PRIME ACADEMY

39th SESSION PROGRESS TEST - FINANCIAL REPORTING

No of Pages: 5 **Total Marks: 75**

Time Allowed: 2 Hrs

PART - A

1) A change in the method of depreciation is
   a) Change in accounting policy
   b) Change in accounting estimate (1 Mark)

2) Which of the following requires disclosure though it is not an extraordinary item
   a) Disposal of fixed assets
   b) Attachment of property of an enterprise
   c) Reversal of provisions
   d) The write-down of inventories to net realizable value as well as the reversal of such write-down (1 Mark)

3) Which of the following is not a method of determining percentage of completion in a construction contract
   a) Proportion of costs to total cost
   b) Progress billing to the customer
   c) Survey of works performed
   d) Completion of physical proportion of the contract (1 Mark)

4) Cost of conversion for the purpose of valuation of inventory will not include
   a) Fixed Production Overhead
   b) Administrative overheads
   c) Variable production overhead (1 Mark)

5) Fair value of the machine – ₹ 4 lakhs Lease term – 5 years Lease rental per annum – ₹ 1 lakh. Guaranteed residual value – ₹ 0.20 lakhs expected residual value – ₹0.40 lakhs. What is gross investment in lease?
   a) ₹ 5,20,000
   b) ₹ 4,20,000
   c) ₹ 4,40,000
   d) ₹ 5,40,000 (1 Mark)

6) 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. (1 Mark)

7) ICICI bank received a gross of ₹ 1500 crores demand deposits from customers and withdrawn Rs.1300 of demand deposits during the FY 2013-14. How will you classify such receipts and payments in cash flow statement of ICICI and the manner of such presentation. Choose any one

   a. Operating activities on a net basis (₹ 200 crores inflow)
   b. Operating activities on a net basis (₹ 200 crores outflow)
   c. Financing activities on a total basis (₹ 1300 crores outflow)
   d. Investing activities on total basis (₹ 1500 crore inflow) (3 Marks)

8) On June 18, 2014 A Ltd incurred the following costs for one of its printing press:

Purchase of collating and stapling attachment	₹ 84000
Installation of attachment	₹ 36000
Replacement parts of overhaul of press	₹ 26000
Labour and overhead in collection with overhaul	₹ 14000

   The overhaul resulted in a significant increase in production. Neither the attachment nor the overhaul increased the estimated useful life of the press. What amount of the above costs should be materialized?

   a. ₹ 105000
   b. ₹ 110000
   c. ₹ 125000
   d. ₹ 130000 (3 Marks)

9) During the year 2013-14 AD softex India Ltd engaged in the following transactions:

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

   Which of the following transactions would be disclosed as related party transactions in AD? Softex ?

   a. Neither transactions
   b. ₹ 100000 transaction only
   c. ₹ 250000 transaction only
   d. Both transaction (3 Marks)

10) Non- monetary grants are recognised as assets at

   a. Fair value
   b. Market value
   c. None of the above
   d. Nominal value (1 Mark)

11) While valuing the inventories, any rebate or discounts should be

   a. Ignored
   b. Added with the cost of purchase
   c. Deducted from the cost of purchase
   d. None of the above (1 Mark)

12) Foreign operations that are integral part of the operations of an entity would have the same functional currency as that of the entity. Where a foreign operation functions independently from the parent the functional currency will be
   a) That of the parent
   b) Determined using the guidance for determining the entity's functional currency
   c) That of the country of incorporation
   d) None of the above (1 Mark)

13) When the buyer has the right to return the goods purchased as per the contract
   a) The seller can recognize the revenue on sale
   b) The revenue cannot be recognized at all
   c) The revenue can be recognized only on approval from the buyer
   d) None of the above (1 Mark)

14) What happens to the allocation of fixed overhead to each unit during the time of low production?
   a) Per unit cost increases
   b) Per unit cost decreases
   c) Per unit cost is fixed
   d) Per unit cost varies (1 Mark)

15) Balaguru Ltd. Entered into a sale deed for its immovable property before the end of the year. But registration was done with registrar subsequent to Balance Sheet Date. But before finalization, is it possible to recognize the sale and the gain at the Balance sheet date?
   a) No recognition possible
   b) Yes it can be recognized
   c) Only sales should be recorded without recognizing the gain
   d) None of the above (1 Mark)

16) As per AS 19 on Leases, unearned finance income is the difference between

   a) Gross investment and return in lease arrangement
   b) Amount accruing to the lessor
   c) Operating and finance lease
   d) The gross investment in the lease and the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value (1 Mark)

17) During 2013, King Company made the following expenditure relating to its Plant Building

Continuous and frequent repairs	₹ 40,000
Repainting the plant building	₹ 10,000
Major improvements to the electrical wiring system	₹ 32,000
Partial replacement of roof tiles	₹ 14,000

   How much should be charged to the repairs and maintenance expenses in 2013
   a) ₹ 96000
   b) ₹ 82000
   c) ₹ 64000
   d) ₹ 54000 (3 Marks)

PART – B **(50 Marks)**

1. Prepare the consolidated Balance sheet as on 31.12.2013 of group of companies A Ltd, B Ltd, C Ltd. Their Balance sheet as on date is given below:

Liabilities	₹	₹	₹
	A Ltd	**B Ltd**	**C Ltd**
Share capital (₹ 100 each)	1,25,000	1,00,000	60,000
Reserves	18,000	10,000	7,200
P & L Account	16,000	4,000	5,000
Sundry creditors	7,000	3,000	
A Ltd		7,000	
B Ltd	3,300		
Total	**1,69,300**	**1,24,000**	**72,200**
Assets			
	A Ltd	**B Ltd**	**C Ltd**
Fixed Assets	28,000	55,000	37,400
Investment in shares			
B Ltd	85,000		
C Ltd		53,000	
Stocks	22,000	6,000	
B Ltd	8,000		
Debtors	26,300	10,000	31,500
A Ltd			3,300
	169300	**124000**	**72200**

Other information:

i) A Ltd holds 750 shares in B Ltd and B Ltd holds 400 shares in C Ltd. These holding were acquired on 30th June 2013.

ii) On 1st January 2013, the following balances stood in the books of B Ltd and C Ltd

	₹	₹
	B Ltd	C Ltd
Reserves	8,000	6,000
P&L a/c	1,000	1,000

iii) C Ltd, sold goods costing ₹ 2500 to B Ltd for ₹ 3100. These goods still remain unsold.

(20 Marks)

2. a. Explain with example, changes in accounting policies and changes in accounting estimates
   b. Distinguish between adjusting and non-adjusting events

(2 X 5 = 10 Marks)

3 a. It has been decided that PURU Ltd will absorb the entire undertaking of SHO Ltd and THAM Ltd as on 1.4.2013. The outside shareholders in the latter companies are to be issued equity shares in PURU Ltd on the basis of an agreed issue price of ₹ 20 per share. For this purpose, the interest of such shareholders is to be determined according to the intrinsic values of the shares of the respective companies. AN Ltd is a subsidiary of THAM Ltd and is also to be merged into PERU Ltd appropriately.

The balance sheets of the companies at 31.03.2012 stood as under:

(₹ In lakhs)

Equity and Liabilities	PURU (₹)	SHO (₹)	THAM (₹)	AN (₹)
Share capital (equity shares of ₹ 10 each)	1500	1000	800	400
Reserves	2000	540	702	400
Loan	1600	900	1000	700
Total	5100	2440	2502	1500
Assets				
Land	200	100	50	10
Building	500	400	100	200
Machinery	1500	800	500	500
Other fixed assets	400	100	200	50
Investments				
₹ 40 Lakh shares of SHO	500			
₹ 20 Lakh shares of THAM	300			
₹ 40 Lakh shares of AN			400	
Others	100			
Other current assets	1600	1040	1252	740
Total	**5100**	**2440**	**2502**	**1500**

For the purpose of the scheme, it is agreed to give effect to the following value appreciations of the assets of the companies to be absorbed.

Land – 100%
Building – 50%
Machinery – 20%
In order to obtain the consent of creditors of THAM Ltd it becomes necessary to accept a claim of ₹ 20 Lakh hitherto classified as contingent. 60% of the claim is accepted by THAM Ltd and the balance is too settled by PURU Ltd.

You are required to

1) Compute number of shares to be issued by PURU Ltd to eligible outsiders
2) Show journal entries
3) Draft the Balance sheet of PURU Ltd after the completion of absorption

(20 Marks)

PRIME ACADEMY
39TH SESSION – FINAL - PROGRESS TEST – FINANCIAL REPORTING
SUGGESTED ANSWERS

PART - A

S. No	Answers
1	A
2	B
3	B
4	b
5	D
6	B
7	a
8	d
9	D
10	A
11	c
12	B
13	C
14	A
15	B
16	d
17	c

PART - B

1. Working Notes:

   Analysis of Profits:

C Ltd

Particulars	Capital Profit	Revenue reserve	Revenue Profit
	₹	₹	₹
Reserve as on 1.1.2013	6000		
Additional reserve credited in 2006	600	600	
Profit and Loss account balance as on 1.1.2013	1000		
Profit for 2013	2000		2000
	9600	600	2000
Due to outsiders – 1/3	3200	200	667
Share of B Ltd – 2/3	**6400**	**400**	**1333**

B Ltd

Particulars	Capital Profit	Revenue reserve	Revenue Profit
	₹	₹	₹
From C Ltd	6400	400	1333
Reserve as on 1.1.2013	8000		
Additional reserve credited in 2013	1000	1000	
P&L a/c			
Balance as on 1.1.2013	1000		
Profit during 2013	1500		1500
	17900	1400	2833
Due to outsiders - ¼	4475	350	708

Share of A Ltd	13425	1050	2125
A Ltd		18000	16000
			18125
Less: Stock reserve			600
		19050	**17525**

Notes:
During the year 2013, ₹ 1200 has been added to the Reserve of C Ltd and ₹ 2000 to the reserves of B Ltd. The profit must have been earned during the whole of the year, hence half of these figures (i.e up to 30.06.2013) must be considered as capital pre-acquisition and the remaining reserve.
Total unrealized profit is ₹ 600 i.e. 3100 less ₹ 2500

Minority Interest:

Particulars	B Ltd ₹	C Ltd ₹
Share capital	25000	20000
Share of capital profits	4475	3200
Share of revenue reserves	350	200
Share of revenue profits	708	667
Total	**30533**	**24067**

	₹	₹
Grand Total		54600
Cost of control		
Amount paid		
A Ltd	85000	
B Ltd	53000	138000
Less : Par value of shares in		
B Ltd	75000	
C Ltd	40000	
Capital Profits	13425	128425
Cost of control/Goodwill		9575

Since X Ltd shows ₹ 8000 against B Ltd whereas B Ltd shows only ₹ 7000 in favour of A Ltd., it is assumed that B Ltd has remitted ₹ 1000 to A Ltd not yet received by A Ltd. The amount is in transit.

If capital profit is increased by ₹ 1600 cost of control will be ₹ 7975.

Consolidated Balance sheet of A Ltd and its subsidiaries B Ltd C Ltd as on 31.12.2013

Liabilities	₹	**Assets**		₹
Share capital (₹ 100 each)	125000	Goodwill		9575
Reserves	19050	Fixed Assets		120400
P&L a/c	17525	Stock	28000	
Sundry Creditors	10000	Less: Reserve	600	27400
Minority interest	54600	Debtors		67800
		Cash in transit		1000
Total	**226175**	**Total**		**226175**

2 a) A change in 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 amount 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 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 whole or part of 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 be 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 they should be taken into 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, use
Ability to make proper evaluations and decisions about the future of the entity would be affected, and then they should be disclosed in the notes to the financial statements.

3 a) Part – I - Calculation of purchase consideration
W.N.1. Calculation of intrinsic value of shares

₹ in lakhs

No	Particulars	SHO ₹	THAM ₹	AN ₹
A	Land (Increase 100%)	200	100	20
B	Building (Increase 50%)	600	150	300
C	Machinery (Increase 20%)	960	600	600
D	Other fixed assets	100	200	50
E	Non- current assets	1040	1252	740
F	Investment in A Ltd (100% subsidiary company) (40 Lakh shares * ₹ 25.25)		**<u>1010</u>**	
		2900	3312	1710
G	Loans	(900)	(1000)	(700)
H	Contingent Loan (60% of ₹ 20 Lakhs)		(12)	
I	Value of net assets	2000	2300	1010
J	No of shares outstanding	100	80	40
K	Intrinsic value per share (i/j)	20	28.75	25.25

Note: First the intrinsic value of AN Ltd is calculated. Then this is used in valuing the investments made by THAM Ltd in AN Ltd

W.N.2 Purchase consideration

No	Particulars	SHO ₹	THAM ₹
A	No of shares outstanding	100	80
B	Less: Already held by PURU Ltd	(40)	(20)
C	No of shares held by outsiders	60	60
D	Value payable at intrinsic value (W.N.2c * W.n.1k)	1200	1725
E	No of shares “now issuable” at value of ₹ 20	60	86.25

Part – II - In the books of Purchasing Company PURU Ltd.

A. Takeover of SHO Ltd.

Nature of Amalgamation - Purchase (as certain assets are revalued)
Method of accounting – Purchase method

No	Particulars	Debit ₹	Credit ₹
A	Due entry		
	Business purchase a/c	1200	
	To Liquidator of SHO		1200
B	Incorporation of assets and liabilities taken over		
	Land a/c	200	
	Building a/c	600	
	Machinery a/c	960	
	Other fixed assets a/c	100	
	Net current assets a/c	1040	
	To Loans a/c		900
	To Business Purchase a/c		1200
	To investment in Sho a/c		500
	To capital reserve a/c		300
C	Discharge of consideration		
	Liquidator of Sho	1200	
	To equity shareholders a/c (60*10)		600
	To securities premium(60*10)		600

B. Takeover of THAM and AN simultaneously

Nature of Amalgamation - Purchase (as certain assets are revalued)
Method of accounting – Purchase

No	Particulars	Debit ₹	Credit ₹
A	Due entry		
	Business Purchase a/c	1725	
	To Liquidator of Tham Ltd a/c		1725
B	Incorporation of assets and liabilities		
	Land a/c (100+20)		
	Building a/c (150+300)	120	
	Machinery (600+600)	450	

	Other fixed assets (200+50) Net current assets(1252+740) To Loans (1000+12+700) To contingent loan payable (40% of 20) To business purchase To investment in Them Ltd To capital reserve a/c	1200 250 1992	 1712 8 1725 300 267
C	Discharge of consideration Liquidator of THAM Ltd	1725	
	To equity share capital To share premium		862.5 862.5
D	Settlement of Contingent Loan Contingent Liability Loan	8	
	To Net current assets		**8**

Part – III

Balance sheet of PURU Ltd as at 1st April 2014 (after amalgamation)

NO	Particulars	Debit ₹	Credit ₹
I	Equity and Liabilities		
	Shareholders' Funds a. Share capital b. Reserves & Surplus	 1 2	 2962.5 4029.5
2	Non-current Liabilities Long term borrowings (Loans) (₹ 1600+900+1012+700)		 4212
	Total		11204
II	Assets		
1	Non-current assets a. Fixed assets Tangible B. Noncurrent investments	 3	 6480 100
	Non-current assets (₹ 1600+1040+1252+740-8)		4624
	Total		**11204**

Notes to the Financial Statements

1) Share capital

No	Particulars	₹
A	Authorised	
B	Issued, Subscribed & Fully paid up 29625000 equity shares of ₹ 10 each (₹ 1500+600+862.5) (Of the above ₹ 60 lakh shares were issued to SHO Ltd and ₹ 86.25 lakhs shares were issued to THAM Ltd as fully paid up for consideration other than cash)	 2962.50

2) Reserves and Surplus

No	Particulars	₹
A	Capital reserve	567.00
B	Securities premium	1462.5
pC	Other reserves	2000
		4029.5

3) Tangible asset

No	Particulars	₹
A	Land (₹ 200+200+100+20)	520
B	Building (₹ 500+600+150+300)	1550
C	Machinery (₹ 1500+960+600+600)	3660
D	Other fixed assets(₹ 400+100+200+50)	750
		6480

Assumptions
Loans are assumed to be long term

PRIME ACADEMY
39TH SESSION PROGRESS TEST
STRATEGIC FINANCIAL MANAGEMENT

No. of Pages: 3 **Total Marks: 75**
Time Allowed: 2Hrs

PART- A
(All questions carry 5 Marks each)

1. T Ltd. is considering an investment in one of the two mutually exclusive proposals – Projects X and Y, which require cash outlays of ₹ 3,40,000 and ₹ 3,30,000 respectively. The certainty-equivalent (C.E.) approach is used in incorporating risk in capital budgeting decisions. The current yield on government bond is 8% and cost of capital is 14%. The expected net cash flows and their certainty-equivalents are as follows:

	Project X		Project Y	
Year-end	Cash flow ₹	C.E.	Cash flow ₹	C.E.
1	1,80,000	.8	1,80,000	.9
2	2,00,000	.7	1,80,000	.8
3	2,00,000	.5	2,00,000	.7

Which project should be accepted?

2. ABC Ltd. issued 9%, 5 year bonds of ₹ 1,000/- each having a maturity of 3 years The present rate of interest is 12% for one year tenure. It is expected that Forward rate of interest for one year tenure is going to fall by 75 basis points and further by 50 basis points for every next year in further for the same tenure. This bond has a beta value of 1.02 and is more popular in the market due to less credit risk.
Calculate
    (i) Intrinsic value of bond
    (ii) Expected price of bond in the market

3. You, a foreign exchange dealer of your bank, are informed that your bank has sold a T.T. on Copenhagen for Danish Kroner 10,00,000 at the rate of Danish Kroner 1 = ₹ 6.5150. You are required to cover the transaction either in London or New York market. The rates on that date are as under:

Mumbai-London	₹ 74.3000	₹ 74.3200
Mumbai-New York	₹ 49.2500	₹ 49.2625
London-Copenhagen	DKK 11.4200	DKK 11.4350
New York-Copenhagen	DKK 07.5670	DKK 07.5840

In which market will you cover the transaction, London or New York, and what will be the exchange profit or loss on the transaction? Ignore brokerages.

4. 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. How much NZD should you sell to get ₹ 50,000
    c. Calculate the appreciation/depreciation percentage of INR

5. 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?
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.

PART B

(Answer any Five. All questions carry 10 Marks each)

1. GHI Ltd, AAA rated Company, has issued fully convertible bonds on the following terms, a year ago:
Face Value of Bond : ₹ 1,000
Coupon (Interest Rate) : 8.5%
Time to Maturity (remaining) : 3 years
Interest Payment : Annual, at the end of year
Principal Repayment : At the end of bond maturity
Conversion Ratio (Number of Shares per Bond) : 25
Current Market Price per Share ₹ 45
Market Price of Convertible Bond ₹ 1,175
AAA rated Company can issue Plain Vanilla Bonds without conversion option, at an interest rate of 9.5%.
Required: Calculate as of today:
(i) Straight Value of the Bond.
(ii) Conversion Value of the Bond.
(iii) Conversion Premium.
(iv) Percentage of Downside Risk.
(v) Conversion Parity Price.

2. XYZ Ltd. is planning to procure a machine at an investment of ₹ 40 lakhs. The expected cash flow after tax for next three years is as follows : (₹ In Lakhs)

Year – 1		Year – 2		Year - 3	
CFAT	Probability	CFAT	Probability	CFAT	Probability
12	0.1	12	0.1	18	0.2
15	0.2	18	0.3	20	0.5
18	0.4	30	0.4	32	0.2
32	0.3	40	0.2	45	0.1

The Company wishes to consider all possible risks factors relating to the machine. The Company wants to know:
(i) The expected NPV of this proposal assuming independent probability distribution with 7% risk free rate of interest.
(ii) The possible deviations on expected values.

3. X Ltd has an internal rate of return @ 20%. It has declared dividend @18% on its equity shares, having face value of `10 each. The payout ratio is 36% and Price Earning Ratio is 7.25. Find the cost of equity according to Walter's Model and hence determine the limiting value of its shares in case the payout ratio is varied as per the said model.

4. Z Ltd. importing goods worth USD 2 million requires 90 days to make the payment. The overseas supplier has offered a 60 days interest free credit period and for additional credit for 30 days at an interest of 8% per annum.
   The bankers of Z Ltd offer a 30 days loan at 10% per annum and their quote for foreign exchange is as follows:
   Spot 1 USD ₹ 56.50
   60 days forward for 1 USD- ₹ 57.10
   90 days forward for 1 USD 57.50
   You are required to evaluate the following options:
   (i) Pay the supplier in 60 days, or
   (ii) Avail the supplier's offer of 90 days credit

5. The Easygoing Company Limited is considering a new project with initial investment, for a product "Survival". It is estimated that IRR of the project is 16% having an estimated life of 5 years Financial Manager has studied the project with sensitivity analysis and informed that annual fixed cost sensitivity is 7.8416%,whereas cost of capital (discount rate) sensitivity is 60%.Other information available are:
   Profit Volume ratio (P/V) is 70%,
   Variable cost ₹60/- per unit
   Annual Cash Flow ₹ 57,500/-
   Ignore Depreciation on initial investment and impact of taxation.
   Calculate
   (i) Initial Investment of the Project
   (ii) Net Present Value of the Project
   (iii) Annual Fixed Cost
   (iv) Estimated annual unit of sales
   (v) Break Even Units

6. In December, 2013 AB Co.'s share was sold for ₹ 146 per share. A long term earnings growth rate of 7.5% is anticipated. AB Co. is expected to pay dividend of ₹ 3.36 per share.
   (i) What rate of return an investor can expect to earn assuming that dividends are expected to grow along with earnings at 7.5% per year in perpetuity?
   (ii) It is expected that AB Co. will earn about 10% on book Equity and shall retain 60% of earnings. In this case, whether, there would be any change in growth rate and cost of Equity?
   (iii) If the investor's expected rate of return is 18% and the growth rate is as in (i) above, calculate the intrinsic value of the share.

PRIME ACADEMY
39th SESSION – FINAL – PROGRESS TEST - STRATEGIC FINANCIAL MANAGEMENT
SUGGESTED ANSWERS

1.

Statement showing Net Present Value of Project X

Year-end	Cash flow ₹	C.E.	Adjusted Cash flow ₹	Present value factor at 8%	Total present value ₹
	(a)	(b)	(c) = (a) × (b)	(d)	(e) = (c) × (d)
1	1,80,000	0.8	1,44,000	0.926	1,33,344
2	2,00,000	0.7	1,40,000	0.857	1,19,980
3	2,00,000	0.5	1,00,000	0.794	79,400
					3,32,724
Less: Initial investment					3,40,000
Net present value					(7,276)

Statement showing the Net Present Value of Project Y

Year-end	Cash flow ₹	C.E.	Adjusted Cash flow ₹	Present value factor	Total present value ₹
	(a)	(b)	(c) = (a) × (b)	(d)	(e) = (c) × (d)
1	1,80,000	0.9	1,62,000	0.926	1,50,012
2	1,80,000	0.8	1,44,000	0.857	1,23,408
3	2,00,000	0.7	1,40,000	0.794	1,11,160
					3,84,580
Less: Initial investment					3,30,000
Net present value					54,580

2.

Intrinsic value of Bond = PV of Interest + PV of Maturity Value of Bond Forward rate of interests

Year	Interest rates (%)
1	12
2	11.25
3	10.75

Year	Cash flow	Discount factor	DCF
1	90	1/(1.12)	80.36
2	90	1/ (1.12 x1.1125)	72.23
3	90	1/(1.12x 1.1125x1.1075)	65.22
3	1000	1/(1.12x 1.1125x1.1075)	724.67
Total			**942.48**

Intrinsic value of Bond = ₹ 942.48

(ii) Expected Price = Intrinsic Value x Beta Value

= ₹ 942.48 x 1.02 = ₹ 961.33

3.

Bank Sold Danish Kroner for ₹ 6.5150

Bank covers the above transaction by buying Danish kroner.(It buys so the other bank sells, so relevant rate is ASk (₹/ DKR)

Cover at London:

Ask(Rs/ DKR)	=	Ask(Rs/ UKP) x Ask(UKP/ DKR)
	=	74.32 x 1/ Bid (DKR/UKP)
	=	74.32 x 1/11.42 = ₹6.5079

Cover at New York:

Ask(Rs/ DKR)	=	Ask(Rs/ $) x Ask($/ DKR)
	=	49.2625 x 1/ Bid (DKR/$)
	=	49.2625 x 1/7.5670 = ₹6.5102

The transaction would be covered through London which gets the maximum profit:
(₹6.5150 - ₹ 6.5079)x 10Lakhs = ₹ 7100

4.

Spot Rate	51.0393	51.1700	
Swap points	30	20	(Swap A< B hence deduct)
1 month forward rate	51.0363	51.1680	

Product in the quote is NZD and price INR
When we sell INR, we buy NZD so bank sells and hence relevant rate is Ask rate

₹ 50,000 =	=50,000/51.1700 =	977.135 NZ Dat spot
₹ 50,000 =	=50,000/51.1680=	977.173 NZD at 1 month forward rate

5.

1. As per MM Model
   $P_0 = (D_1 + P_1)/(1 + k_e)$
   (i) When Dividend is not declared:
   P_0 = 100(given), D_1 = 0 and k_e = 10%
   100 = (0 + P_1)/ (1 +.10), P_1 = ₹110.

   (ii) When Dividend is declared:
   P_0 = 100(given), D_1 = 15 and k_e = 10%
   100 = (15 + P_1)/ (1 +.10), P_1 = ₹ 95

PAT		600,000
Less dividend paid:	15 x 10,000	150,000
Retained earnings		450,000
Investment		12,00,000
Less: retained earnings		450,000
Fresh issue		750,000
No: of shares @ 95		7,894.74

i.e 7895 shares.

Part B

1.

1. Straight Value of the Bond	=	Present Value of Future Cash Flows from a Bond discounted at 9.5%
	=	PV of Interest @ 8.5% on ₹ 1,000 for 3 years + PV Terminal Inflow of ₹ 1,000 at the end of 3rd Year
Note: 0.9132 + 0.8340 + 0.7617 = 2.5099	=	(1,000 x 8.5% x 2.5099) + (1,000 x 0.7617)

= 974.95 = ₹ 975

2.	Conversion Value of the Bond	= Value, if the Bond is converted into Shares = Number of Shares on Conversion x Market Value per Share = 25 Shares x ₹ 45 = ₹ 1,125
3.	Conversion Premium	= Market Price of the Convertible Bond – Conversion Value = ₹ 1,175 – ₹ 1,125 = ₹ 50

4.	Percentage of Downside Risk	(1175-975)/975=	20.51%
5	Conversion Parity Price	Market Price of Convertible Bond/No: of shares on conversion	1175/25 = ₹47

2.

								(₹ in lakhs)
Year I			Year II			Year III		
CFAT	P	CF×P	CFAT	P	CF×P	CFAT	P	CF×P
12	0.1	1.2	12	0.1	1.2	18	0.2	3.6
15	0.2	3.0	18	0.3	5.4	20	0.5	10
18	0.4	7.2	30	0.4	12	32	0.2	6.4
32	0.3	9.6	40	0.2	8	45	0.1	4.5
	x or CF	21.		x or CF	26.60			x or CF 24.50

NPV (₹in lakhs)	PV factor @ 7%	Total PV (₹ in lakhs)
21	0.935	19.635
26.60	0.873	23.222
24.50	0.816	19.992
PV of cash inflow		62.849
Less: Cash outflow		(40.000)
	NPV	22.849

1 Possible deviation in the expected value

Year I

X - X	X - X	(X - X)2	P1	(X - X)2 P1
12 – 21	-9	81	0.1	8.10
15 – 21	-6	36	0.2	7.2
18 – 21	-3	9	0.4	3.6
32 – 21	11	121	0.3	36.30
				55.20

SD = Sq. Root of 55.20 = 7.43

Year II

X - X	X - X	(X - X)2	P2	(X - X)2 ×P2
12-26.60	-14.60	213.16	0.1	21.32
18-26.60	-8.60	73.96	0.3	22.19
30-26.60	3.40	11.56	0.4	4.62
40-26.60	13.40	179.56	0.2	35.91
				84.04

SD = Sq. Root of 84.40 = 9.17

Year III

X - X	X - X	(X - X)2	P3	(X - X)2 × P3
18-24.50	-6.50	42.25	0.2	8.45
20-24.50	-4.50	20.25	0.5	10.13
32-24.50	7.50	56.25	0.2	11.25
45-24.50	20.50	420.25	0.1	42.03
				71.86

SD = Sq. Root of 71.86 = 8.48

Standard deviation is the Sq.root of (aggregate of variance double discounted) = 12.6574

3. According to Walter's approach: P =

$$\frac{D\left(\frac{r}{K_e}\right)(E-D)}{K_e}$$

where P = Market price per share, D = Dividend per share, E = Earnings per share, r = Return earned on investment, K_e = Cost of equity capital

P = EPS x PE ratio = 5 x 7.25 = ₹ 36.25,D = 18% x 10 = ₹ 1.8 per share, E = ₹ 5 per share

r = 0.2,36.25 = $\frac{1.8+\left(\frac{0.2}{K_e}\right)(E-D)}{K_e}$

36.25 K_e- 1.8 - 0.64 = 0 ; Solving the quadratic equation gives K_e=0.16 or -0.11.

As Cost of equity cannot be negative, it is taken as 16%.

As internal rate of return is greater than cost of equity, value of share is maximum when payout is zero and minimum when payout is 100%, which define the limits for the value of shares.

When payout ratio is zero, P = $\frac{0+\left(\frac{0.2}{0.16}\right)(5-0)}{0.16}$= ₹ 39.06

When payout ratio is 100%, P == $\frac{5+\left(\frac{0.2}{0.16}\right)(5-5)}{0.16}$= ₹ 31.25

4.

(i) Pay supplier in 60 days
USD required after 60 days = USD 20Lakhs
60 days forward rate for USD = ₹ 57.10
INR required after 60 days = ₹ 20Lakhs x 57.10 = 1142 Lakhs.
Interest at 10%p.a = 1142 Lakhs x 10% x 30/360= ₹ 9,51,667
Total payment including interest = 11,51,51,667

(ii) Pay supplier in 90 days

USD required after 60 days = USD 20Lakhs + interest

Interest at 8%p.a = 20Lakhs x 8% x 30/360= 13,333USD

USD required after 90 days = 20 lakhs + 13,333= 20,13,333USD

90 days forward rate for USD = ₹57.50

INR required after 690 days = ₹ 20,13,333 x 57.50

= ₹ 11,57,66,648

Option (i) is lower and hence better.

5.

(i) Initial Investment

IRR = 16% (Given) At IRR, NPV shall be zero, therefore

Initial Cost of Investment = PVAF (16%,5) x Cash Flow (Annual)

= 3.274 x ₹ 57,500

= ₹ 1,88,255

(ii) Net Present Value (NPV)

Let Cost of Capital be X, then

16 – X/ X = 60%

X = 10% , NPV @10%

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

= ₹ 57,500 x 3.791 – ₹ 1,88,255

= ₹ 2,17,982.50 – ₹ 1,88,255 = ₹ 29,727.50

(iii) Annual Fixed Cost

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

₹ 29,727.50 – 3.791X = 0 Thus X = ₹ 7,841.60

Let original Fixed Cost be Y then, Y × 7.8416% = ₹ 7,841.60

Y = ₹ 1,00,000

Thus Fixed Cost is equal to ₹ 1,00,000

(iv) Estimated Annual Units of Sales

Selling Price per unit = ₹ 60/(100% - 70%)

= ₹ 200

Annual Cash Flow + Fixed Cost =Sales Value P/V Ratio

57,500 + ₹1,00,000/ 0.70

=₹2,25,000

Sales in Units = 1125

(v) Break Even Units

Fixed Cost = ₹ 1,00,000 / Contribution Per Unit (140)

= 714.285 units

6.

(i) Ke = D1/ P0 + g

=3.36/146 + .075

0.09801 i.e 9.8%

(ii) r= 10% and b = 60%.

growth (g) = b x r= 60% of 10 = 6%

Ke =3.36/146 + .06

= 8.30%

(iii)

Intrinsic value(P0) =

= D1/ Ke-g

= 3.36/.18-.075

= ₹ 32

PRIME ACADEMY
39th SESSION PROGRESS TEST
ADVANCED AUDITING AND PROFESSIONAL ETHICS

No. of pages: 3 **Total marks: 75**
Time Allowed: 2 Hrs

PART - A

1) A systematic process of evaluating an organisations effectiveness, efficiency and economy of operations under the managements control is referred as
   a) Management audit
   b) Operational audit
   c) Internal audit
   d) System audit (1 Mark)

2) 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 (1 Mark)

3) The objective of an auditor in preparing the documentation is to ensure that the 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)

4) 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 judgement requires special audit consideration. Such risk is called as
   a) Audit risk
   b) Inherent risk
   c) Assessed risk
   d) Significant risk (1 Mark)

5) In respect of the work entrusted to the other auditors, the level of responsibility of the principal auditor is
   a) Nil
   b) Fully responsible
   c) The principal auditor would not be responsible unless some suspicion arises about the reliability of the work performed by the other auditor
   d) None of the above (1 Mark)

6) The purpose of the standards of auditing is to
   a) Provide guidance to the member of ICAI
   b) Enhance confidence to the members of institute
   c) Enhance the degree of confident if intended users in the Financial Statements
   d) All of the above (1 Mark)

7) Write short notes on sampling risk? (3 Marks)

8) The concept of materiality to be applied in
    a) Planning the audit
    b) Performing the audit
    c) Planning and performing of audit
    d) Concluding the audit (1 Mark)

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

10) 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)

11) EDP accounting system are classified as
    a) Processing systems
    b) File systems
    c) Hardware Configurations
    d) All of the above (1 Mark)

12) Control over input
    a) General EDP controls
    b) EDP application controls
    c) Administrative controls
    d) Procedural controls (1 Mark)

13) EDI stands for
    a) Electronic Data Input
    b) Electronic Data Information
    c) Electronic Data Interchange
    d) Electronic Data Index (1 Mark)

14) CIS infrastructure refers to
    a) Hardware
    b) Operating system
    c) Application software
    d) All of the above (1 Mark)

15) Financial statement are
    a) Audited statement of accounts
    b) P&L account statement
    c) Statement of facts and figures
    d) Statements prepared for a financial period presented.

16) Individual transactions entered added to transaction file after checks and validation is known as

   a) On-line batch processing system
   b) On-line real time processing system
   c) Batch processing system
   d) None of the above (1 Mark)

17) On-line System falls under

   a) Hardware Configuration System
   b) On-line computer system
   c) Personal computer system
   d) All of the above (1 Mark)

18. List the matters to be included in the Auditors report in the case of Non Banking Financial Companies (NBFC) accepting or holding deposits (5 Marks)

PART - B

1. Discuss the following based on the provisions of CA Act, rules and guidelines

   a) A firm of practicing Chartered Accountants advertised in a newspaper regarding a get together party arranged for the members of the institute to celebrate its Silver Jubilee year.

   b) Mr.Alex, a practicing Chartered Accountant has mentioned on the letter heads and his visiting cards, the year of establishment of the firm in which he is partner

   c) Mr.Haridoss a member in practice accepted his appointment as auditor after intimating his appointment over the phone to the previous auditor

   d) Joe, a CA in practice, during the course of audit of M/s Joy Limited came to know that the company has taken a loan of ₹ 10 lakhs from EPF. The said loan was not reflected in the books of account. However, the auditor ignored this information in this report

(4 x 5= 20 Marks)

2. a) What are the important steps involved while conducting Investigation on behalf of incoming partner? (8 Marks)

   b) Write short notes on Special report to Register of Co-operative Societies? (4 Marks)

   c) What are the areas to be considered in an Environmental Audit? (8 Marks)

3. As an concurrent auditor of Z Bank Ltd you are requested by its management to draft an internal control policy in respect of loans and advances. What factors do you consider as important while drafting such a policy? (10 Marks)

PRIME ACADEMY
39th SESSION - FINAL - PROGRESS TEST
ADVANCED AUDITING AND PROFESSIONAL ETHICS
- SUGGESTED ANSWERS
PART-A

1) b
2) d
3) a
4) d
5) c
6) c
7) Sampling risk: The risk that the auditors conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk leads to 2 types of erroneous conclusions:
   a. In the case of test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist but it actually does. This affects audit effectiveness and leads to inappropriate opinion
   b. In the case of test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist but it actually does. This leads to additional work to establish that initial conclusions were incorrect.
8) c
9) a
10) a
11) d
12) b
13) c
14) d
15) d
16) c
17) a
18) Matters to be included in the Auditors report in case of NBFC accepting or holding public deposits:
    The auditors are required to make a separate report to BoD and the RBI for every financial year as per the Non Banking Companies Auditors Report (RBI) Direction 1998, in addition to the reporting obligations u/s 227 of the companies Act, 1956.
   1. Reporting requirements: The auditor shall make a statement on the following matters together with reasons in case of any unfavourable or qualified statement.
      a. Registration: Whether the NBFC has obtained certificate of registration or applied for registration
      b. Communication from RBI: Whether the NBFC has received any communication from RBI refusing grant of Certificate of registration
   2. NBFCs accepting/holding public deposits:
      i. Limit on public deposits: Whether the public deposits and the following borrowings are within the permissible limits:
         a. Borrowing from public by issue of unsecured non-convertible debentures/bonds
         b. Borrowing from its shareholders by a public limited company and
         c. Other deposits within the definition of “Public Deposit” in the NBFC Direction, 1998.

ii. Credit rating: Whether credit rating for fixed deposits assigned by the credit rating agency is done
iii. Limit on fixed deposits: Whether aggregate amount of FDs outstanding at any point of time during the year has exceeded the limit specified in the credit rating agency
iv. Default: Whether the NBFC has defaulted in paying its Depositors the interest/principal amount of the deposits after such interest/principal became due
v. Prudential norms: Whether the NBFC has complied with the NBFC 1998, in relation to Income recognition. According standards, classification, provisioning for bad and doubtful debts and concentration of credit/investment.
vi. Capital adequacy: Whether the capital adequacy ratio disclosed in the return submitted to the RBI is correctly determined and whether such ratio is in compliance with the minimum capital to Risk asset ratio prescribed by the RBI
vii. Liquidity: Whether the NBFC has complied with the prescribed liquidity requirement and kept the approved securities with designated bank.
Viii. Return of Deposits: Whether the NBFC has furnished the return of deposits to RBI within the stipulated period as required

PART - B

1 a. As per clause 6, Part 1 of First Schedule to the Chartered Accountants Act,1949, a member in practice is guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by another means. Likewise, a member may be held guilty of professional misconduct if he advertises his professional attainments as per clause 7.

However, ICAI has clarified that, while considering the implications of clause 6 & clause 7 ofpart I of the First Schedule of the Act in relation to such advertisements and also the need of interpersonal socialization/relationship of the members through such get-together occasions, the advertisement for Silver, Diamond, Platinum and centenary celebrations of the firm has been permitted to be published in any newspaper or newspapers.

b. As per the Central Council direction given under Clause (7) of Part I of the First Schedule to the Chartered Accountants Act, the date of setting up of the firm on the letterheads and the professional documents, etc. should not be mentioned. However, in the Website, the year of establishment can be given on a specific “pull” request.

Hence, in the given case Mr. Alex is not allowed to mention the year of establishment of the firm on the letter head or visiting card and any such act would result in violation of the Central Council direction.

c. As per Clause 8, Part I of First Schedule to the Chartered Accountants act, a member in practice may be held guilty of professional misconduct, if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing; In the given case, Mr. Haridoss can not accept his appointment as auditor without communicating to the other auditor in writing.

d. Failure to disclose material facts:

As per Clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered Accountant in practice will be held liable for misconduct if he fails to disclose a material fact known to him, which is not disclosed in the financial statements but disclosureof which is necessary to make the financial statements not misleading.

In this case, Mr. Joe has come across information that a loan of ` 10 lakhs has been taken by the company from Employees Provident Fund. This is contravention of Rules and the said loan has not been reflected in the books of accounts.

Further, this material fact has also to be disclosed in the financial statements. The very fact that Mr. Joe has failed to disclose this fact in his report, he is attracted by the provisions of professional misconduct under clause (5) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

2 a) Steps involved while conducting investigation on behalf of an incoming partner:

The general approach of the investigating accountant in this type of investigation would be more or less similar, irrespective of the nature of business of the firm-manufacturing, trading or rendering a service.

Primarily, an incoming partner would be interested to know whether the terms offered to him reasonable having regard to the nature of the business, profit records, capital distribution, personal capability of the existing partners, socio-economic setting, etc., and whether he would be capable of deriving continuing benefit in the shape of return on capital to be contributed and remuneration for services to be rendered, which can be justified by the overall economic conditions prevailing and other considerations considering his own personality and achievements. In addition, he would be interested to ascertain whether the capital to be contributed by him would be safe and applied usefully.

Broadly, the steps involved are the following:

a) Ascertainment of the history of the inception and growth of the firm.
b) Study of the provisions of the deed of partnership, particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, financial management, goodwill, etc.
c) Scrutiny of the record of profitability of the firm's business over a suitable number of years, with usual adjustments that are necessary in ascertaining the true record of business profits.
Particular attention should, however, be paid to the nature of partners' remuneration, which may be excessive or inadequate in relation to the nature and profitability of the business, qualification and expertise of the partners and such other factors as may be relevant.
d) Examination of the asset and liability position to determine the tangible asset backing for the partner's investment, appraisal of the value of intangibles like goodwill, know how, patents, etc. impending liabilities including contingent liabilities and those for pending tax assessment. Incase of firms rendering services, the question of tangible asset backing usually is not important, provided the firm's profit record, business coverage and standing of the partners are of the acceptable order.
e) Position of orders at hand and the range and quality of clientele should be thoroughly examined, which the firm is presently operating.
f) Position and terms of loan finance would call for careful scrutiny to assess its usefulness and implication for the overall financial position; reason for its absence should be studied.
g) It would be interesting to study the composition and quality of key personnel employed by the firm and any likelihood of their leaving the organization in the near future.
h) Various important contractual and legal obligations should be ascertained and their nature studied. It may be the case that the firm has standing agreement with the employees as regards salary and wages, bonus, gratuity and other incidental benefits .Full import of such standing agreements would be gauged before a final decision is reached.

i) Reasons for the offer of admission to a new partner should be ascertained and it should be determined whether the same synchronizes with the retirement of any senior partner whose association may have had considerable bearing on the firm's success.
j) Appraisal of the record of capital employed and the rate of return. It is necessary to have a comparison with alternative business avenues for investments and evaluation of possible result son a changed capital and organization structure, if any, envisaged along with the admission of the partner.
k) It would be useful to have a firsthand knowledge about the specialization, if any, attained by the firm in any of its activities.
l) Manner of computation of goodwill on admission as also on retirement, if any, should be ascertained.
m) Whether any special clause exists in the deed of partnership to allow admission in future of anew partner, who may be specified, on concessional terms.
n) Whether the incomplete contracts which will be transferred to the reconstituted firm will be a liability or a loss.

It would always be worthwhile to remember that, in a partnership, personal considerations count predominantly over other considerations and assessment of standing of the firm, standing and reliability of other partners, their personal reputation and the goodwill enjoyed by the products/services are important.

On the basis of the broad frame of considerations as given above, the investigating accountant should devise his own considerations in each case which may be quite diverse.

Additional considerations may come up in the case of service-rendering firms where profit and business record, goodwill of the firm and of individual partners would assume greater significance. Again, in the case of industrial firms, the network of customers, their scatter, size, etc., would be relevant for consideration.

b) Special Report to the Registrar:

The auditors are required to report on number of matters as prescribed in various states. In addition to the main report, the auditors are also required to submit by way of schedules/audit memorandum information on the working of the company as well.

During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society he may report these special matters to the Registrar, drawing his specific attention to the points.

The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance a special report may become necessary:

a. Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.
b. Detection of fraud relating to expenses, purchases, property and stores of the society.
c. Specific examples of miss-management. Decisions of management against cooperative principles.
d. In the case of urban co-operative banks, disproportionate advances to vested interest groups, such as relatives of management, and deliberate negligence about the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.

c) Main areas to be considered in an Environmental audit:

i) Layout and Design – The layout to be sketched in the style which will allow adequate provisions for installing pollution control devices, as well as provision for up gradation of pollution control measures and the meeting of the requirements of the regulations framed by the Government. In the course of the audit, the area which requires attention but not attended to by the industry to be pinpointed as well as the future requirements of the environmental measures required in commensuration with the proposed future course of working plan are to be identified.

ii) Management of Resources – Management resources includes air, water, land, energy, raw materials and human resources besides others. The use of all resources is interlinked and the best uses in a synchronized manner results the best output and minimum waste. The waste of resources to the minimum possible extent is good for the health of the industry as well as the environment.
iii) Pollution Control System – An effective system of pollution control should be in existence. One aspect should be whether all required pollution control measures are in vogue or not next aspect should be whether the same is effective or not, further it is to investigate, whether more measures are required, keeping ill view the type of industry and it's nature of working with respect to it's grade of polluting the environment.
iv) Emergent Safety Arrangement – The chemical, gas, etc., industries which are prone to sudden requirement of safety arrangements, must remain alert all the while. The emergency plans are to be reviewed periodically; sufficient staff along with other required safety amenities should be kept ready. The staff, remained so engaged, must possess the required awareness and alertness to meet the contingency. The degree of awareness, however, can be upgraded with proper training provisions.
v) Medical & Healthcare Facilities – The medical services should be maintained. The health of the workers should be a big consideration for the management.
vi) Industrial Hygiene – Proper system should be in vogue to eliminate industrial unhygienic state.
vii) Occupational Health – The requirement for safeguarding against occupational health hazards should be available for all the workers. As the occupational health hazards varies from industry to industry due to the difference in the nature of working atmosphere and the pollutants present in it, the concerned industry must pay proper weight age to those diseases which are prone to that particular type of industry.
viii) Information Assimilation and Reporting System – The information system should be strengthened to generate and its reporting system should be proper, keeping in view, the authorities, responsibilities and subsequent delegations. A report of compliance of all statutory environmental laws along with other preventive and precautionary measures should be put to Board at regular intervals.
ix) EIA Methodology – The Environmental Impact Assessment (EIA) is usually are prerequisites to start an industry. This is done considering the known spheres of activities on the existing environmental conditions. But the predictions necessarily deviate from the actual happenings when the industry starts working. To accommodate the deviation in the system is also to be incorporated in the EIA report, if it is noticed that the degradation to the environment caused on the establishment and running of the industry is much higher than what was predicted, the initiatory measures suggested must also be furthered.
x) Compliance to the Regulatory Mechanism – As the persons who are directly working with the system, may be unaware of the latest developments and requirements for the compliance of stipulations and standards prescribed by the various regulatory authorities, they should be trained and instructed on regular basis, to avoid making the Board/owner vulnerable to prosecution and penalty.
xi) Concern for the Society – The industry very often transforms the agrarian environment into an industrial environment. The people so displaced by industrialization feel alienated and develop a feeling of facing the gaseous, dustful, clumsy state of surroundings. The audit should look into this aspect how the industry is making a balance between its own development and the society's concern

3. Factors to be considered for drafting of internal control policy for loans and advances:

i) The bank should make advances only after satisfying itself as to the creditworthiness of the borrowers and after obtaining sanction from
ii) All the necessary documents (e.g agreement, demand promissory note, letter of hypothetication etc) should be executed by the parties before advances are made.
iii) Sufficient margin should be kept against securities taken so as to cover any decline in the value thereof and also to comply with the reserve bank directives. Such margins should be determined by the proper authorities of the bank as a general policy or for particular accounts.
iv) All the securities should be received and returned by responsible officer. They should be kept in the judicial custody of 2 such officers
v) All securities requiring registration should be registered in the name of bank or otherwise accompanied by the documents sufficient to give the title of the bank.
vi) In the case of goods in the possession of the bank, contents of the package should be test checked at the time of receipts. The goods should be regularly and frequently inspected by a responsible officer of the branch concerned in addition by th inspector of the bank.
vii) Surprise check should be made in respect of hypothecated goods not in the possession of the bank.
viii) The submission of claims of DIGGC and EGGC should be on time
ix) The classification of advance should be as per RBI
x) LOC issued by the branch should be within the delegated power and should be for genuine trade transactions
xi) All accounts should be kept within both the drawing power and sanctioned limit at all times.

PRIME ACADEMY
39th SESSION - PROGRESS TEST
CORPORATE AND ALLIED LAWS

No of Pages: 3 **Total Marks: 75**
Time Allowed: 2 Hrs

PART - A
(Each blank carries one Mark)

I. Fill in the blanks with respect to the provisions of the new companies act, 2013.

1. According to section 127 of the companies act, 2013 dividend has to be paid within _________ days from the Date of _____________

2. Dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for __________only after transfer to __________of such percentage of profits not exceeding ___________

3. According to section 161(4) of the Companies Act, 2013, if office of any director who was appointed at the general meeting is vacated before he is due to retire on normal course, such casual vacancy can be filled in by the_________________

4. Small shareholders' director can be appointed for a maximum period of _________ subject to meeting the requirements of provisions of Companies Act except that he is not required to retire by__________.

5. Proportional representation can be by way of ______ transferable vote or _______ voting.

6. no company shall make any loan/ guarantee/security for a loan/purchase the securities exceeding __________(paid up share capital + free reserves) or _____ (Free reserves) whichever is more.

7. According to section 202 of the Companies Act, 2013, (compensation for loss of office), The compensation payable shall be on the basis of average remuneration actually earned by such persons for _________ years

8. ______and _________are not allowed to contribute to any political party as per section 182(1) of the Companies Act, 2013.

II. Give reasons. Each question carries two marks.

1. XYZ Company Ltd. in its annual general meeting appointed all its directors by passing one single resolution. No objection was made to the resolution. Is this valid?
2. Mr. John has been appointed as Additional Director on the Board of MCX Ltd. on 12th January, 2013. Mr. John has filed his consent to Act as a Director, if appointed, only with the company. Examine with reference to the provisions of the Companies Act, 1956 whether he is also required to file his consent with the Registrar of Companies.
3. A company has in its Articles of Association provided for appointment of not less than two-thirds of the total number of its directors according to the principle of proportional representation. (Companies act, 2013)

4. Can an additional director continue to be in office where the annual general meeting is not held as per section 166?
5. A managing or governing or whole-term director cannot resign merely by giving a notice.

PART - B **(50 Marks)**

Question 1 is compulsory. Answer any **four** from the rest.

1. (a) DVJ Ltd, a company incorporated under the Companies Act, 1956 applies to Bombay Stock Exchange for listing of its shares. The Stock Exchange refuses to grant listing without assigning any reasons for refusal. Company seeks your advice on the options available to it against the Stock Exchange and wants to move the Court. Examining the provisions of the Securities Contracts (Regulation) Act, 1956, advise the company. **(5 Marks)**

   (b) The Securities and Exchange Board of India issued an order against a stock broker to redress the grievances of the investors within the stipulated time. The stock broker failed to do so, which is an offence under the provisions of the Securities Contracts (Regulation) Act, 1956. Decide:
   (i) Whether the offence committed by the stock broker is compoundable? If so, by whom?
   (ii) Whether this offence can be compounded after institution of proceedings against the stock broker? **(5 Marks)**

2. Hi-tech Engineering Limited engaged in the business of engineering construction and cement manufacturing, decided to concentrate on its core business of engineering construction and hive off (demerge) its cement business in favour of Premier Cement Limited. State the steps to be taken by Hi-tech Engineering Limited to give effect to the proposed demerger under the provisions of the Companies Act, 1956. **(10 Marks)**

3. (a) In ABC Ltd. three Directors were to be appointed. The item was included in agenda for the Annual General Meeting scheduled on 30th September, 2010, under the category of 'Ordinary Business'. All the three persons as proposed by the Board of directors were elected as directors of the company by passing a 'single resolution' avoiding the repetition (multiplicity) of resolution. After the three directors joined the Board, certain members objected to their appointment and the resolution. Examine the provisions of Companies' Act, 2013 and decide: Whether the contention of the members shall be tenable and whether both the appointment of Directors and the 'single resolution' passed at the Company's Annual General Meeting shall be void. **(5 Marks)**

   (b) When dividend is to be kept in abeyance? **(5 Marks)**

4 a) Explain with reference to the provisions of companies act, 2013 – appointment of nominee director and appointment of casual vacancy. **(5 Marks)**

b) The profits of MJR Company Limited for the financial year 2009-2010 fell considerably due to recession. The Board of directors of the company, therefore, bona fide did not recommend any dividend for the year. At the Annual General Meeting of the company, a group of shareholders/members objected to the Board's decision and wanted the Board to make recommendation for dividend. On refusal by the Board, the members, who feel oppressed by the Board's decision to skip the dividend, move to the Company Law Board/ and complain against the Board on the ground of oppression and mismanagement. Examining the provisions of the Companies Act, 1956, decide:

(i) Whether the members contention shall be tenable?

(ii) Whether the act of Board of Directors not to recommend any dividend shall amount to oppression and mismanagement? **(5 Marks)**

5 a) M/s FAB Electronics Ltd. (FEL) has appointed four private companies as its selling agents for sale of its white goods in the four regions of the country. A complaint has been made to the Registrar of Companies, New Delhi that the four selling agents are in fact functioning as sole selling agents and that the terms and conditions of their appointment are not in the interest of FEL. Advise FEL about the provisions of the Companies Act, 1956 and the action that may be taken by the authorities under the Act. **(5 Marks)**

b) Explain the time limit for payment of dividend and default in payment with respect to section 127 of the companies act, 2013. **(5 Marks)**

PRIME ACADEMY
39th SESSION – FINAL - PROGRESS TEST- CORPORATE AND ALLIED LAWS
SUGGESTED ANSWERS
PART - A

I.

1. 180 days, date of declaration
2. Depreciation, reserves, 10%
3. Board of Directors
4. 3 years, rotation
5. Single, cumulative
6. 60%, 100%
7. 3 years.
8. A Government company; and a company which has been in existence for less than three financial years.

II.

1. Section 162 (1) of the Companies Act, 2013, requires that the appointment of every director shall be voted on individually. Thus, two or more directors cannot be appointed by a single resolution. However an exception has been carried out where under if a resolution has been first passed to the effect that all the directors shall be appointed by a single resolution without any vote being against it. Appointment invalid.

2. Section 264(1) of the Companies Act, 1956requires that a person proposed as a candidate for the office of director should file with the company his consent to act as a director, if appointed. Section 264(2) stipulates that a person shall not act as a director unless he has filed with the Registrar of Companies his consent in writing (Form No. 32) to act as such. Additional directors appointed as a director at the annual general meeting at which his term of office comes to an end is not required to file consent under section 264(2). Not required.

3. The articles of a company may adopt the principle of proportional representation for appointing not less than 2/3rd of the total number of directors, whether by a single transferable vote or by a system of cumulative voting or otherwise. In such a case,appointments will be so made once in every three years and casual vacancies will be filled in conformity with the provisions of sections 161(4) and 163 of the Companies Act,2013.

4. An additional director shall vacate his office latest on the date on which the annual general meeting could have been held under section 166. He cannot continue in office on the ground that the meeting was not held or could not be called within the time prescribed.

5. True. a formal acceptance of resignation by the company is essential so as to make it complete and effective. This is because he occupies two positions or possesses two capacities, viz., (a) one that of a director, and (b) the other that of manager or officer of the company in the sense of a whole-time employee

PART – B

1 a) Refusal of Listing by Stock Exchange: According to Section 22A of the Securities Contracts (Regulation) Act, 1956 where a recognised Stock Exchange refuses to list the securities of any public company, the company shall be entitled to be furnished with reasons for such refusal. If aggrieved, the company may appeal to the Securities Appellate Tribunal:

(i) within 15 days from the date on which the reasons for such refusal are furnished to it, or

(ii) where the Stock Exchange has omitted or failed to dispose of within the time specified in section 73(1A) of the Companies Act, 1956 (i.e., before the expiry of ten weeks from the date of closing of the subscription list as per prospectus) within 15 days from the expiry of the specified time or within such further period not exceeding one month as securities Appellate Tribunal may allow.

Hence, DVJ Ltd. may avail the above option accordingly.

b) According to Section 23C of the Securities Contracts (Regulation) Act, 1956, if any stock broker or sub-broker or a company whose securities are listed or proposed to be listed in a recognised stock exchange, after having been called upon by the Securities and Exchange Board of India or a recognised stock exchange in writing, to redress the grievances of the investors, fails to redress such grievances within the time stipulated by the Securities and Exchange Board of India or a recognised stock exchange, he or it shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

i. Composition of certain offences: According to Section 23N of the Act, notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under Securities Contracts (Regulation) Act, 1956, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending. Thus, in the instant case, offence committed by the stock broker is compoundable as he is punishable with fine only as provided under section 23C.

ii. Yes, this offence can be compounded after institution of proceedings against the stock broker as it is clearly stated under Section 23N.

2. Hi-Tech Engineering Ltd. can demerge its cement business with Premier Cement Ltd. by obtaining the approval of Court as provided in section 394 of the Companies Act, 1956. For this purpose, Hi-Tech Engineering Ltd. is required to take the following steps:

1) Hi-Tech Engineering Ltd., known as “Transferor Company” for this purpose, has to prepare a scheme under which its properties and liabilities in respect of cement business will be transferred to Premier Cement Ltd., known as “Transferee Company” for this purpose. Such scheme must contain the consideration for transfer, known as “Exchange Ratio”.

2) An application under Section 391(1) of the said Act must be made to Court for an order convening meetings of creditors and/or members.

3) Notice(s) of the meeting(s) must be sent to members/creditors as per the direction of Court. Such notice must be accompanied by a statement under Section 393(1) of the said Act setting forth the terms of the compromise or arrangement and explaining its effect in general and in particular, the effect on the interests of Managerial Personnel.

4) To hold the said meetings and pass necessary resolution approving the scheme subject to the confirmation of Court. It may be noted that the resolution must be passed by a majority in number representing 3/4th in value of the members/creditors as required under Section 391(2) of the said Act.

5) Thereafter, Hi-Tech Engineering Ltd. is required to move to Court jointly with Premier Cement Ltd. for approval of the scheme disclosing all material facts relating to the Company (Proviso to section 391(2). Court as required under section 394A shall give notice to the Central Government and shall take into consideration any representation received from Central Government before passing any order on the application made to it for approval of the scheme.

6) On receipt of Court's order, Hi-Tech Engineering Ltd. is required to file a certified copy of the order with the Registrar of Companies (ROC) for registration within 30 days after making of the order by Court [(Section 394(3)]. This is very important since the non-filing of the order with ROC would make the approval order ineffective.
7) Lastly, to proceed to give effect to the scheme as approved by Court in the manner as directed by it.

3 a) The matter of appointment of directors at the general meeting has been correctly stated in the agenda as the ordinary business to be transacted at the general meeting. But in accordance with the provisions of the Companies Act, 2013 as contained in section 162 at a general meeting of a company, a motion shall not be made for the appointment of two or more persons as directors of the company by a single resolution the meeting first agreed that the appointment shall be made by a single resolution and no vote has been cast against such agreement. Any resolution moved in contravention of subsection (1) shall be void, whether or not objection was taken at the time to its being so moved. Taking into account the above, the contention of the members shall be tenable. Each director has to be appointed by way of a separate resolution.

Appointment of directors and proportion of those who are to retire by rotation (Section 255) & Ascertainment of directors retiring by rotation and filing of vacancies (Section 256)

b) Where any instrument of transfer of shares has been delivered to any company for registration and the transfer of such shares has not been registered by the company, the company shall —
   (a) transfer the dividend in relation to such shares to the special account referred to in section 205A of the Companies Act, 1956 unless the company is authorised by the registered holder of such share in writing to pay such dividend to the transferee specified in such instrument of transfer; and
   (b) keep in abeyance in relation to such shares any offer of rights shares under clause (a) of sub-section (1) of section 81 of the Companies Act, 1956 and any issue of fully paid-up bonus shares in pursuance of sub-section (3) of section 205 of the Companies Act, 1956.

4 a) **Appointment of Nominee Director:** According to section 161(3) of the Companies Act, 2013, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company, subject to the articles of a company.

Appointment of Casual Vacancy: According to section 161(4) of the Companies Act, 2013, if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board. This provision is applicable only in the case of a public company. Any person so appointed shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.

b) Under sections 397 and 398 of the Companies Act, 1956,members may apply to the Company Law Board/ in cases of oppression and mis management.However, bona fide decisions consistent with the company's memorandum and articles are not to be equated with mismanagement even if they turn out to be wrong in the circumstances or these cause temporary losses. The Court will not permit the machinery created by the sections to be used by the minority for compelling the majority to come to terms, where the company is honestly managed. Directors' bona fide decision not to declare dividend and to accumulate available profits into reserves is not mismanagement. (Thomas Vettom (V.J.) vs. Kuttanad Rubber Co. Ltd. (1984) 56 Com. Cases 284 (Ker).

Thus in the given case, the group of shareholders/members who complain to CLB/ against the decision of the Board not to declare any dividend and to accumulate available profits into reserves, would not succeed, as the act of directors does not amount to mis management.Furthermore, the shareholders cannot compel the Board to recommend a dividend. The Board's recommendations are placed in the general meeting. The general meeting can reduce the dividend, but cannot even increase the dividend as recommended by the Board.

Therefore, the shareholders/members cannot compel the company to declare dividend and cannot charge the directors with oppression or mis management. Applying the above, answers to the question shall be as under:

(1) The contention of shareholders/members shall not be tenable.

(2) The act of the Board of directors who acted bona fide, not to recommend any dividend shall not amount to oppression or mismanagement.

5 a) According to Section 294(6) of the Companies Act, 1956 where a company has more selling agents than one, by whatever name called and it appears to the Central Government that it is necessary to obtain information about the terms and conditions and appointment of such agents for the purpose of determining whether any of those selling agents are in fact working as sole selling agents.

The Central Government has the power to call for such information a may be necessary to find out the correct position. On the basis of the information obtained,the Central Government may by an order declare that selling agents be the sole selling agent for the area so related with effect from such date as may be specified in the order. From the date so specified in the order, the appointment of the sole selling agent shall be regulated by the terms and conditions as may be varied by the Central Government. It shall be the duty of the company to furnish all information and documents and refusal to do so will involve penalty which may extend upto ₹ 50,000/-.

Thus it is imperative for the company to furnish all the information and documents in its possession to or any authority making any enquiry in this regard that the selling agents are not functioning as sole selling agents.

b) According to Section 127 of the Companies Act, 2013, dividend has to be paid within 30days from the date of its declaration. The posting of dividend warrant by the company within 30 days will be deemed to be payment irrespective of the fact whether the shareholder has en cashed it or not. Failure to pay or post dividend warrant within 30days, constitutes an offence under the Act and renders every director of the company, if he is knowingly a party to the default, punishable with simple imprisonment for a term which may extend to two years and also to a fine of one thousand rupees for every day during which such default continues and the company shall be liable to pay simple interest at the rate of eighteen per cent per annum during the period for which such default continues.

However, no offence shall be deemed to have been committed in the following cases:

(a) Where the dividend could not be paid by reason of the operation of any law;

(b) Where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him;

(c) Where there is a dispute regarding the right to receive the dividend;

(d) Where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or

(e) Where, for any other reason, the failure to pay the dividend or to post the warrant within the period aforesaid was not due to any default on the part of the company.