a. Nil.
   b. Fully responsible.
   c. The principal auditor would not responsible unless some suspicion arises about the reliability of the work performed by the other auditor.
   d. None of the above.

7. The auditor issuing the unmodified opinion:
   a. shall not refer the work of the auditor's expert.
   b. Shall refer the work of the auditor's expert only if required by any law.
   c. Shall refer the work of the auditor's expert, if such auditor's expert has given his consent.
   d. May refer the work of the auditor's expert only if the auditor is satisfied to do so.

8. If the auditor makes reference to the work of an auditor's expert in the modified report, the responsibility of the auditor:
   a. Is reduced to the extent of the work performed by the auditor's expert.
   b. Does not reduce the responsibility of the auditor for the audit opinion.
   c. Fully absolved from the responsibility of the audit opinion.
   d. Depends on the circumstances of the case.

9. To which of the following private unlimited company, Companies (Auditor's Report) Order is applicable:
   a. Whose turnover is less than ` 3 crore.
   b. Whose loan outstanding from banks and public financial institution is ` 15 lakhs or less.
   c. Whose paid up capital is more than 50 lakhs.
   d. All of the above.

10. Which of the following is not the duty of Public Accountants Committee:
   a. Distribution of moneys.
   b. Ensuring the authorisation of expenditure.
   c. Re-appropriation (i.e., distribution of funds).
   d. Managing Assets.

11. A systematic process of evaluating an organisation's effectiveness, efficiency and economy of operations under the management's control is referred as:
    a. Management audit.
    b. Operational audit.
    c. Internal audit.
    d. System Audit.

12. The period within which the auditor should be given the intimation of his appointment under section 224(1) of the Companies Act, 1956 is:
    a. 7 days
    b. 10 days
    c. 30 days
    d. 60 days

13. The time limit within which the auditor shall inform the registrar, of his appointment is:
    a. 7 days from the date of receipt of intimation.
    b. 30 days from the date of receipt of intimation.
    c. 7 days from the date of appointment.
    d. 30 days from the date of appointment.

14. The casual vacancy other than resignation caused in the office of the first auditors appointed by the Board of Directors may be filled by:
    a. Board of Directors.
    b. Shareholders in general meeting.
    c. Either a or b above.
    d. None of the above.

15. For removal of first auditors before the expiry of the term, appointed by the Board of directors whose approval is required:
    a. Approval of the Central Government.
    b. Approval of the shareholders in general meeting.
    c. Approval of the Board of Directors.
    d. Either (a) or (b) above.

16. A firm consists of two partners Mr. X and Mr. Y. How many number of audits this firm can accept, if Mr. X who is also a partner in another firm where he is having 10 public companies' internal audit and 3 public companies having paid up capital of less than 20 lakhs statutory audit.
    a. 27 companies statutory audit irrespective of their share capital.
    b. 37 companies out of which 20 companies having less than 25 lakhs share capital.
    c. 37 companies out of which not more than 17 companies having ` 25 lakhs or more share capital.
    d. 37 companies irrespective of their share capital.

17. The appointment of auditors of a company whose 30% of the subscribed capital is held by an institution in which state government holds 60% of the subscribed share capital is to be made by:
   a. Comptroller and Auditor –General of India.
   b. Passing an ordinary resolution in AGM.
   c. Passing an special resolution in AGM.
   d. Board of Directors.

18. The first auditors of a company in which 26% of the share capital is held by a nationalised bank will be appointed by:
   a. Board of directors within 30 days of registration.
   b. Share holders in general meeting by way of special resolution.
   c. Either (a) or (b).
   d. Share holders in AGM by way of ordinary resolution.

19. A company in which 30% of the subscribed share capital is held by an insurance company is required to pass which of the following resolution to appoint it auditors in AGM:
   a. Special resolution
   b. Ordinary resolution
   c. Circular resolution
   d. Any of the above

20. To which of the following companies CARO is not applicable:
   a. A private company having loan outstanding from banks is `20 lakhs and interest accrued and due is ` 6 lakhs.
   b. A private unlimited company.
   c. A public unlisted company having paid up capital is 35 lakhs.
   d. A private company having loan outstanding from banks is ` 20 lakhs and from directors `10 lakhs.

21. A company in which 55% of the paid up capital is held by more than one government companies cumulatively. However none of the government companies holding more than 25% of the paid up capital. The auditor of such company shall be appointed by:
   a. Passing a special resolution in the general meeting.
   b. Comptroller and Auditor General.
   c. Board of Directors.
   d. Both (a) and (b) is required.

22. To which of the following companies CARO is applicable:
    a. Section 25 Companies.
    b. Private Companies having paid up equity capital of `30 lakhs and preference share capital of 30 lakhs.
    c. Private Companies having authorised share capital of `60 lakhs.
    d. Private Companies which are subsidiary of public company having paid up capital of 25 lakhs.

23. On which of the following item an auditor is not required to make an inquiry u/s 227(1A) of the Companies Act, 1956.
    a. Whether loans made by the company have been shown as deposits.
    b. Whether advances made by the company have been shown as deposits.
    c. Both (a) and (b).
    d. Whether advances of personal nature are charged to revenue account.

24. Which of the following type of modified audit report does not affect the auditors opinion on true and fairness of the financial statements?
    a. An audit report with Qualified Opinion.
    b. An audit report with Disclaimer Opinion.
    c. An audit report with Adverse Opinion.
    d. An audit report with emphasis on matter paragraph.

25. According to section 619 of the Companies Act, 1956, comments upon or supplement to the audit reports by the Comptroller and Audit General:
    a. Shall be placed before the annual general meeting.
    b. Shall be placed before both the houses of parliament.
    c. Shall be circulated to the members of the company along with the notice to AGM.
    d. Shall forms part of the audit report issued by the auditor.

(25 X 1 =25 Marks)

PART – B

I. Answer any 7 Questions

1. What are the aspects to be considered when relying upon the work of an expert ?
2. Discuss the reporting requirement under CARO, where a company has defaulted in compliance of section 58AA of the Companies Act, 1956 with regard to public deposits
3. Relying upon the work of another auditor --- Comment
4. Write a short explanatory note on areas of propriety audit u/s 227(1A) of the Companies Act, 1956.
5. Operational audit is not different from internal audit – discuss
6. Explain in brief behavioural aspects encountered in the management audit and state the ways to solve them.
7. What are the steps to be taken by a firm of charted accountants to ensure that its appointments as statutory auditor of a company is valid.
8. List out the pre-conditions to be presented and agreed upon with the management as per SA 210 which forms the basis for performing an audit.

(7 x 5 = 35 Marks)

II . Answer any 5 questions

1. Company A has charged `10 lakhs to its revenue account which are incurred to meet the personal expenses of the employees. The nature of expenses incurred are provision of rent-free quarters, conveyance for personal use, mobile phone expenses etc. Give your comments as an auditor of the company whether the same needs to be commented or highlighted in the audit report to be issued u/s 227 of the Companies Act, 1956.
2. State the circumstances under which the Companies (Auditors Report) Order, 2003 is applicable to branch of a private company.
3. State the companies which are required to have an internal audit system commensurate with its nature and size of the business under Companies (Auditor's Report) Order, 2003.
4. X limited did not follow the applicable Accounting Standard for disclosing Earnings Per Share (EPS) in the financial statements. The fact of such non-disclosure was however, mentioned in the notes forming part of accounts. As the statutory auditor of X limited how you report in the above case?
5. Write short note on remuneration to Statutory Auditors under the Companies Act, 1956
6. A Private Limited company which is a subsidiary of a public limited company is incorporated on 1st July, 2011. During the year ended 31st March, 2012, it had issued equity shares (fully paid up) of `25 lakhs, preference shares (fully paid up) of ` 30 lakhs, had borrowed ` 7.5 lakhs each from 2 financial institutions and its turnover (Net of excise ` 50 lakhs which is credited to a separate account) is `475 lakhs. Will Companies Auditors Report Order, 2003 (CARO) be applicable to A Pvt. (5 x 3 = 15 Marks)

PRIME ACADEMY

35th SESSION PROGRESS TEST – ADVANCED AUDITING AND

PROFESSIONAL ETHICS - SUGGESTED ANSWERS

PART-A

1	D
2	C
3	D
4	A
5	A
6	B
7	B
8	B
9	C
10	D
11	B
12	A
13	B
14	C
15	B
16	B
17	C
18	A
19	A
20	D
21	B
22	B
23	C
24	D
25	A

PART-B

I.

1. As per “SA 620 Using the Work of an Auditor’s Expert”, the auditor shall evaluate the adequacy of the auditor’s expert’s work for the auditor’s purposes, including: The relevance and reasonableness of that expert’s findings or conclusions, and their consistency with other audit evidence;

   If that expert’s work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and If that expert’s work involves the use of source data that is significant to that expert’s work, the relevance, completeness, and accuracy of that source data. Specific procedures to evaluate the adequacy of the auditor’s expert’s work for the auditor’s purposes may include:

   - Inquiries of the auditor’s expert.
   - Reviewing the auditor’s expert’s working papers and reports.
   - Corroborative procedures, such as:
   - Observing the auditor’s expert’s work; Examining published data, such as statistical reports from reputable, authoritative sources;
   - Confirming relevant matters with third parties;
   - Performing detailed analytical procedures; and
   - Re-performing calculations.
   - Discussion with another expert with relevant expertise when, for example, the findings or conclusions of the auditor’s expert are not consistent with other audit evidence.
   - Discussing the auditor’s expert’s report with management.

   Relevant factors when evaluating the relevance and reasonableness of the findings or conclusions of the auditor’s expert, whether in a report or other form, may include whether they are:

   - Presented in a manner that is consistent with any standards of the auditor’s expert’s profession or industry;
   - Clearly expressed, including reference to the objectives agreed with the auditor, the scope of the work performed and standards applied;
   - Based on an appropriate period and take into account subsequent events, where relevant;
   - Subject to any reservation, limitation or restriction on use, and if so, whether this has implications for the auditor; and

- Based on appropriate consideration of errors or deviations encountered by the auditor's expert. If after performing all these procedures the auditor concludes that the work of the expert is not consistent with the information in the financial statements or that it does not constitute sufficient appropriate audit evidence, the auditor should express a qualified, disclaimer or an adverse opinion. In other cases, the opinion has to be unqualified. If while giving his report the auditor considers it appropriate to disclose the identity of the expert, he should obtain his prior consent.

2. Under paragraph 4(vi) of Companies (Auditor's) Report Order 2003 the audit report should include following matters:

In case company has accepted any deposits from public whether directives issued by the Reserve Bank of India and the provisions of sections 58 A and 58 AA or any other relevant provisions of the Act and the rules framed there under, where ever applicable, have been complied with. If not the nature of contraventions should be stated. If an order has been passed by Company Law Board or National Law Tribunal or Reserve Bank of India or any court or any other tribunal whether the same has been complied with or not ?

Section 58 AA deals with small depositors. As per this, a small depositor means a depositor who has deposited during a financial year a sum not exceeding rupees twenty thousand. This section requires compliance of certain matters by the company.

Non compliance of section 58 AA occurs where company fails to intimate company law board, any default in repayment of deposit by small depositors or part there of or any interest thereupon. The auditor has therefore, to first determine whether there is any default in repayment of such deposits, when number of depositors are large, it may not be possible for an auditor to verify each repayment. In such situation, he should examine internal control system. He should obtain schedule of repayment to small depositors, and should make reasonable test checks of repayments made by the company. If during test check, default in repayment is noticed, he should see whether the same has been intimated to Company Law Board.

Over and above this, auditor should also examine regarding non compliance of Section 58AA or rules made there under he should enquire, about any order passed by any of the relevant authorities for contravention of section 58 AA

The auditor should obtain management representation to the effect whether:

(i) Company has complied with directives issued by Reserve Bank of India and provision of Section 58AA or relevant rules, and

(ii) Where an order has been passed by any of the relevant authorities, the company has complied with requirements of the order

3. SA 600 on "Using the Work of another Auditor" lays down the procedure to be applied in Situations where a principal auditor reporting on the financial statement of the entity uses the work of another independent auditor.

- SA 600 contemplates coordination between auditors and requires that there should be sufficient liaison between the principal auditor and the other auditor.
- For this purpose, the principal auditor may find it necessary to issue written communication(s) to the other auditor. The other auditor, knowing the context in which his work is to be used by the principal auditor, should co-ordinate with the principal auditor.
- For example, by bringing to the principal auditor's immediate attention any significant findings requiring to be dealt with at entity level, adhering to the time-table for audit of the component, etc. He should ensure compliance with the relevant statutory requirements. Similarly, the principal auditor should advise the other auditor of any matters that come to his attention that he thinks may have an important bearing on the other auditor's work.
- When considered necessary by him, the principal auditor may require the other auditor to answer a detailed questionnaire regarding matters on which the principal auditor requires information for discharging his duties.
- The other auditor should respond to such questionnaire on a timely basis. When the principal auditor concludes, based on his procedures, that the work of the other auditor cannot be used and the principal auditor has not been able to perform sufficient additional procedures regarding the financial information of the component audited by the other auditor, the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit.
- In all circumstances, if the other auditor issues, or intends to issue, a modified auditor's report, the principal auditor should consider whether the subject of the modification is of such nature and significance, in relation to the financial information of the entity on which the principal auditor is reporting that it requires a modification of the principal auditor's report .

4. **Areas of propriety audit under the provisions of Section 227(1A) may be following:**

a. Whether the terms on which secured loans and secured advances have been made are not prejudicial to the interests of the company or its members. It may be appreciated that the terms of loans include such matters as security, interest, repayment period and other business considerations. The auditor has to inquire whether the terms are such that they can be adjudged as prejudicial to the legitimate interest of the company or of its shareholders. This is a process of judging a situation by reference to certain objective standards or reasonableness whether the terms entered into are prejudicial or not, not only to the company but also to the shareholders.

b. Whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company. This proposition has got to be inquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards. It is also possible that some transactions may not adversely affect the interests of the company. The auditor has to judiciously consider what does and does not constitute the interest of the company.

c. Whether investment of companies, other than a banking or an investment company, in the form of shares, debentures and other securities have been sold at a price lower than the cost. Apparently, this is a matter of verification by the auditor. The intention, however, is not know whether loss has occurred due to the sale. The auditor is required to inquire into circumstances of sale of investments that resulted in loss. Obviously, the duty cast on him is propriety based, i.e., reasonableness of the decision to sell at a loss. It involves exercise of judgment having regard to the circumstances in which the company was placed at the time of making the sale.

d. Whether loans and advances made by the company have been shown as deposits. Again, considering the propriety element, rationalizing the proper disclosure of loans and advance given by company is made.

e. Whether personal expenses have been charged to revenue. It is an accepted principle that expenses which are not business expenses should not be charged to revenue. The effect of charging personal expenses to the business is to distort the profitability of the company and to secure a personal gain at the cost of the company. Obviously, propriety is involved in this; charging personal expenses to business account is highly improper and abusive hence this provision.

f. In case it is stated in the books and papers of the company that shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash actually received, whether the position in books of account and balance sheet so stated is correct, regular and not misleading. A control has been set up to verify the receipt of cash in case of allotment of shares for cash. Further, if cash is not received, the books of accounts and statement of affairs shows the true picture.

Cost records and the provisions of cost audit are designed to inculcate cost consciousness in the management and to know whether productivity is of acceptable order and whether undue wastage or loss etc. has occurred. It would be useful to go into some of the specific requirement of cost audit report in this context. The cost audit report requires the cost auditors to report, inter alia on:

(a) matters which appear to him to be clearly wrong in principle or apparently unjustifiable;
(b) cases where the company's funds have been used in a negligent or inefficient manner;
(c) factors which could have been controlled, but have not been, resulting in increase in the cost of production. These are clearly enquiries into propriety and the cost accounting records have been prescribed to facilitate these enquiries.

5. Internal auditing is an activity carried out by the internal staff of the organisation to meet the management requirements of information.

- 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, especially 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.

6. Financial auditors deal mainly with figures. Management auditors deal mainly with people.

- There are many causes for behavioural problems arising in the review function of management audit. Particularly, when management auditors performs comprehensive audit of operations, they cannot be as well informed about such operations as a financial auditor in a financial department. Operating processes may be unfamiliar and complex.
- The operating people may be speaking a language and using terms that are foreign to the auditor's experience. The nature and causes of behavioural problems that the management auditor is likely to face in the discharge of the review function that is expected of him and possible solutions to overcome these problems are discussed below:

(1) **Staff / Line conflict**: Management auditors are staff people while the members of other departments are line people. Management auditors tend to discount the difficulties the line staff may face, if called on to act on the ideas of management auditors. Management auditors are specialists in their field and they may think their approach and solutions are the only answers.

(2) **Control**: The management auditor is expected to evaluate the effectiveness of controls, there is an instinctive reaction from the auditee that the report of the auditor may affect them. There is a fear that the action taken based on the management audit report will affect the line people. It breeds antagonism. The causes are as under:

(i) Fear of criticism stemming from adverse audit findings.

(ii) Fear of change in day to day working habits because of changes resulting from audit recommendations.

(iii) Punitive action by superior prompted by reported deficiencies.

(iv) Insensitive audit practices.

(v) Hostile audit style.

Solution to behavioural problems: *The following steps may be taken to overcome the aforesaid problems:*

(i) To demonstrate that audit is part of an overall programme of review for protective and constructive benefit.

(ii) To demonstrate the objective of review is to provide maximum service in all feasible managerial dimensions.

(iii) To demonstrate the review will be with minimum interference with regular operation.

(iv) The responsible officers will be involved in the process of review of the findings and recommendations before the audit report is formally released. It is essential to create an atmosphere of trust and friendliness so that audit reports will be understood in their proper perspective. Finally, it needs hardly any emphasis that there should be right management culture, enlightened auditees and auditors of the right calibre. May be to expect a combination at all times of all the three is asking for the impossible. But, a concerted effort by the management, auditors and auditees to achieve a more acceptable climate would go a long way to achieve the goal.

7. ***Validity of appointment as a statutory auditor:*** *To ensure that the appointment is valid, the incoming auditor should take the following steps before accepting his appointment:*

(i) **Ceiling limit:** Ensure that a certificate has been issued u/s 224 of the Companies Act, so that the total number of company audits held by the firm (including the new appointment) will not exceed the specified number.

(ii) **Resolution at AGM:** Verify that at AGM of the Company, a proper resolution is passed. Inspect general meeting minutes book to see that the appointment is duly recorded.

(iii) **Compliance with law:** Satisfy that the legal procedure contemplated in Sections 224 and 225 of the Companies Act, dealing with removal of existing auditor, if required, has been followed. Also see whether Section 224A (provision of special resolution in case of companies in which not less than 25% of the subscribed capital of the Company is held by public financial institutions or Government Companies) and Section 619B (in case of a company in which not less than 51 % of the paid up share capital is held by Central / State Government - C&AG appointment) are attracted and complied with.

(iv) **Code of conduct:** Communicate with the previous auditor, if any, to ascertain if there are any professional reasons for not accepting the appointment.

8. In order to establish whether the preconditions for an audit are present, the auditor shall:

(a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and

(b) Obtain the agreement of management that it acknowledges and understands its responsibility:

(i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;

(ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(iii) To provide the auditor with:

a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

b. Additional information that the auditor may request from management for the purpose of the audit; and

c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

PART B

II.

1. Clause (e) of section 227(1A) requires the auditor to inquire: "Whether personal expenses have been charged to revenue account".

   The practice of meeting certain types of personal expenses of employees is normal and is recognised both by the Income tax authorities and the Company Law Board. Illustrative of such expenses are the provision of rent-free quarters, conveyance for personal use, medical expenses, expenses on leave travel, maternity benefits, canteen facilities, etc. The charging to revenue of such personal expenses, either on the basis of the company's contractual obligations, or in accordance with accepted business practice, is perfectly normal and legitimate or does not call for any special comment by the auditor. Where, however, personal expenses not covered by contractual obligations or by accepted business practice are incurred by the company and charged to revenue account, it would be the duty of the auditor to report thereon.

2. The companies (Auditor's Report) Order is applicable to the audits of branch(es) of a company under the Act. Since sub-section 3(a) of section 228 of the Act clearly specifies that a branch auditor has the same duties in respect of audit as the company's auditor. It is, therefore, necessary that the report submitted by the branch auditor contains a statement on all the matters specified in the Order, except where the company is exempt from the applicability of the Order, to enable the company's auditor to consider the same while complying with the provisions of the Order.

3. comment on whether the company has an internal audit system commensurate with the size and nature of the business. According to which in the case of listed companies and/or other companies Paragraph 4(vii) of the Companies (Auditor's Report) order, 2003 requires the auditor having a paid-up capital and reserves exceeding Rs.50 lakhs as at commencement of the financial year concerned, or having an average annual turnover exceeding five crores rupees for a period of three consecutive financial years immediately preceding the financial year concerned are required to have internal audit system commensurate with the size and nature of the business.

4. Disclosure of EPS is required for all companies as per AS 20 "Earnings per Share". AS 20 is also one of the AS notified by the Companies (Accounting Standards) Rules, 2006. If the disclosures required by AS 20 are not made, it is the duty of the auditor to qualify in his report "Whether Accounting Standards under the clause as notified u/s 211(3C) have been followed?". Mere disclosure by company in notes does not absolve him of his duty. The same is however not a qualification to affect the "True & Fair" position of financial results of the company.
5. **Remuneration to Statutory Auditors under the Companies Act, 1956:** Under Section 224(8) of the Act, it is fixed:

a. in case of an auditor appointed by the Board or the Central Government, may be fixed by the Board or the Central Government as the case may be; and
b. subject to clause (a) above, shall be fixed by the company in General meeting or in such manner as the company in general meeting may determine. For this purpose, the expression "remuneration" should be deemed to include any sums paid by company in respect of the auditor's expenses.

Students may note that the Act does not require that the remuneration should be fixed at the same meeting of the company at which the appointment is made. It may, therefore, be fixed at a subsequent meeting. Where a retiring auditor has been re-appointed, his remuneration in the absence of any resolution fixing a different remuneration is considered to be the amount already fixed, in respect of the previous appointment.

6. The Companies (Auditor's Report) Order, 2003 exempts from its application a private limited company which fulfils all the following conditions throughout the reporting period covered by the audit report:
   (i) its paid-up capital and reserves are rupees fifty lakh or less;
   (ii) its outstanding loan from any bank or financial institution are rupees twenty five lakh or less; and
   (iii) its turnover does not exceed rupees five crore.

   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.

   In the given case, A private limited has a paid up capital of Rs.55 lakhs (both equity and preference capital are to be considered), hence it does not satisfy one of the conditions which requires paid up capital and reserves to be fifty lakh or less. Thus the Companies (Auditor's Report) will be applicable to this private limited company.

PRIME ACADEMY
35TH SESSION – PROGRESS TEST
CORPORATE AND ALLIED LAWS

No of Pages: 5 | Total Marks: 75
Time Allowed: 2 Hours

PART – A

1) A person who absents himself, without obtaining leave of absence from the board from_________
   a) 3 consecutive board meetings or from all the board meetings for a continuous period of 3 months, whichever is longer
   b) 3 consecutive board meetings or from all the board meetings for a continuous period of 3 months, whichever is earlier
   c) 3 consecutive board meetings and from all the board meetings for a continuous period of 3 months, whichever is longer
   d) 3 consecutive board meetings and from all the board meetings for a continuous period of 3 months, whichever is earlier

2) Appointment of a MD does not require the permission of Central Government if the appointment is made in conformity to the provisions of
   a) Section 309 read with Schedule XIII
   b) Schedule XIII
   c) Section 198
   d) Schedule V

3) A person's ________ determines whether he is a director or not in a company
   a) Remuneration
   b) Designation
   c) Role in the organisation
   d) All of the above

4) Which of the following powers of directors are required to be exercised only by passing a resolution at a Board meeting with the consent of all the directors present and entitled to vote?
   a) Issue of debentures.
   b) Appointment of Company Secretary
   c) Making a loan beyond the limit prescribed in the Articles of Association
   d) Making of loans to other bodies corporate

5) Minimum number of qualification shares to be held by a director as per Companies Act, 1956 is ________
   a) Two
   b) One
   c) Five
   d) None

6) X is a director in 20 public companies out of which 1 are Sec.25 companies. In one company he is an alternate director and in another company he is a small shareholders' director and all other companies are Public Limited companies. Now, he has been offered directorship of

ABC Ltd. How many companies' directorship should be given up by him to take up the appointment in ABC Ltd and make it effective?

a) 4
b) 3
c) 2
d) 1

7) Time limit under Section 286 for sending the notice is _______

a) 21 days
b) 30 days
c) 25 days
d) No time limit

8) X, a director of XYZ Ltd was convicted under Sec 209(A) on 01.06.09. From which date can he be re-appointed as a director again?

a) 01.06.10
b) 01.06.11
c) 01.06.14
d) 01.06.12

9) In the case of every company, a meeting of its Board of Directors shall be held at least once in ________ months and at least _______ such meetings shall be held in every year.

a) Three, four
b) Three, three
c) Four, three
d) Four, four

10) X has absented himself from a Board Meeting of ABC Ltd. held on 01.09.2010. Since he has not attended 3 consecutive Board Meetings, he was disqualified to act as a director under Section 274 of the Companies Act, 1956. But, he argues that the he did not receive notice for any of the board meetings held in the past at his usual address and hence he could not attend the meetings. What is the legal status of his plea?

a) Is tenable
b) Is not tenable
c) Is tenable if no other director had attended those meetings.
d) Is not tenable only if dates of Board Meeting are already mentioned in the Articles of Association of the company.

11) Which of the following statements is / are true about the removal of a director before the expiry of his period of office by company?

1) Special Resolution can be passed in a General Meeting.
2) If calling of General Meeting is avoided by the director to be removed then Central Govt. can call the meeting.
3) Shareholders themselves can remove him

a) Only 1 is correct
b) Only 1 and 2 are correct
c) Only 2 and 3 are correct
d) All are correct

12) X is due for retirement in the forthcoming AGM, which is to be held on 05^{th} Sep 2011. The company, due to delay in finalization of accounts, postponed the AGM to 25^{th} Oct 2011 with the permission of Central Government. What is the status of X in such a situation?
   a) He can continue to be a director till the 25^{th} Oct 2011
   b) He cannot continue to be a director after 05^{th} Sep 2011
   c) He can seek extension from Central Government
   d) His tenure can be extended by Board through a board resolution

13) For the purpose of calculation of maximum number of directors the following shall not be considered:
   a) Unlimited liability company
   b) Private company
   c) Section 25 company
   d) All of the above

14) Additional director may be appointed provided
   a) Articles of a company confer power to the Board
   b) Provision in the MoA
   c) Approved by the shareholders at the EGM
   d) Approved by the Central Govt

15) A director can be appointed by the Central Government under section
   a) 408
   b) 313
   c) 260
   d) 262

16) Minutes of the Board Meeting can be signed by
   a) Chairman of the meeting
   b) Any director authorised by the board
   c) Any of the directors
   d) Any director who was present in the meeting

17) From the list below, who are disqualified to be a director
   a) A person who has been disqualified by a court
   b) A person who is un-discharged insolvent
   c) A person who has applied to be adjudicated as an insolvent and his application is pending
   d) All of the above

18) A single resolution was passed thereby appointing A and B as directors of the company. What is the legal status of the appointment?
   a) Invalid
   b) Valid
   c) Can be ratified by the directors
   d) None of the above

19) Directors re-appointed after retirement need to file his consent with
    a) Company
    b) Registrar
    c) Managing director
    d) Other directors

20) As per Section 28 of Securities Contracts (Regulation) Act, 1956, the provisions of the Act shall not apply to ________
    a) The Government
    b) The RBI
    c) Any local authority
    d) All of the above

21) Citizenship is ________ for determining the residential status of a person under FEMA
    a) Relevant
    b) Not relevant
    c) Can't say
    d) None of the above

22) An appeal to High Court shall be filed within _____ days of the communication of decision or order of the Appellate Tribunal under FEMA
    a) 60
    b) 90
    c) 120
    d) 30

23) A person cannot be appointed as small shareholders' director in more than _____ companies
    a) 1
    b) 2
    c) 3
    d) Any number of companies

24) Appoint of an additional director as mentioned in Sec 260 is applicable to _____
    a) Only private limited companies
    b) Only public limited companies
    c) As per AoA
    d) Both public and private limited companies

25) A director may be appointed by BIFR need to obtain qualification shares
    a) Incorrect
    b) Applicable only for a nominee director
    c) Apply when Sick Industries Company Act apply
    d) Only when board permits it

(25x1 = 25 Marks)

PART – B

ANSWER ANY FIVE QUESTIONS

1) What are the powers of the Board to be exercised only at Board Meetings?

(10 Marks)

2) Clearly mention the provisions of the Companies Act, 1956 with respect to removal of a director by shareholders.

(10 Marks)

3) Mention the circumstances in which a director retiring by rotation in AGM gets automatically re-appointed

(10 Marks)

4) **A)** Describe the procedure to be followed when the quorum is not present for a Board meeting.

   B) XYZ Ltd wants to appoint an alternate director. They seek your help in advising them on the procedural formality for appointment of an alternate director.

(5+5 = 10 Marks)

5) X is a Director of ABC Limited, XYZ Limited and PQR Limited. ABC Limited was regular in filing annual returns, but did not file annual accounts for the year ended 31st March 2002. Further ABC Limited failed to pay interest on loans taken from a public financial institution from 1st January, 2002 onwards and also failed to repay the matured deposits on due date from 1st April, 2002 onwards.

   X is proposed to be appointed as additional director of MN Limited on 1st June 2003. MN Limited has sought a declaration from X to the effect that the disqualification specification Section 274 (1) (g) of the Companies Act, 1956 is not applicable in his case. X seeks your advice on the following.

   i. Whether it is in order for him to give the declaration sought by MN Limited in view of the defaults committed by ABC Limited.
   ii. Whether he can continue as a Director in XYZ Limited and PQR Limited and also seek re- appointment when he retires by rotation at the annual general meetings of respective companies to be held in September, 2003.

   Advise explaining the relevant provisions of the Companies Act, 1956. Would your answer be different, if X resigned his office of director in ABC Limited on 31st December 2007.

(10 Marks)

6) **A)** Mention whether the following are "Person Resident in India".

   1) XYZ Ltd, an Indian company having its Registered Office at Chennai, India established a branch at New York, USA on 01^{st} April 2009
   2) ABC Ltd, a company incorporated and registered in Singapore established a branch at New Delhi, India on 01^{st} April 2010.

   B) Rural Electrification Corporation (REC), New Delhi issued 6 years bonds to public directly and not through any stock exchange. Whether REC can do so? Is it not a violation of the provisions of Securities Contracts (Regulation) Act, 1956?

(5+5 = 10 Marks)

PRIME ACADEMY

35t SESSION PROGRESS TEST -- CORPORATE AND ALLIED LAWS

SUGGESTED ANSWERS

PART – A

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

PART – B

1) Powers of Board to be exercised at the Board Meeting

1) Power to make calls on shareholders in respect of money unpaid on their shares.
2) Power to authorize buy-back u/s 77A.
3) Power to issue debentures.
4) Power of borrow money otherwise than on debentures.
5) Power to invest funds of the company.
6) Power to make loans.

The following are also to be noted in this regard:

1) The powers shall not apply to acceptance of deposits from public by a banking company in the ordinary course of its business.
2) Power to issue debentures shall not apply to borrowings by a banking company from other banking companies.
3) The section is not applicable to operation on OD, CC or on account by means of which ordinary business is carried out.

Additionally, following powers are also to be exercised only at the board meeting:

1. Filling of casual vacancy (Sec. 262)
2. Extending sanction or consent to a contract with any director (Sec. 297)
3. Contribution to political fund (Sec. 293A)
4. Receive a notice of discloser of interest. (Sec. 299)
5. Receive a notice of disclosure of shareholding of director (Sec. 307 and 308)
6. Appoint a person as MD who is already a MD or Manager of another company (Sec. 316)
7. Appoint a person as Manager who is already a Manager or MD of another company (Sec. 386)
8. Sanction of investment in a group company (Sec. 372 A)
9. Declare insolvency in voluntary winding up (sec. 488)

2) Removal of a director by shareholders:

Removal of a director by shareholders: Sec. 284 read with Sec. 190

Company can remove a director before the expiry of his tenure of office by passing a resolution at the General Meeting. The Court or the Government may call for a meeting, if the director avoids calling a meeting [Re. Elsanbrero Ltd.]

Alternatively, shareholders have got every right to hold a meeting to remove an existing director and place new ones. [LIC Vs. Escorts ltd.]

The procedure for removal of a director:

1. A special notice shall be served on the company at least 14 days before the meeting by the shareholders.
2. If no notice is given, then resolution passed to remove a director will be invalid.
3. The director concerned can present his case at the meeting. He can also make a representation in writing.
4. Company shall send a copy of representation to every member thereof.
5. If the representation could not be forwarded due to its late receipt then the same may be read out in the meeting with the consent of the concerned director.

6. He enjoys qualified privilege (Sec. 284). He cannot be sued for defamation based on the representation.
7. The Central Govt. may permit non-circulation or reading out of the representation, if it is felt that the director is trying to obtain needless publicity through the representation.
8. Removed director shall be eligible for compensation for loss of office or damage.
9. Vacancy arising out of such removal can be filled in the same meeting provided notice is given in that behalf.
10. If not, the vacancy may be filled up as a casual vacancy u/s 262.
11. Director removed cannot be re-appointed in such casual vacancy.

Exception to Sec. 284

The following persons cannot be removed by shareholders under the powers of Sec. 284.

1. Private companies in which a director is holding office for life as on 1^{st} day of Apr.1952.
2. A Company that has adopted the principle of proportional representation for appointing its director u/s 265.
3. Nominee directors of Govt. , Financial Institution, etc.
4. Govt. Director u/s 408

3) Circumstances in which a director retiring in AGM gets re-appointed automatically:

At an AGM, a director retiring by rotation is eligible for reappointment and may be reappointed. But the company may appoint some other person in place of the retiring director. If the AGM ends without filing the vacancy of a retiring director, either by reappointing the retiring director or appointing some other person, that gives rise to the automatic reappointment of the retiring director. (Section 256(4)(a))

Accordingly, if the retiring director is not reappointed at the AGM and his vacancy is not filled by appointing some other person, the AGM must expressly resolve not to fill that vacancy. If no such resolution is passed, the AGM will automatically stand adjourned till, and it will be held again on the same day in the next week, at the same time and the same place; but if that day is a public holiday, the meeting will be held on the next succeeding day, which is not a public holiday, at the same time and same place.

If the adjourned meeting also ends without filling the vacancy of the retiring director or without resolving that the vacancy to be not filled, the retiring director will get automatically reappointed even in absence of any resolution for the reappointment of the retiring director, unless any of the following five things happens:

a. At that meeting or at the previous meeting a resolution for the reappointment of such director has been put to the meeting and lost .
b. The retiring director has by a notice in writing addressed to the company or its Board of Directors, expressed his unwillingness to be so reappointed .
c. He is not qualified or is disqualified for appointment .
d. A resolution, whether special or ordinary, is required for his appointment or reappointment in virtue of any provisions of this Act.
e. The proviso to sub section (2) of section 263 is applicable to the case.

Thus, if any of the following three positive acts does not occur and none of the five circumstances mentioned above becomes applicable, the retiring director will get automatically reappointed.

(a) To fill the vacancy by reappointing the retiring director or ,
(b) To fill the vacancy by appointing somebody else instead of the retiring director or ,
(c) To pass a resolution to the effect that the vacancy of the retiring director be not filled

In order that the retiring directors automatically reappointed under section 256(4), the AGM as well as adjourned meeting must be held. Unless there is a valid meeting under section 256(4)(a), the consequences mentioned in 256(4)(b) would not apply.

4) A) Procedure to be followed when the quorum for a board meeting is not present:

Section 288 of the Companies Act, 1956 states:
If a meeting of the board could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned till the same day in the next week, at the same time and place, or if that day is a public holiday, till the next succeeding day which is not a public holiday, at the same time and place.

The provisions of Section 285 shall not be deemed to have been contravened merely by reason of the fact that a meeting of the board which had been called in compliance with the terms of that section could not be held for want of quorum. Also, the adjourned board meeting cannot be held if the quorum is not present in the adjourned meeting too.

B) Procedure for appointment of alternate director:

- ***Consent to act as director**:* In the case of a public company, consent of the person proposed to be appointed as an alternate director, shall be obtained in the form of a letter.

- ***Board Resolution**:* The Board of Directors may appoint an alternate director, and if the board decides to do so it must be by its resolution. Unless, the articles of a company provide otherwise, the Board may appoint an alternate director by a circular resolution. However, the CLB has held that the appointment of an alternate director by a circular resolution was in violation of the provisions of section 313.

- ***Intimation to appointee**:* After the Board meeting whereas, the appointment is made, the appointee shall be informed of the appointment, if he was not invited to attend the meeting.

- ***Intimation to stock exchange**:* In the case of a listed company, intimation of the appointment of the alternate director will be given to the stock exchanges where the company's securities are listed immediately after the AGM.

- ***Consent to be filed with Registrar**:* In the case of a public company, consent of the director in e-Form 32 signed by him will be filed with the ROC within 30 days from the date of the Board meeting / passing of the circular resolution.

- ***Entry in registers**:* The particulars of the alternate director will be entered in the Register of Directors kept under section 303 immediately after AGM. Similarly, the particulars of the directors' shareholding will be entered in the Register of Directors' Shareholding.

- ***Qualifying shares**:* If the alternate director appointed does not already hold any share of the company as the share qualification of directors, requisite number of shares will have to be acquired by him within two months from the date of the Board meeting.

- ***Disclosure of interest**:* Information relating to the alternate director's interests in other companies, firms and also names of his relatives for the purposes of section 297 and 299 of the Companies Act will be obtained.

  ***Filing of e-Form 32 on cessation**:* When the alternate director ceases to hold the office because of the return of the original director, e Form 32 will be filed with the ROC and the entry of the date of cessation will be made in the register of directors.

5) ABC Ltd., has been regular in fitting Annual Returns, but has not filed annual accounts for one year i.e. financial year ended 31st March 2002.
The disqualification under S.274 (1) (g) will apply only where both Annual Accounts and Annual Return have not been filed for three consecutive financial years. Therefore, X is not disqualified under S.274 (i) (g) on this ground.
ABC Ltd., has failed to pay interest on term loans from 1.4.2002. This is not a ground for disqualification under S.274 (1) g. But ABC Ltd., has filed to pay matured deposits from 1.4.2002 and the default continues for more than 1 year. Therefore, X is disqualified under S.274 (1) (g). In this background,

i) He cannot give the declaration sought by MN Ltd., He cannot be appointed as additional director of MN Ltd., on 1st June 2003.
ii) He can continue as director in XYZ Ltd., and PQR Ltd., But he cannot seek reappointment as he is disqualified under 274 (1) (g) for a period of five years.
In case, he resigns as a director of ABC Ltd., on 31st December 2002, he will not be a director of ABC Ltd., when the default in repayment of matured deposits crystallizes. Therefore, if X so resigns, he can give the declaration as sought by MN Ltd., and seek reappointment as a director in XYZ Ltd. and PQR Ltd., when he retires by rotation in September, 2003.

6) A)

1) As per the Provisions of Section 2(v)(ii) of FEMA, 1999, any person or body corporate registered or incorporated in India is a "Person resident in India". As per Section 2(v) of the FEMA, 1999 the term "Person" includes a company. Section 2(v)(iv) of the said Act states that an office, branch or agency outside India owned or controlled by a person resident in India is a "Person resident in India".
Accordingly, the residential status of the New York branch of the XYZ Ltd is that of a "Person resident in India" from the date of its establishment.

2) As per the Provisions of Section 2(v)(iii) of FEMA, 1999, an office, branch or agency in India owned or controlled by a person resident outside India is a "Person resident in India". Further, Section 2(w) of the said Act states that a person not resident in India is a "Person resident outside India".
On application of the above provisions, it can be concluded that ABC Ltd is a "Person resident outside India" and its New Delhi branch is a "Person resident in India" since its establishment.

B) As per Section 28 of Securities Contracts (Regulation) Act, 1956, the provisions of the Act shall
not apply to any corporation set up under a special law. Since REC has been set up under a
special law (Rural Electrification Corporation Act), the provisions of Securities Contracts
(Regulation) Act, 1956 shall not apply to it. Therefore, REC can issue 6 years bonds to public
directly without requiring any permission of any stock exchange.