PRIME ACADEMY

38th SESSION PROGRESS TEST - FINANCIAL REPORTING

No of Pages: 7

Total Marks: 75

Time Allowed: 2 Hrs

Part - A

Answer all questions

1) X Ltd sold its building to Mini Ltd for ₹ 60 Lakhs on 31st March 2013 and gave possession of the property to Mini Ltd. However documentation and legal formalities are pending. The book value of the building is ₹ 25 Lakhs. How X Ltd should account the above transaction for the year ended 31st March 2013.
   a. The entire amount received should be treated as advance
   b. Record the sale at ₹ 60 Lakhs and recognize profit of ₹ 35 Lakhs

2) Costs of conversion for purposes of valuation of inventory will not include
   a. Fixed Production Overhead
   b. Administrative Overheads
   c. Variable Production Overhead

3) Cost of inventories that are not ordinarily interchangeable should be valued using
   a. LIFO
   b. FIFO
   c. Weighted average cost
   d. Specific identification method

4) K Ltd purchased raw material @ ₹400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in stock. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However replacement cost of raw material is ₹ 300 per kg. How will you value the inventory of raw material?
   a. The company should estimate realizable value and value inventory at lower of cost and net realizable value
   b. Cost of ₹ 400 per kg
   c. Replacement cost of ₹ 300 per kg

5) Anil Pharma Ltd ordered 16,000 kg of certain material at ₹ 160 per unit. The purchase price included excise duty ₹ 10 per kg in respect of which CENVAT credit is admissible. Freight incurred amounted to ₹ 1,40,160. Compute unit cost of inventory for valuation of inventory.
   a. 160
   b. 150
   c. 162
   d. 168.76

6) A change in method of depreciation is
   a. Change in accounting policy
   b. Change in accounting estimate

7) Which of the following requires disclosure though it is not an extraordinary item
   a. Disposals of fixed assets
   b. Attachment of property of an enterprise
   c. Reversals of provisions
   d. The write-down of inventories to net realizable value as well as the reversal of such write-downs

8) Which of the following activities of a financial enterprise may be reported on a net basis
   a. cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;
   b. Purchase and sale of investments in equity shares by a company
   c. the placement of deposits with and withdrawal of deposits from other financial enterprises; and
   d. cash advances and loans made to customers and the repayment of those advances and loans.

9) Cash flows on extraordinary items should always be shown under
   a. Investing activity
   b. Operating activity
   c. Financing activity
   d. Any of the above

10) Tax deducted on Interest income should be disclosed under
   a. Investing activity
   b. Operating activity
   c. Financing activity
   d. Any of the above

11) An addition or extension which becomes integral part of the existing asset should be
   a. Depreciated over useful life of the addition or extension
   b. Charged to profit and loss account
   c. Depreciated over the remaining useful life of the asset

12) When a contract covers numbers of assets, construction of each asset should be treated as separate construction contract if
   a. Separate proposals are submitted for each asset
   b. Each asset has been separately negotiated
   c. Cost and revenues can be separately identified
   d. All of the above conditions should be met

13) Contract revenue comprise of
   a. Amount of revenue agreed
   b. Variations
   c. Claims
   d. Incentives
   e. Progress billing

14) Which of the following is not a cost that is directly related to the contract
   a. Cost of hiring plant and equipment
   b. Cost of materials used in construction
   c. Claims from third parties
   d. Insurance

15) Which are the additional conditions for estimating outcome of the contract reliably for a fixed price contract
    a. total contract revenue can be measured reliably;
    b. it is probable that the economic benefits associated with the contract will flow to the enterprise;
    c. both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and
    d. the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

16) Which of the following is not a method of determining percentage of completion in a construction contract
    a. Proportion of costs to total costs
    b. Progress billings to the customer
    c. Surveys of work performed
    d. Completion of physical proportion of the contract

17) Revenue should be recognized on cash on delivery sales when
    a. Significant risks and rewards are transferred
    b. No significant uncertainty exists as to ultimate collection
    c. Cash is received by seller or his agent

18) In the case of instalment sales revenue should be recognized
    a. As and when instalment amount is received
    b. At Sales price exclusive of interest upfront
    c. At the total of installment amounts but upfront

19) A group of fixed assets was revalued during the year 2010. The revaluation profit of ₹ 12 Lakhs was credited to revaluation reserve during the period. During the year 2012, the same group of assets was revalued. This time revaluation has resulted in a loss of ₹ 10 Lakhs. The depreciation on revalued portion for the year 2011 was ₹ 3 Lakhs. What is treatment of revaluation loss for the year 2012?
    a. Debit ₹ 10 Lakhs to Revaluation Reserve
    b. Debit ₹ 10 Lakhs to Profit and Loss Account
    c. Debit ₹ 9 Lakhs to Revaluation Reserve and ₹ 1 Lakh to Profit and Loss Account

20) A portion of current investments purchased for ₹20 Lakhs to be reclassified as long term investments, as the company decides to retain them. Market value is ₹ 35 Lakhs
    a. Transfer at Market value of ₹35 Lakhs
    b. Transfer at cost ₹20 Lakhs

21) Refund of Government grants should not be treated as an extraordinary item as it is normal to expect refund of government grant
    a. True
    b. False

22) Exchange differences on EEFC account (Foreign currency account held by an Indian company) should be treated as realized exchange difference for the purpose of Cash flow statement and need not be added as unrealized exchange difference.
    a. True
    b. False

23) M/s XYZ Ltd has three segments namely X,Y,Z. The total assets of the company are ₹ 10 Crores. Segment X has ₹ 0.90 Crores, Segment Y has ₹ 3.90 Crores and Segment Z has ₹ 5.20 Crores. Deferred tax assets included in each of the segment are X- ₹ 0.50 crores, Y – ₹ 0.40 Crores and Z – ₹ 0.30 Crores. Which of the segments are reportable segments?
    a. Segment Y, Z
    b. Segment X,Y,Z
    c. Segment Z

24) A company purchased a plant with a quoted price of ₹ 180 Lakhs. Cash discount of 1.25% will be allowed if the payment is made within one month. VAT is 12.5% of the quoted price. Company incurred 2% on transportation costs and 3% on erection costs of the quoted price. Pre-operative costs amounted to ₹ 1.50 Lakhs. What is the original cost of asset for capitalization?
    a. ₹ 209.25 Lakhs
    b. ₹ 213 Lakhs
    c. ₹ 210.75 Lakhs

25) In the consolidated financial statements, transactions between parent and subsidiary should be shown under related party transactions.
    a. True
    b. False

(25x1 = 25 Marks)

Part – B **(50 Marks)**

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

1. P Ltd owns 80% of S and 40% of J and 40% of A. J is a jointly controlled entity and A is an associate. Summarized Balance Sheets of four companies as on 31.03.2012 are: (₹ Lakhs)

Particulars	P Ltd ₹	S ₹	J ₹	A ₹
Investment in S	800			
Investment in J	600			
Investment in A	600			
Fixed Assets	1000	800	1400	1000
Current Assets	2200	3300	3250	3650
Total	5200	4100	4650	4650
Liabilities				
Equity Share Capital ₹ 1	1000	400	800	800
Retained earnings	4000	3400	3600	3600
Creditors	200	300	250	250
Total	5200	4100	4650	4650

P Ltd acquired shares in 'S' many years ago when 'S' retained earnings were ₹ 520 Lakhs. P Ltd acquired its shares in 'J at the beginning of the year when 'J' retained earnings were ₹ 400 Lakhs. P Ltd acquired its shares in 'A' on 1.4.2011 when 'A' retained earnings were ₹ 40 Lakhs.

The balance of goodwill in relating to S had been written off three years ago. The value of goodwill in 'J' remains unchanged.
Prepare the Consolidated Balance Sheet of P Ltd as on 31.03.12 as per AS 21,23,27. (20 Marks)

2. H ltd which has an authorized and issued capital of ₹ 10 Crore equity shares of ₹ 10 each fully paid, has a balance revenue reserve of ₹ 1,62,000 thousand on 31st March 2011, after paying a dividend for the year ended on that date

   You are also given the following information.

   - On 1st April 2011, H Ltd purchased ₹ 90 Lakh of the ₹ 4 crore issued equity shares of ₹ 10 each fully paid in A Ltd for ₹ 1,42,500 thousand. The balance in revenue reserve of A Ltd as on 31st March 2011 was ₹ 3,45,000 thousand after paying dividend for the year.
   - For the year ended 31st March 2012, H Ltd made a trading profit of ₹ 1,84,000 thousand and paid a dividend of 15% while A Ltd made a trading profit of ₹ 1,40,000 thousand and paid a dividend of 20%
   - For the year ended 31st March 2013, H Ltd mad a trading profit of ₹ 2,64,500 thousand and paid a dividend of 20% while A Ltd incurred a trading loss of ₹ 1,41,000 thousand and no dividend was paid.
   - During the year ended 31st March 2013, A Ltd had manufactured and sold for H Ltd, an item of plant for ₹ 80,000 thousand which included 25% profit on selling price to A Ltd. The plant had been included in the fixed assets of H Ltd and a full year's depreciation had been provided thereon at 20% on cost.

   You are required to show the relevant Notes to Accounts for the Consolidated Balance Sheet of H Ltd as on 31st March 2013, together with the corresponding figures for the preceding year assuming that H Ltd has a subsidiary and it prepared consolidated financial statements as on 31st March 2012 and 31st March 2013. (10 Marks)

3. The following information relates to the draft financial statements of Mocha.

Summarized statements of Balance Sheet as at 30 September:

Particulars	2013		2012	
Assets	₹ '000	₹ '000	₹ '000	₹ '000
Non-current assets				
Property, plant and equipment (note (i)		32,600		24,100
Financial asset: equity investments (note (ii)		4,500		7,000
		37,100		31,100
Current assets				
Inventory		10,200		7,200
Trade receivables		3,500		3,700
Bank		nil		1,400
		13,700		12,300
Total assets		50,800		43,400
Equity and liabilities				
Equity				
Equity shares of ₹ 1 each (note (iii)		14,000		8,000
Share premium (note (iii)	nil		2,000	
Revaluation reserve (note (iii)	2,000		3,600	
Retained earnings	13,000	15,000	10,100	15,700
		29,000		23,700
Non-current liabilities				
Finance lease obligations	7,000		6,900	
Deferred tax	1,300	8,300	900	7,800
Current liabilities				
Tax	1,000		1,200	
Bank overdraft	2,900		Nil	
Provision for product warranties (note (iv)	1,600		4,000	
Finance lease obligations	4,800		2,100	
Trade payables	3,200	13,500	4,600	11,900
Total equity and liabilities		50,800		43,400

Summarized income statements for the years ended 30 September:

Particulars	₹ '000	₹ '000
Revenue	58,500	41,000
Cost of sales	(46,500)	(30,000)
Gross profit	12,000	11,000
Operating expenses	(8,700)	(4,500)
Investment income (note (ii)	1,100	700
Finance costs	(500)	(400)
Profit before tax	3,900	6,800
Income tax expense	(1,000)	(1,800)
Profit for the year	2,900	5,000

The following additional information is available:
(i) Property, plant and equipment:

	Cost ₹	Accumulated depreciation ₹	Carrying amount ₹
As at 30 September 2012	33,600	(9,500)	24,100
New finance lease additions	6,700		6,700
Purchase of new plant	8,300		8,300
Disposal of property	(5,000)	1,000	(4,000)
Depreciation for the year		(2,500)	(2,500)
At 30 September 2013	43,600	(11,000)	32,600

The property disposed of was sold for ₹ 8,100.

(ii) Investments/investment income:

During the year an investment that had a carrying amount of ₹ 3,000 was sold for ₹ 3,400. No investments were purchased during the year.

Investment income consists of:

Year ended	**2013**	**2012**
Dividends received	200	250
Profit on sale of investment	400	Nil
Increases in fair value	500	450
	1,100	700

(iii) On 1 April 2012 there was a bonus issue of shares that was funded from the share premium and Some of the revaluation reserve. This was followed on 30 April 2012 by an issue of shares for Cash at par

(iv) The movement in the product warranty provision has been included in cost of sales.

Required:
Prepare a statement of cash flows for Mocha for the year ended 30 September 2011, in accordance with AS 3 Statement of cash flows, using the indirect method. (10 Marks)

4.

a. A company has an inter segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company correct?
b. P Ltd has 60% voting right in Q Ltd. Q Ltd has 20% voting right in R Ltd. Also, P Ltd directly enjoys voting right of 14% in R Ltd. R Ltd is a listed company and regularly supplies goods to P Ltd. The management of R Ltd has not disclosed its relationship with P Ltd. How would you assess the situation from the viewpoint of AS 18, related party transactions? (10 Marks)

5.

a. Explain with an example, changes in accounting policies and changes in accounting estimates
b. Distinguish between adjusting and non-adjusting events. (10 Marks)

PRIME ACADEMY

38TH SESSION PROGRESS TEST- FINANCIAL REPORTING

SUGGESTED ANSWERS

PART- A

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

Part - B

1.

Consolidated Balance Sheet of P Ltd as on 31st March 2012

Particulars	Note No	Amount (₹ Lakhs)
Equity and Liabilities		
1. Shareholders' funds a. Share Capital b. Reserves and Surplus	 1	 1,000 8,944
2. Minority Interest		760
3. Current Liabilities a. Trade Payables (200+300+40% of 250)		 600
		11,304
Assets		
1. Non-currents Assets Fixed Assets Tangible Assets(1,000+800+40% of 1400) Intangible Assets		 2,360 120
2. Non current investment – cost including goodwill Rs. 264 Lakhs)	2	2,024
3. Current Assets (2,200+3,300 + 40% of 3,250)		6,800
		11,304

Working Notes:

1. Computation of goodwill

S (Subsidiary) ₹

Cost of investment		800
Represented by share of net assets i) Share capital ii) Share in pre-acquisition profit (520*80%)	 320 416	 (736)
Goodwill		64

J (Jointly controlled entity) ₹

Cost of investment		600
Represented by share of net assets i) Share capital ii) Share in pre-acquisition profit (40*40%)	 320 16	 (336)
Goodwill		264

A (Associate) ₹

Cost of investment		600
Represented by share of net assets i) Share capital ii) Share in pre-acquisition profit (400*40%)	 320 160	 (480)
Goodwill		120

Goodwill for Balance Sheet ₹

Goodwill of J	120
Goodwill of S	64
Less: Goodwill written off	(64)
Goodwill	120

2. Consolidated retained earnings ₹

P Ltd	4,000
Share in post acquisition profits S – 80% of (₹ 3,400-520)	2,304
Share in post acquisition profits J – 40% of (₹ 3,600-400)	1,280
Share in post acquisition profits A – 40% of (₹ 3,600-40)	1,424
Less: Goodwill written off	(64)
	8,944

3. Minority interest ₹

Share capital	80
Share in retained earnings	680
	760

4. Investment in associate ₹

Cost of investments including goodwill ₹ 120 Lakhs	600
Share of post acquisition profits	1,424
Carrying amount of Investment (Goodwill ₹ 120 Lakhs)	2,024

2. Notes to Accounts for Consolidated Balance Sheet of H Ltd as on 31st March 2013 (An Extract)

		As on 31st March 2013 ₹	As on 31st March 2012 ₹
Share Capital 10 Crore Equity shares of ₹ 10 each fully paid up		10,00,000	10,00,000
Reserves and Surplus			
Profit and loss account Less: Un realised gains	2,43,175 (4,500)	2,38,675	2,09,500
Investment reserve A/c		77,625	77,625
		3,16,300	2,87,125
Non-current investment			
In A Ltd (associate) at cost (Including capital reserve ₹ 25,125)		1,42,500	1,42,500
Share of Profit/loss			
Post-acquisition		(18,225)	13,500
Pre-acquisition		77,625	77,625
		2,01,900	2,33,625

W.N. 1. Profit and Loss account balances

	H Ltd ₹	A Ltd ₹
Balance as on April 1,2011	1,62,000	3,45,000
Add: Profit for 2011-12	1,84,000	1,40,000
	3,46,000	4,85,000
Less: Dividend 15% and 20% respectively	(1,50,000)	(80,000)
Balance as on April 1, 2012	1,96,000	4,05,000
Add: Profit/(loss) for year 2012-13	2,65,400	(1,41,000)
	4,61,400	2,64,000
Less: Dividend for year 2013	(2,00,000)	-
Balance as on March 31, 2013	2,61,400	2,64,000
Less: Share of Net loss	(18,225)	
	2,43,175	2,64,000

W.N. 2. Share of Profit/loss of H Ltd in A Ltd (22.5%)

	31.3.12 ₹	31.3.13 ₹
Post acquisition profit/loss	1,40,000	(1,41,000)
Less: Dividend	(80,000)	-
	60,000	(1,41,000)
Share of H Ltd	13,500	(31,275)
Adjustment of post acquisition profit of 2011-12 in 2012-13	-	13,500
	13,500	(18,225)

W.N. 3. Goodwill/Capital Reserve on acquisition of shares of A Ltd

	₹
Investment	1,42,500
Less: Share capital	(90,000)
Pre-acquisition profit	(77,625)
Capital Reserve	25,125

3.

Cash flows from operating activities:	₹ '000	₹ '000
Profit before tax		3,900
Adjustments for depreciation of non-current assets profit on the disposal of property, plant and equipment (8,100 – 4,000) investment income interest expense increase in inventory (10,200 – 7,200) decrease in receivables (3,700 – 3,500) decrease in payables (4,600 – 3,200) decrease in warranty provision (4,000 – 1,600)	 2,500 (4,100) (1,100) 500 (3,000) 200 (1,400) (2,400)	 (8,800)
Cash generated from operations		(4,900)
Income tax paid (w (i))		(800)
Net cash deficit from operating activities		(5,700)
Cash flows from investing activities:		
Purchase of property, plant and equipment Disposal of property, plant and equipment Disposal of investment Dividends received	(8,300) 8,100 3,400 200	
Net cash from investing activities		3,400
Cash flows from financing activities:		
Shares issued (w (ii))	2,400	
Payment of finance lease obligations (w (iii))	(3,900)	
Interest paid	(500)	
Net cash from financing activities		(2,000)
Net decrease in cash and cash equivalents		(4,300)
Cash and cash equivalents at beginning of the year		1,400
Cash and cash equivalents at end of the year		(2,900)

Workings

(i) Income tax paid:	₹ '000
Provision b/f – current	(1,200)
– deferred	(900)
Income statement tax charge	(1,000)
Provision c/f – current	1,000
– deferred	1,300
Difference – cash paid	(800)

(ii) Share issues	₹ '000
Increase in share capital (₹ 14,000 – 8,000)	6,000
Bonus issue – share premium	(2,000)
– revaluation reserve (₹ 3,600 – 2,000)	(1,600)
Shares issued for cash at par	2,400

(iii) Finance lease	₹ '000
Balance b/f – current	(2,100)
– non-current	(6,900)
New leases in year	(6,700)
Balance c/f – current	4,800
– non-current	7,000
Principal repaid	(3,900)

a. Since, XYZ ltd's turnover of ₹ 35 Lakhs does not exceed ₹ 50 Crores and borrowings of ₹ 10 Lakhs is less than ₹ 10 Crores, it is a small and medium sized company.

The following relaxations and exemptions are available of XYZ Ltd

1. AS 3 and AS 17 is not mandatory
2. Some paragraphs of AS 19 are exempt, certain requirements of AS 15
3. Disclosures of diluted EPS of AS 20 and few paragraphs of AS 29
4. 'Value in use' need not be computed using present value technique for testing impairment of assets
5. AS 21, 23 and 27 are not applicable

However, if XYX is a partnership firm and not a corporate, then its classification will be done on the basis of the classification of non-corporate entities as prescribed by ICAI. Accordingly to ICAI, non-corporate entities can be classified under 3 levels viz., Level I, Level II and Level III.

Since, turnover of XYZ, a partnership firm is less than ₹ 1 Crore and borrowings of ₹ 10 lakhs is less than ₹ 1 Crores, therefore it will be classified as Level III SME. In addition to the above exemptions, AS 18 and 24 are exempt and relaxations from AS 25 is available.

b. AS 2 states that inventories should be valued at lower of cost and net realisable value. AS 9 states in certain industries like agricultural crops and mineral ores when they have been harvested or extracted, performance may be substantially complete prior to execution of transaction. Such cases where sale is assured under forward contracts or government contracts or when market exists and there is negligible risks to sell, the goods invoiced are often valued at Net Realisable Value.

Terry towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing stock of finished goods should have been valued at lower of cost and net realisable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing stock of inventories is not correct.

4.

a. AS 17, Segment reporting requires that inter-segment transfer should be measured on the basis that enterprise actually used to price these transfers. The basis of inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, an enterprise can have its own policy for pricing inter-segment transfers and hence inter-segment transfers may be based on cost, below cost or market price. However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore in the given case, inter-company transfer pricing policy adopted by the company is correct if, followed consistently.

b. P Ltd has direct economic interest in R Ltd to the extent of 14% and through Q Ltd in which it is the majority shareholders, it has further control of 12% in R Ltd (60% of Q Ltd's 20%). These two taken together (14%+12%) make the total control of 26%.

Para 10 of AS 18 defines related party as one that has at any time during the reporting period, the ability to control the other party or exercise significant influence over the other related party in making financial and operating decisions.

Hence control is defined as ownership directly or indirectly of more than one-half of the voting power of an enterprise; and significant influence is defined as participation in the financial and/or operating policy decisions of an enterprise but not control of those policies

In the present case, control of P Ltd in R Ltd directly and through Q Ltd, does not go beyond 26%. However as per Para 12 of AS 18, significant influence may be exercised as an investing party (P Ltd) holds, directly or indirectly through intermediaries 20% or more of the voting power of the R Ltd. As R Ltd is listed company and regularly supplies goods to P Ltd, related party disclosures are required.

5.

a. A change in an accounting policy usually relates to a change of principle, basis or rule being applied by an entity. Accounting estimates are used to measure the carrying amounts of assets and liabilities, or related expenses and income. A change in an accounting estimate is a reassessment of the expected future benefits and obligations associated with an asset or a liability.

Thus, for example, a change from non-depreciation of a building to depreciating it over its estimated useful life would be a change of accounting policy. To change the estimate of its useful life would be a change in an accounting estimate.

b. An adjusting event is one that provides further evidence of conditions that existed at the end of the reporting period, including an event that indicates that the going concern assumption in relation to the whole or part of the entity is not appropriate. Normally trading results occurring after the end of the reporting period are a matter for the next reporting period, however, if there is an event which would normally be treated as non-adjusting that causes a dramatic downturn in trading (and profitability) such that it is likely that the entity will no longer be a going concern, this should be treated as an adjusting event.

A non-adjusting event is an event after the end of the reporting period that is indicative of a condition that arose after the end of the reporting period and, subject to the exception noted above, the financial statements would not be adjusted to reflect such events.

The outcome (and values) of many items in the financial statements have a degree of uncertainty at the end of the reporting period. AS 5 effectively says that where events occurring after the end of the reporting period help to determine what those values were at the end of the reporting period, they should be taken in account (i.e. adjusted for) in preparing the financial statements.

If non-adjusting events, whilst not affecting the financial statements of the current year, are of such importance (i.e. material) that without disclosure of their nature and estimated financial effect, users' ability to make proper evaluations and decisions about the future of the entity would be affected, then they should be disclosed in the notes to the financial statements.

PRIME ACADEMY
38th SESSION PROGRESS TEST
STRATEGIC FINANCIAL MANAGEMENT

No. of pages 3 **Total Marks-75**
Time Allowed-2 Hrs

Part - A
(All questions carry 5 Marks each)

1.

US Interest rate (Borrowing)	9 % p.a
US Interest rate (Deposit)	8 % p.a
CAD Interest rate (Borrowing)	10.50 % p.a
CAD Interest rate (Deposit)	9.50 % p.a
Spot rates	1.2350-1.2400 CAD/$
Forward(1 year)	1.2550-1.2600 CAD/$

Which country will you invest? Support your decision showing cash flows.

2. Determine the risk adjusted net present value of the following projects :

	X ₹	Y ₹	Z ₹
Net cash outlays (Rs.)	2,10,000	1,20,000	1,00,000
Project life	5 years	5 years	5 years
Annual Cash inflow (Rs.)	70,000	42,000	30,000
Coefficient of variation	1.2	0.8	0.4

The Company selects the risk-adjusted rate of discount on the basis of the coefficient of variation:

Coefficient of Variation	Risk-Adjusted Discount Rate (RADR)	P.V. Factor 1 to 5 years at RADR
0	10%	3.791
0.4	12%	3.605
0.8	14%	3.433
1.2	16%	3.274
1.6	18%	3.127
2	22%	2.864
More than 2.0	25%	2.689

3.

Spot Rate =51.0393 - 51.1700 INR / NZD

One month SWAP points = 30 – 20

a. What will be the one month forward rate for NZD?
b. Calculate the appreciation/depreciation percentage of INR

4.

ABC Ltd has a capital of ₹ 10,00,000 in equity shares of ₹ 100 each. The shares are currently quoted at par. The Company proposes to declare a dividend of ₹ 15 per share at the end of the current financial year. The capitalization rate for the risk class of which the Company belongs is 10%. What will be the market price of the share at the end of the year, if

(i) Dividend is not declared?

(ii) Dividend is declared?

(iii) Assuming that the Company pays the dividend and has net profits of ₹ 6,00,000 and makes new investments of ₹ 12,00,000 during the period, how many new shares must be issued? Use the MM model.

5. Given :

   1 USD = 1.05386/1.05405 CAD

   1GBP = 1.62186/1.62205 USD

   a. How much GBP will you get by selling 50,000 CAD?
   b. What is the cost of buying ₹ 40,000 GBP?

Part – B **(50 Marks)**

Answer all Questions

6. Your bank's London office has surplus funds to the extent of USD ₹ 5,00,000/- for a period of 3 months. The cost of the funds to the funds to the bank is 4% p.a. It proposes to invest these funds in London, New York or Frankfurt and obtain the best yield, without any exchange risk to the bank. The following rates of interest are available at the three centers for investment of domestic funds there at for a period of 3 months.

London 5% p.a.
New York 8% p.a.
Frankfurt 3% p.a.

The market rates in London for US dollars and Euro are as under:

US Dollars per GBP:

Spot	1.5350/90
1 month	15/18
2 month	30/35
3 month	80/85

Euros per GBP:

Spot	1.8260/90
1 month	60/55
2 month	95/90
3 month	145/140

At which centre, will the investment be made & what will be the net gain (to the nearest pound) to the bank on the invested funds?

(10 Marks)

7.

a. X Limited just declared a Dividend of ₹ 14 per Share. Mr. B is planning to purchase the Share of X Limited, anticipating increase in growth rate from 8% to 9%, which will continue for three years. He also expects the Market Price of this Share to be ₹ 360 after three years. You are required to determine –

   i. The maximum amount Mr. B should pay for the Shares, if he requires a rate of return of 13% per annum.
   ii. The maximum price Mr. B will be willing to pay for Share, if he is of the opinion that the 9% Growth Rate can be maintained indefinitely and requires 13% Rate of Return per annum.
   iii. The price of Share At the end of three years, if 9% Growth Rate is achieved, and assuming other conditions remaining same as in (b) above.

Calculate Rupee amount up to two decimal points. The following factors may be used for computation –

Factors	Year – 1	Year – 2	Year – 3
FVIF at 9%	1.090	1.188	1.295
FVIF at 13%	1.130	1.277	1.443
PVIF at 13%	0.885	0.783	0.693

b. A firm has an investment proposal requiring an outlay of ₹ 40,000. The investment proposal is expected to have 2 years economic life with no salvage value. In year 1, there is a 0.4 probability that cash inflow after tax will be ₹ 25,000 and 0.6 probability that cash inflow after tax will be ₹ 30,000. The probabilities assigned to cash inflows after tax for the year 2 are as under:

Year	Cash flows		Cash flows	
Year 1	₹ 25,000		₹ 30,000	
Year 2	₹ 12, 000	0.2	₹ 20, 000	0.2
	₹ 16, 000	0.3	₹ 25, 000	0.3
	₹ 22, 000	0.5	₹ 30, 000	0.5

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

Required:

- Construct a decision tree for the proposed investment project
- What net present value will be the project yield if worst outcome is realized? What is the probability of occurrence of this NPV?
- What will be the best and probability of that occurrence?
- Will the project be accepted? (10% discount factor 1 year – 0.909 2 year - 0.826)

(2 x10= 20 Marks)

8.

a. Calculate market price of shares as per Graham and Dodd model if the multiplier is 1.5, the DPS is ₹ 10 and the EPS is ₹ 20.

b. Compute DPS if dividend policy is treated as a residual decision and company the Prefers to maintain debt equity ratio of 1:3. Given
PAT : ₹ 20,000
Capital expenditure : ₹ 10,000
No. of shares :10,000.

c. Write a short note on Purchasing power parity theory

d. The following information calculate the market price per share using Walters formula.

Earning per share	₹ 12
Dividend per share	₹ 3
Cost of capital	18%
Internal Rate of Return on investment	22%
Retention Ratio	40%

(4 x5= 20 Marks)

PRIME ACADEMY
38TH SESSION PROGRESS TEST - STRATEGIC FINANCIAL MANAGEMENT
SUGGESTED ANSWERS

PART - A

1. Exchange rate given: 1.2350-1.2400 CAD/ USD
   So CAD(price) is the home currency and USD foreign currency.
   Using IRPT formula , (F= 1.255, S= 1.235, Rf=.09) we get theoretical Rh=10.76%
   Actual Rh is 10.5%(borrowing). Since actual rate is lesser its cheaper to borrow in CAD and invest in USD.
   But investment in US would lead to a return of 8% and appreciation on USD is 1.6% (F-S/S x 100) totaling to an overall return of 9.6% however cost of funds is 10.5%.Hence investment is not advisable.

2. GBP is the product and CAD is the price
   a) GBP is bought, hence bank sells GBP relevant rate: Ask
      Ask (CAD/ GBP) = Ask (CAD/ USD) x Ask (USD/GBP)
      = ₹ 1.05405 x 1.62205
      =₹ 1.709721803
      When 50,000 CAD is sold GBP received is 50,000 /1.709722
      = ₹ 29244.52383 GBP
   b) To buy 40,000 GBP, CAD required is 40,000 x 1.709722
      = ₹ 68388.8721 CAD

3.

	Projects		
	X	Y	Z
Coefficient of variation	1.2	0.8	0.4
Relevant discount rate (r)	16%	14%	12%

Calculation of Risk adjusted NPV

		Projects		
		X ₹	Y ₹	Z ₹
a.	Annual cah inflow	70,000	42,000	30,000
b.	PVAF(r%, 5 years)	3.274	3.433	3.605
c.	PV of inflows (a x b)	229,180	144,186	108,150
d.	Initial outflows	210,000	120,000	100,000
e.	Risk adjusted NPV	19,180	24,186	8,150

4.
   Spot rate: 51.0393-51.1700 INR/ NZD
   Swap points (1 month): 30-20
   Since Swap ask < Swap bid. Points have to be deducted to arrive at forward rate.
   So 1 month forward rate is : 51.0363-51.1680INR/ NZD.
   Since INR is the price, % of appreciation(Forward rate of NZd is lower, so INR appreciating) = (S-F)/ F x12/m x 100
   (51.0393-51.0363)/ 51.0363 x 12/1 x 100 =0.07%

5. As per MM Model

   $P_0 = (D_1 + P_1)/(1 + k)$

   (i) When Dividend is not declared:

   P_0 = 100(given), D_1 = 0 and k= 10%

   $100 = (0 + P_1)/ (1 +.10)$, P_1 = ₹ 110.

   (ii) When Dividend is declared:

   P_0 = 100(given), D_1 = 15 and k = 10%

   $100 = (15 + P_1)/ (1 +.10)$, P_1 = ₹ 95

PART B

6.

i) Invested in London

Amount available in \$ = ₹ 5,00,000

Amount available in GBP = ₹ 5Lacs/1.5390(product is GBP and relevant rate is spot ask) = ₹ 324886.2898 GBP

Maturity value of investment = ₹ 324886 x[1 + (5%x3/12)]

= ₹ 328947.075 GBP

ii) Invested in New York

Amount available in \$ = ₹ 5,00,000

Maturity value of investment = ₹ 500000 x[1 + (8%x3/12)]

= ₹ 510000 GBP

Maturity value in GBP = ₹ 5.10 Lacs/1.5475 (product is GBP and relevant rate is forward ask) = ₹ 329563.8126 GBP

iii. Invested in Frankfurt

Amount available: 5,00,000\$ or 324886GBP (computed in i)

Amount available in Euros = ₹ 324886x1.8260 (product is GBP and relevant rate is spot Bid) = ₹593241.836 Euros

Maturity value of investment = ₹ 593242 x[1 + (3%x3/12)]

= ₹ 597691.315 Euros

Maturity value in GBP = ₹ 597691/1.815 (product is GBP and relevant rate is forward ask)

= ₹ 329306.3361GBP

Since maximum cash flows arise from investing in New York the same should be opted. Borrowing cost is common for all alternatives and hence ignored.

7.

(a)

i) Given D0 = 14. g= 9% and P3 = 360

Maximum amount B should pay is present value of cash flows of year 1 to 3 discounted at 13%

Cash flows: D1, D2 D3 and P3

D1=	Do (1+9%)	15.26
D2=	D1 (1+9%)	16.63
D3=	D2 (1+9%)	18.13

$P0= (D1 \times .885) + (D2 \times 0.783)+(D3 \times 0.693) + (P3 \times 0.693)=$ ₹ 288.57

ii) Given D0= 14, Constant growth rate (g) = 9% and Ke=13%

$P0= D1/(Ke- g)$, D1 computed above is 15.26

$P0 = 15.26/(0.13-0.09) =$ ₹ 381.25

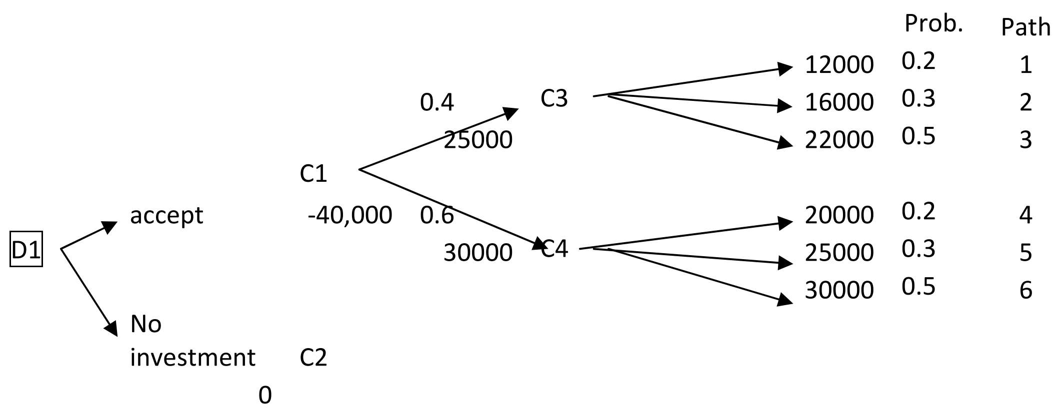
iii) Given D0= 14, Constant growth rate (g) = 9% and Ke=13%

$P3 = D4/(Ke- g)$,

D4 is D1 x FVIF (9%,4 years = 15.26 x 1.295 = 19.76

$P3 = 19.76/(0.13-0.09) =$ ₹ 494

(b)



Calculation of nodes:

		₹
C4	[(20,000 x 0.2) + (25,000 x 0.3) + (30,000 x 0.5)]x 0.826x 0.6	13133
C3	[(12,000 x 0.2) + (16,000 x 0.3) + (22,000 x 0.5)]x0.826 x 0.4	6,013
C2	No investment so 0	0
C1	[(25000x0.4) + (30,000x0.6)]x0.909 + c3 + C4 – 40,000	4599
D1	Higher of C1 and C2,	4599

Computation of joint probability(jp)

Path	Year 1	Year 2	JP
1	0.4	0.2	0.08
2	0.4	0.3	0.12
3	0.4	0.5	0.2
4	0.6	0.2	0.12
5	0.6	0.3	0.18
6	0.6	0.5	0.3

Computation of Expected NPV#

Path	Year 1	Year2	DCF 1	DCF 2	NPV	JP	Expected NPV
	i	ii	iii(I x.909)	iv(iix.826)	iii+iv-40K		
1	25000	12000	22725	9912	-7363	0.08	-589.04
2	25000	16000	22725	13216	-4059	0.12	-487.08
3	25000	22000	22725	18172	897	0.2	179.4
4	30000	20000	27270	16520	3790	0.12	454.8

5	30000	25000	27270	20650	7920	0.18	1425.6
6	30000	30000	27270	24780	12050	0.3	3615
							4598.68

This step is not required in the exam. Given for the purpose of understanding the concept of Joint probability only

- NPV of the worst outcome is Path 1 which is (-)7363 and its corresponding probability is 0.08 or 8%
- Npv of the best outcome is Path 6 which is ₹ 12,050 and probability is 0.30 or 30%
- The project is acceptable as it has a positive NPV

8.

a. P = m x (D + E/3)
M=1.5, D=10 and E=20 so Market price P is
1.5 x (10 + 20/3) =1.5 x(16.67)
= ₹ 25

b. Capital expenditure ₹ 10,000. Since Debt equity ratio of 1:3 is maintained share of Equity is 10,000 x ¾ = ₹ 7500 which is financed from retained earnings.
Profit available for dividend is ₹ 20,000-7,500= ₹ 12,500
Dividend per share = 12,500/10,000= ₹ 1.25 per share

c. Purchasing power parity theory:
- Inflation prevailing in 2 countries affects the exchange rate.
- Exchange rates will move in such a way that there is parity in inflation rates and no arbitrage opportunity exists. High inflation would be offset by depreciation in the currency.
- Formula

d. Walter's model:
P0 = D/Ke +[{r(E-D)/Ke} /Ke]
D= 3 E= 12 r=22% and Ke= 18%
P0=₹ 77.78

PRIME ACADEMY

38th SESSION PROGRESS TEST

AUDITING ASSURANCE AND PROFESSIONAL ETHICS

No of Pages: 4 **Total Marks: 75**

Time Allowed: 2 Hrs

Part A

1. Which of the following type of modified audit report does not affect the auditor's opinion on true and fairness of the financial statement?
   a. An audit report with qualified opinion
   b. An audit report with disclaimer of opinion
   c. An audit report with adverse opinion
   d. An audit report with emphasis of matter paragraph (1 Mark)

2. The purpose of Standards on Auditing is to:
   a. Provide guidance to the members of Institute of Chartered Accountants of India
   b. Enhance confidence of the members of the Institute
   c. Enhance the degree of confident of intended users in the Financial Statements
   d. All of the above (1 Mark)

3. The right of an auditor to attend and to be heard at any general meeting is restricted to:
   a) The business relating to adoption of accounts
   b) The business relating to appointment of auditors
   c) The business which concerns him as an auditor
   d) The business relating to appointment of experts (1 Mark)

4. The concept of materiality is to be applied in:
   a) Planning the audit
   b) Performing the audit
   c) Planning and Performing the audit
   d) Concluding the audit (1 Mark)

5. In examining the disclosure requirement of the financial statement of the entity, the joint auditors are:
   a) Jointly and severally liable
   b) For whom the disclosure requirement is allotted are responsible
   c) Not liable
   d) Liable to the extent as decided by the management (1 Mark)

6. Which of the following person is entitled to sign the Auditor's Report on behalf of the firm appointed as auditors of a company,
   a) Any partner whether or not he is in full time employment elsewhere
   b) Any partner who is practising either in India or abroad
   c) Any partner who is practising in India
   d) Any employee or partner who is practising in India (1 Mark)

7. In the context of specific assignment, when planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor:
   a) Only if the other auditor is a member of ICAI
   b) Only if the other auditor is not a member of ICAI
   c) Whether or not the other auditor is a member of ICAI
   d) Only if the principal auditor considers it to be necessary (1 Mark)

8. 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. (1 Mark)

9. 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. (1 Mark)

10. 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. (1 Mark)

11. 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. (1 Mark)

12. XYZ Co Ltd has sold during the year 35% of its fixed assets used for production. As an auditor which of the following is the best way to substantiate the going concern of the company.
   a. Exercise judgment whether 35% constitutes substantial portion and ensure whether it has affected the going concern.
   b. Obtain representation from management to such an effect
   c. Both a & b
   d. None of the above (2 Marks)

13. As per SA 230 what is the minimum period for retention of audit documentation
   a. 8 years from the date of auditor's report
   b. 8 years from the end of financial year
   c. 10 years from the end of financial year
   d. 10 years from the date of auditor's report (1 Mark)

14. In cases where there is a disagreement between the Joint Auditors of the company then
   a. Joint auditor who has different opinion can report separately and other joint auditors can report jointly
   b. The rule of majority prevails
   c. Each of the Joint auditors should report separately
   d. None of the above (1 Mark)

15. PQR Mining Limited is engaged in extraction of copper ore and production of copper. The auditor of the company has assessed the risk of material misstatement in inventory and ore extracting assets, which in his judgment requires special audit considerations. Such risk is called as
   a. Audit Risk
   b. Inherent Risk
   c. Assessed Risk
   d. Significant Risk (1 Mark)

16. Which of the statement is false: The concept of materiality is applied by the auditor
   a. In planning and performing the audit
   b. In evaluating the effectiveness and appropriateness of Internal Controls
   c. In evaluating the effect of identified misstatements and of uncorrected misstatements
   d. In forming an opinion in the Auditors Report. (1 Mark)

17. Which of the following is not true: Requirements of an auditor as per SA 620 are
   a. Auditor can seek audit evidence from an expert independently
   b. Where the experts opinion is inconsistent with provision of law, then auditor should deal with it accordingly by discussing with client or expert
   c. Auditor should ensure that experts opinion is prima facie dependable before relying on the same
   d. The auditor should refer to the work of an expert in his unqualified report. (1 Mark)

18. Non disclosure of information to a third party without specific authority or legal or professional necessity is called as
   a. Confidentiality
   b. Integrity
   c. Objectivity
   d. All of the above (1 Mark)

19. The date of written representations shall be as near as practicable to, but not after
   a. date of financial statements
   b. the date of auditors report on financial statements
   c. the date of approval of financial statement
   d. the date on which the financial statements are issued (1 Mark)

20. This is necessary for questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance.
   a. Professional behaviour
   b. Objectivity
   c. Professional scepticism
   d. Professional judgement (1 Mark)

21. Which of the following consist of evaluations of financial information made by the study of plausible relationship among both financial and non-financial data?
   a. Analytical procedure
   b. Substantive procedure
   c. Control procedure
   d. All the above (2 Mark)

22. The objective of compilation engagement is for the accountant to use
    a. Auditing expertise
    b. Accounting expertise
    c. Both accounting and auditing expertise
    d. To use auditors expertise (1 Mark)

23. Application of analytical procedures at the planning stage of an audit will:
    a. Assist in understanding the business and in identifying areas of potential risk
    b. Assist in forming overall conclusion as to whether the financial statements as a whole are consistent with the auditors knowledge of the business
    c. Assist identifying significant fluctuation or relationship that are inconsistent with other relevant information
    d. Will not help in planning stage (1 Mark)

Part B **(50 Marks)**

Answer all questions

1. **a)** What are the leadership qualities and ethical requirement required by an auditor while doing the quality control for an audit of financial statements

b) Write short notes on matters to be considered by the engagement partner while assigning engagement terms for an audit of financial statements (2*5 = 10 Marks)

2. **a)** What are the aspects to be considered while relying upon the work of an expert.

b) What are the steps to be taken by a firm of chartered accountants to ensure that their appointment as statutory auditor of a company is valid. (2*5 = 10 Marks)

3. Give your references with respect to the companies act, 1956 and the chartered accountant act, 1949 and schedule thereto:

- A chartered accountant who was in practices since the last 20 years died in the road accident. His widow sold the practice to another chartered accountant in price for ₹ 30 lakhs. The price also included the right to use the firm name.

- K, Chartered Accountant in practice as a sole proprietor at Chennai has an office in the suburbs of Chennai. Due to increase in the income tax assessment work, he opens another office near the income tax office. For running the new office, he has employed a retired Income tax commissioner. (2*5 = 10 Marks)

4. a) Mr.A has been appointed statutory auditor of a private limited company where his spouse sisters husband is having 75% ownership (5 Marks)

b) A Chartered Accountant in practice has been suspended from practice for a period of 6 months. During the period he didn't undertake an audit assignment since he has surrendered certificate of practice. He had appeared before Income tax authorities in his capacity as CA. (5 Marks)

5. What are the various factors to be considered while performing analytical procedures as substantive procedures

(10 Marks)

PRIME ACADEMY

38TH SESSION PROGRESS TEST- ADVANCE AUDITING AND PROFESSIONAL ETHICS

SUGGESTED ANSWERS

Part - A

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

Part B

1. a) The leadership qualities and the ethical requirements
    - The engagement partner shall take overall responsibility for the quality on each engagement audit to which the partner is assigned
    - Through the engagement the auditor will remain alert through observation and making enquiries as necessary for evidence of non-compliance with relevant ethical requirements by the members
    - If matters come to the attention of the auditor on not complying with relevant ethical standards or requirements , then the engagement partner/ auditor with consultation with other in the firm shall determine the appropriate action.

    b) As per SA – 220 (Revised) – "Quality Control for an Audit of Financial Statements", the engagement partner shall be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to:

    (a) Perform the audit engagement in accordance with professional standards and regulatory and legal requirements; and
    (b) Enable an auditor's report that is appropriate in the circumstances to be issued.

    An engagement team also includes a member using expertise in a specialised area of accounting or auditing, whether engaged or employed by the firm, if any, who performs audit procedures on the engagement. When considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's:

    - Understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
    - Understanding of professional standards and regulatory and legal requirements.
    - Technical expertise, including expertise with relevant information technology and specialised areas of accounting or auditing.
    - Knowledge of relevant industries in which the client operates.
    - Ability to apply professional judgment.
    - Understanding of the firm's quality control policies and procedures.

2. a) 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. b) **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.

3.a) Sale of goodwill : With reference to clause 2 of the Part 1 of the first schedule to Chartered Accountants, 1949 the council of the ICAI of India had an occasion to consider whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor.

The council resolved that the sale/transfer of goodwill in the case of a proprietary firm of chartered accountant to another eligible member of the institute shall be permitted. It further laid down in cases where death of proprietor occurs before 30/08/1998. The goodwill of the deceased member's practice can be sold to another member who is otherwise eligible , after the death of the proprietor.

It is even more laid down in such cases the name of proprietary firm concerned would not be removed up to a period of one year from the death of the proprietor.

Thus in the instant case, when the widow of the chartered accountant sold the practice to another member, it is nothing but goodwill sold to another member. The sale of the practice and the right to use the name is also allowed in terms of the above decision of the council. Therefore the act is permissible.

b) Member of the branch office in the same city – As per sec 27 of the Chartered Accountants Act, 1949 if the CA in practice has more than one office in India, each of these offices should be in separate charge of a member of the institute. However a member can be in charge of 2 offices if the second office is located in the same premises or same city in which the first off is located or second off is located within a distance of 50 kms from the municipal limits of a city, in which the first off is located.

In the given case Mr.K, CA practicing as a sole proprietor in Chennai has an office in the suburbs in Chennai and due to increase in work he opened another branch near the income tax office. He also employed the income tax commissioner to run the new office.

Assuming the second office is situated within a distance of 50 kms from municipal limits, there wil be no misconduct if Mr.K will be in charge of both the office, and however he will be liable to declare the two offices is the main office

4.i) Appointment of auditor with substantial interest – Clause 4 of the Part I of Second Schedule of the CA Act 1949, states that if an auditor expresses his opinion on the FS of any business or enterprise in which he or his firm or partner or relative has substantial interest, he is committing professional misconduct unless he discloses the interest in his report.

In the given case, Mr. A has been appointed as statutory auditor of private limited company where his spouse sisters husband is having 75% ownership. i.e substantial interest. As per AS-18, spouse sis husband not covered in the definition of the relative.

Therefore, appointment of Mr. A as statutory auditor would not amount to professional misconduct.

ii) Undertaking tax representation work - A CA not holding COP cannot take up any work because it would amount to violation of the relevant provisions of the CA Act, 1949.

In case a member is suspended and is not holding COP, he cannot in any other capacity take up any practice separable from his capacity. This is because once a member becomes a member, he is bound by the provisions of the CA Act, 1949.

He is found guilty. He cannot appear before the authorities during the period of suspension.

5. Factors to be considered

- Objectives of the analytical procedures and the extent to which the results are relied upon
- Nature of the entity and the degree to which information can be disaggregated
- Availability of information both financial and non financial
- Reliability of information available
- Relevance of the information available
- Source of the information available
- Comparability of the information available
- Knowledge gained during previous audits together with auditors understanding of the effectiveness of the accounting and internal control systems and the type of problems that in prior period has given rise to accounting adjustment

PRIME ACADEMY
38TH SESSION - PROGRESS TEST
CORPORATE AND ALLIED LAWS

No of Pages: 4 **Total Marks: 75**
Time Allowed: 2 Hours

Part - A

1) Under Sec 252 a public limited company shall have at least
   a) Three directors
   b) Two directors
   c) Five directors
   d) Seven directors
2) Appointment of alternate director is the prerogative of
   a) General Meeting
   b) Board of Directors
   c) Government
   d) None of the above
3) Small shareholder under company Law means a shareholder holding shares of
   a) Nominal value of ₹ 20000 or less
   b) Paid up value of ₹20000 or less
   c) Paid up value of ₹ 50000 or less
   d) Nominal value of ₹ 50000 or less
4) Prescription of qualification shares applies to
   a) Only private limited companies
   b) Only public limited companies
   c) As per AoA
   d) Both public and private limited companies
5) Disqualification u/sec 274(1)(g) does not apply to
   a) Government companies
   b) Nominee directors of PFI's and statutory companies company
   c) Small shareholders directors
   d) All of the above
6) Which of the following companies are excluded for calculating ceiling on directorships
   a) Private company
   b) Sec 25 companies
   c) Alternate Directorships
   d) All of the above
7) A casual vacancy u/sec 262 can be filled by
   a) A circular Resolution
   b) Directors at a meeting of the Board
   c) Postal Ballot
   d) Any of the above
8) An alternate director vacates office when
   a) Original Director returns to the state where Board Meetings are held
   b) Original Director returns to the state where the Registered office is situated
   c) Original Directors office is terminated
   d) None of the above

9) Retirement of directors by rotation applies to
    e) Only private limited companies
    f) Only public limited companies
    g) As per AoA
    h) Both public and private limited companies
10) The tenure of a small shareholders' director is
    a) For a maximum period of three years
    b) For a minimum period of 3 years
    c) For a maximum period of 5 years
    d) None of the above
11) Agenda for a Board meeting is
    a) Mandatory for all proposals
    b) Mandatory for proposals seeking unanimous approval
    c) Optional
    d) As provided in AOA.
12) Sec 295 is applicable to
    a) Banking companies
    b) Loan made , guarantee given or security provided by a pvt company
    c) Loan made , guarantee given or security provided by a holding company to a subsidiary company
    d) None of the above
13) Approval of Central Government is not required for the appointment of a Managing Director if the appointment is made in conformity with the provisions of ________
    a) Schedule XIII
    b) Schedule V
    c) Schedule 198
    d) Section 309 read with Schedule XIII
14) Appointment of additional directors is applicable to
    a) All Companies
    b) Pubic companies
    c) Private companies not subsidiary of public companies
    d) None of the above
15) Sec 408 directors are appointed by
    a) Central Government
    b) BIFR
    c) Financial Institutions
    d) None of the above
16) __Director removed u/sec 388 is
    a) Entitled to compensation for his complete tenure
    b) Entitled to compensation for his tenure or 3 years whichever is more
    c) Entitled to such compensation as Tribunal may direct
    d) None of the above
17) Every company shall have a company secretary if
    a) Paid up capital is not less than 5 crores
    b) Paid up capital exceeds 2 crores
    c) Paid up capital exceeds 3 crores
    d) None of the above
18) Which of the following directors cannot be displaced u/sec 284
    a) 265 Director
    b) Nominee director
    c) 408 director
    d) All of the above

19) First Directors are appointed by ________
   a) Shareholders
   b) Government
   c) Subscribers to the memorandum
   d) Company Law Board
20) Every ____________ shall constitute an audit committee
   a) Public company having a paid up capital of not less than 5 crores
   b) Company having a paid up capital of not less than 5 crores
   c) Private company having a paid up capital of not less than 5 crores
   d) None of the above

(20 x1 = 20 Marks)

21) The Board of Directors of WYZ Limited at a Board meeting held on 15.01.2012 resolved to borrow 150 crores from a Nationalised Bank, the amount was granted by bank. One of the Directors who opposed this contends that this borrowing is beyond the powers of the Board. The following are the additional data:

Share Capital	: 50 crores
Reserves	: 50 crores
Loans	: 25 crores

Advice suitably (5 Marks)

Part - B (50 Marks)

ANSWER ANY FIVE QUESTIONS

1) State with reference to provisions of the Companies Act whether the following can be appointed as directors of a Public company - Examine 274
   - Mr A who has liabilities in excess of Assets has applied to the court to have him adjudicated as Insolvent and such an application is pending
   - Mrs X was caught in a petty theft and was convicted and imprisoned by a Court for 8 weeks
   - Mr Z a senior bank professional was held guilty in an embezzlement case7 years ago and was convicted and imprisoned for a period of 1 year
   - Mr S is a director of XYZ Limited which has not filed Annual returns for AGM's held in 3 calendar years 2001, 2002 & 2003.
   - Mr T is a director of a company which has failed to repay its Fixed Deposits since April 2002.

(2*5 = 10 Marks)

2) A) SEBI is of the opinion that in the interest of investors it is desirable to amend rules of XYZ Stock Exchange prohibiting the appointment broker member as President of Stock Exchange . Explain the powers of SEBI incase stock exchange does not change rules?

   B) State with reference to provisions of the Companies Act on the applicability of Sec 295 to the following in case of a public company
   - A salary advance of ₹ 5000 to an employee who is the wife of the MD
   - Sale of the company's flat to director at the prevailing market price out of which the Director pays 50% immediately and balance in 10 equal Instalments
   - Making a deposit with landlord for securing residential accommodation of the MD
   - Loan to 100% subsidiary. (2*5=10 Marks)

3) A) Directors of GHJ Limited do not have any shares in RTY Limited. Similarly directors of RTY Limited do not hold any shares in GHJ Limited. But wife of director G of GHJ Limited holds 25% of RTY Limited. The directors of GHJ Limited enter into a contract with RTY Limited for purchase of goods and G has not disclosed his indirect interest. Examine the validity under Companies Act?

B) State with reference to provisions of the Companies Act on the applicability of Sec 314to the following

- Mr X son of Mr C Director is proposed to be appointed as MD on a monthly remuneration of ₹ 75000
- Mr D son of a Director is proposed to be appointed as Accounts Manager on a salary of ₹ 60000/-.
- Mr V Director is a chartered Accountant and is a partner in V & CO Chartered Accountants. The company proposes to appoint the firm as a consultant on a regular basis.
- Mr V Director is a chartered Accountant and is a partner in V & CO Chartered Accountants. The company proposes to appoint the firm as an authorised representative to appear before ITAT. (2*5 = 10 Marks)

4) A) Delhi Stock Exchange wants to establish additional Trading Floor - Advice

B) Bell worth Hospitals Ltd proposes to utilize the services of Mr G a senior heart surgeon . It has appointed Mr G as its Non Executive Director and wants to pay him on a case to case basis for surgeries performed. Examine the remuneration aspect from Companies Act 1956.

(2*5 = 10 Marks)

5) ABC Ltd., has a paid up capital of ₹ 100 Lakhs and reserves of ₹ 200 lakhs. It has already entered into the following transactions

Loan to A ltd	₹ 50 Lakhs
Investment in B Ltd	₹ 20 lakhs
Investment in C Ltd	₹ 50 lakhs
Investment in X Ltd	₹ 25 lakhs
Investment in D Ltd	₹ 25 Lakhs

Examine in the following chronological order applicability of 372 A

a) Investment of ₹ 20 Lakhs in B Limited as a rights 1:1
b) Grant a Loan of ₹ 8 lakhs to Z Limited
c) To Give a Guarantee of ₹ 5 Lakhs to Corporation Bank in respect of loan to be granted to Y limited a group company
d) To Invest in the shares of A ltd to the extent of ₹ 25 lakhs

(10 Marks)

6) A) Mr XYZ is the Managing Director of M/S VBN Limited and FGY Limited. PQR Limited wants to appoint him as its Managing Director. State the legal requirements and draft a resolution for appointment of Mr XYZ as Managing Director of PQR Limited.

B) Mr X was appointed as Managing Director of M/S VBN Limited for a period of 5 years with effect from 01.04.2008 on a salary of ₹ 12 lakhs p.a. On coming to be aware of a certain questionable transactions Mr X was terminated from 01.04.2010. Mr X termed his removal as illegal and claimed a compensation. VBN Limited paid ₹ 5 lakhs adhoc pending his dues settlements. Examine

(2*5=10 Marks)

PRIME ACADEMY
38TH SESSION PROGRESS TEST- CORPORATE AND ALLIED LAWS
SUGGESTED ANSWERS

PART- A

1) a

2) b

3) a

4) b

5) d

6) d

7) b

8) a (or) c

9) b

10) a

11) b

12) d

13) a

14) a

15) a

16) d

17) a

18) d

19) c

20) a

21)

The share capital + free reserves aggregate ` 100 crores , the present borrowing is ` 150 crores hence beyond the powers of the Board. However it is within the powers of the company and can be ratified through a resolution in a general meeting.

Thus WYZ Limited shall have an EGM and pass a resolution to ratify the same thus making it a valid borrowing .

RESOLVED that pursuant to Sec 293(1)(d) and other applicable provisions of the Companies Act the consent of the company be and is hereby accorded to the Board of the company for borrowing such sums as they may deem requisite for the purpose of the business notwithstanding the sums so borrowed will exceed the aggregate of paid up capital & Free Reserves of the company provided such borrowings do not exceed ` 350 crores outstanding at any time.

Explanatory Statement :

The sanction is sought for a borrowal of excess of capital plus free reserves. This requires consent in a General Meeting. With the diversification plans it is necessary for such a sanction and commends passing of the resolution.

None of the directors are interested in the resolution.

PART – B

1)

- Yes pending application attracts 274 – hence disqualified
- Less than six months – 274 not attracted
- Sentenced for > 6 months but 5 years have expired hence out of 274
- Annual accounts AND Annual Returns mentioned in 274 – hence not disqualified
- Failed to repay deposits and default continues more than one year – hence Disqualified

2) A)

The Central Government may after consulting with Governing Bodies of Stock Exchange generally or specifically of a stock exchange form an opinion that it is necessary to direct rules to be made or amended . The SEBI may by an order in writing along with reasons direct such amendments within a period of 2 months from the order. If the stock exchange fails compliance Central Government may pass such orders for amending. Such amendment by the Central government will be published in the official gazette and also in the Gazette of the State where the principal office of the stock exchange is situated. This once published has an overriding effect on any statute for the time being in force.

B)

- No not a loan under 295
- It is a credit sale – not a loan hence 295 is not attracted
- Part of terms of Securing a residential accommodation- director has nothing to do with the same – 295 is not attracted
- Transaction with 100% subsidiary – outside 295.

3) A)

Sec 299 talks only when there is a holding of 2% or more by the Directors of one company in the other. In this case Directors do not hold only the spouse holds. Hence 299 does not get attracted. Sec 297 does not cover the transactions between 2 public companies. Hence the contract is valid.

B)

- No appointment of a MD outside preview of Sec 314
- Approval by a Special resolution – need not be prior. – Yes 314 is attracted
- Appointment of retainer attracts 314 , however when professional services are rendered 314 is not attracted
- The appointment is on a case to case basis hence 314 is not attracted.

4) A)

Additional Trading floor means a trading ring offered outside its area of operation. This is to enable investors who do not have an immediate access to trading facility to buy and sell securities under the regulatory framework of the stock exchange. Such a floor requires prior approval of SEBI under such terms and conditions as it deems fit.

B)

The Remuneration shall not be included if it is rendered in professional capacity and the Central Government is of the opinion that the Director possesses the requisite qualification. The company is required to approach Central Government in Form 25A and get its consent.

5)

The Limits are 60% of paid up capital + free reserves or 100% of free reserves whichever is higher

60% of ` 300 lakhs or 100% of ` 200 lakhs = ` 200 lakhs

Value already entered : ` 170 lakhs

a) Investment in rights is outside 372 A.
b) The total value is ` 170+20 lakhs = ` 190 lakhs , even with this transaction the limits are not exceeded (190+8).- Within Limits Board approval at a meeting of the Board
c) The normal prescription is prior approval of shareholders through a Special Resolution , but if exceptional circumstances exists then approval can be got subsequently.
d) The approval is in excess of limits – prior approval through a special resolution is mandatory.

6) A)

A person cannot be a Managing Director for more than two companies . However on an application in Form 25A by PQR Limited the Central Government may allow Mr XYZ to act as MD of PQR Limited .

RESOLVED that pursuant to Sec 316(4) of Companies Act 1956 the Consent of the Board be and is hereby accorded to approach Central Government for the appointment of Mr XYZ as Managing Director who is already a Managing Director in two Public companies M/S VBN and FGY Limited

RESOLVED further that Mr Z Secretary be and is hereby authorised to submit necessary application and do such acts to give effect to the Resolution

B)

If found to be guilty no compensation shall be payable to MD/WTD/Manager. Hence if found guilty no compensation would be payable and compensation can be recovered by VBN Limited