PRIME ACADEMY
40th SESSION PROGRESS TEST - FINANCIAL REPORTING

No of Pages: 6 **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) M/s Kani Ltd has included interest and borrowing cost related to overdraft 45 crores while valuing the inventories. The CFO argues that it will form part of cost of inventories. As per AS 2, which of the following should be the alternative adopted by the company.
   a) Interest on bank O/D will not form part of inventory. And therefore not to be included while valuing the inventory.
   b) The interest cost will be included in the value of inventory.
   c) The interest will be included only with respect to the proportion of inventory amount on the total loan amount.
   d) d) All of the above (2 Marks)

3) In Hari & Co Ltd there was a theft of cash to the extent of ₹ 5 lakhs in January 2013. The theft was detected only in May 2013. The accounts of the company were not yet approved by board of directors Whether the theft of cash should be disclosed in books of accounts? If so provide the most appropriate way.
   a) The event is an adjusting event as per AS 4 and the financial statements required adjustment to the reported values.
   b) The event is an non adjusting event requiring no adjustments to the reported values in financial statements.
   c) Only disclosure required without any adjustment to the reported values.
   d) Mentioned in the director's report without adjusting financial statements. (1 Mark)

4) 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)

5) 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)

6) An unquoted long term investment is carried in the books at a cost of ₹ 2 lakhs. The published accounts of the Unlisted company received in May, 1998 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than ₹. 20,000. Which of the following will be more appropriate by virtue of AS 13?
   a) provision for diminution should be made to reduce the carrying amount of long term investment to ₹ 20,000
   b) Investment taken only at cost
   c) Investments are taken at market value basis
   d) Either b or c whichever is lower (2 Mark)

7) 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)

8) ICICI bank received a gross of ₹ 1500 crores demand deposits from customers and withdrawn ₹ 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)

9) 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	₹ 10000

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)

10) 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)

11) During 2014, AB 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 2014

a) ₹ 96000
b) ₹ 82000
c) ₹ 64000
d) ₹ 54000 (3 Marks)

12) For financial statement to achieve true and fair view which of the following is not a major consideration?
   a) Prudence
   b) Going concern
   c) Substance over form
   d) Materiality (1 Mark)

13) An entity purchases a building and the seller accepts payment partly in equity shares and partly in debentures of the entity. This transaction should be treated in the cash flow statement as follows:
   a) This does not belong in a cash flow statement and should be disclosed only in the footnotes to the financial statements.
   b) The purchase of the building should be investing cash outflow and the issuance of shares and the debentures financing cash outflows.
   c) The purchase of the building should be investing cash outflow and the issuance of debentures financing cash outflows while the issuance of shares investing cash outflow.
   d) Ignore the transaction totally since it is a noncash transaction. No mention is required in either the cash flow statement or anywhere else in the financial statements. (2 Marks)

14) XYZ Ltd. owns a fleet of over 100 cars and 20 ships. It operates in a capital-intensive industry and thus has significant other fixed assets that it carries in its books. It decided to revalue its fixed assets.
The company's accountant has suggested the alternatives that follow. Which one of the options should XYZ Ltd select in order to be in line with the provisions of AS 10?

   a) Revalue an entire class of fixed assets.
   b) Revalue only one-half of each class of fixed assets, as that method is less cumbersome and easy compared to revaluing all assets together.
   c) Revalue one ship at a time, as it is easier than revaluing all ships together.
   d) Since assets are being revalued regularly, there is no need to depreciate. (1 Mark)

PART - B

1. a) A company is engaged in the business of ship building and ship repair. On completion of the repair work, a work completion certificate is prepared and countersigned by ship owner (customer). Subsequently, invoice is prepared based on the work completion certificate describing the nature of work done together with the rate and the amount.

Customer scrutinizes the invoice and any variation is informed to the company. Negotiations take place between the company and the customer. Negotiations may result in a deduction being allowed from the invoiced amount either as a lump sum or as a percentage of the invoiced amount. The accounting treatment followed by the company is as follows:

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

Following two aspects are settled in the negotiations:

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

   Comment whether the accounting treatment of deduction as trade discount is correct? If not, state the correct accounting treatment. (6 Marks)

b) A major fire has damaged the assets in a factory of M/s AGNI Limited on 5th April – five days after the year end and closure of accounts. The loss is estimated at ₹ 10 crores out of which ₹ 7 crores will be recoverable from the insurers
Explain briefly how the loss should be treated in the final accounts for the previous year. (4 Marks)

2. a) A Ltd purchased 1,00,000 MT for Rs 100 each MT of raw material and introduced in the production process to get 85,000 MT as output. Normal wastage is 5%. In the process company incurred the following expenses: Direct Labour ₹ 10,00,000
Direct Variable overheads ₹ 1,00,000
Direct Fixed overheads (Including interest ₹ 40,625) ₹ 1,00,000
Of the above 80,000 MT was sold during the year and remaining 5,000 MT remained in closing stock. Due to fall in demand in market the selling price for the finished goods on the closing day was estimated to be Rs 105 per MT. Calculate the value of closing stock. (5 Marks)

b) From the following summary cash accounts of X ltd prepare a Cash flow statement for the year ended 31 March 2014 in accordance with the AS 3(revised) using the Direct method. The company does not have any cash equivalents.
Summary cash account for the year ended 31.3.2014

	₹'0000		₹'0000
Balance as on 1.4.2013	50	Payment to suppliers	2,000
Issue of equity shaeres	300	Purchase of fixed assets	200
Receipt of customers	2,800	Overhead expenses	200
Sale of fixed assets	100	Wages and salaries	100
		Taxation	250
		Dividend	50
		Repayment of loan	300
		Balance as on 31.3.2014	150
	3250		**3250**

(5 Marks)

c) On 1.1.2013, VC Co Ltd, undertook a contract to construct a building for ₹ 85 lakhs On 31.3.2014 the company found that it had already spent ₹ 64.99 Lakhs on the construction. Prudent estimate of additional cost for completion was ₹ 32.01 Lakhs. What amount should be charged to revenue in the final accounts for the year ended 31.3.2014 as per the provisions of AS 7? (5 Marks)

d) Following details are given for S Ltd for the year ended 31 March 2014

	₹ in lakhs	₹ in lakhs
Sales (including inter-segment sales)		
Food products	10000	
Plastics and packaging	1240	
Health and scientific	690	
Others	364	12294
Expenses		
Food products	7170	
Plastics and packaging	800	
Health and scientific	444	
Others	400	8814
Other items		
General corporate expenses		1096
Income from investment		252
Interest expenses		126

Identifiable assets		
Food products	15096	
Plastics and packaging	4000	
Health and scientific	1400	
Others	1364	21860
General corporate assets		1664
a) Inter segment sales are as below		
Food products		120
Plastics and packaging		168
Health and scientific		36
b) Operating profit includes 66 on inter segment sales		

You are requested to identify reportable segments **(5 Marks)**

3. The balance sheet of three companies angel limited, bolt limited and Canopy Ltd., as at 31st Dec 2014 are given below:

Liabilities	Angel ₹	Bolt ₹	Canopy ₹
Share capital (equity shares of ₹100 each)	15,00,000	10,00,000	6,00,000
Reserves	2,00,000	1,25,000	75,000
Profit and loss a/c	5,00,000	2,75,000	2,50,000
Sundry debtors	2,00,000	2,50,000	1,00,000
Bills payable			50,000
Angel Ltd		1,00,000	80,000
Total	24,00,000	17,50,000	11,55,000
Goodwill	2,50,000	5,80,000	4,50,000
Plant and machinery	4,00,000	2,50,000	3,25,000
F&F	2,00,000	1,50,000	1,40,000
Shares in			
Bolt Ltd (7500 shares)	9,00,000		
Canopy Ltd (1000 shares)	1,50,000		
Canopy Ltd (3500 shares)		5,20,000	
Sundry debtors	1,40,000	70,000	70,000
Stock in trade	1,00,000	1,50,000	1,60,000
Bills receivable	50,000	20,000	
Due from			
Bolt Ltd	1,20,000		
Canopy Ltd	80,000		
Cash in hand	10,000	10,000	10,000
Total	24,00,000	17,50,000	11,55,000

All shares were acquired on 1st July 2013,

a. On 1st January 2013, the balances were

Particulars	Angel ₹	Bolt ₹	Canopy ₹
Reserves	1,00,000	1,00,000	50,000
P&L account	50,000	(50,000) Dr	30,000
Profit during 2013 were earned evenly over the year	3,00,000	2,50,000	1,00,000

b. Each company declared a dividend of 10% in the year 2014 on its shares out of profits for the year 2013. Angle ltd and Bolt ltd have credited their profit and loss account with the dividends received
c. The increase in reserves in the case of Angel, bolt and Canopy Ltd was effected in the year 2013.
d. All the bills payable appearing in Canopy's Ltd balance sheet were accepted in favor of Bolt Ltd out of which bills amounting ₹ 30,000 were endorsed by Bolt Ltd., in favour of Angel Ltd
e. Stock with Bolt Ltd includes goods purchased from Angle Ltd., for ₹ 18000. Angel Ltd invoiced the Goods at cost plus 20%.

Prepare

Consolidated balance sheet of the group as at 31st Dec 2014. Workings should form part of answer. Ignore taxation including dividend distribution tax; disclose minority interest as per AS 21.

(20 Marks)

PRIME ACADEMY
40TH SESSION – FINAL - PROGRESS TEST – FINANCIAL REPORTING
SUGGESTED ANSWERS
PART - A

1. a. Change in accounting policy
2. a. Interest on bank O/D will not form part of inventory. And therefore not to be included while valuing the inventory.
3. a. The event is an adjusting event as per AS 4 and the financial statements required adjustment to the reported values
4. b. Attachment of property of an enterprise
5. b. Progress billing to the customer
6. a. provision for diminution should be made to reduce the carrying amount of long term investment to ₹ 20,000
7. b. Purchase and sale of investments in equity shares by a company
8. a. Operating activities on a net basis (₹ 200 crores inflow)
9. d. ₹ 130000
10. d. Both transaction
11. c. ₹ 64000
12. b. Going concern
13. a. This does not belong in a cash flow statement and should be disclosed only in the footnotes to the financial statements.
14. a. Revalue an entire class of fixed assets

PART - B

1. (a)

(i) As per AS 9 "Revenue Recognition", revenue is recognized at the time when the invoice is raised to the customers; however the treatment of deduction as trade discount is not as per AS 9. Considering the treatment prescribed by AS 4 "Contingencies and Events occurring after the Balance Sheet Date", the correct treatment of the difference between the invoice amounts and finally settled amount should be under:

The adjustment of the difference between the invoiced amount and the amount finally settled against "Ship Repair Income" account is in order. Events occurring up to the date of approval of the accounts by the Board of Directors should be taken into consideration in determining the amount of adjustment to be made in this regard.
The description of the difference as "trade discount" is not appropriate.

(b) The loss due to break out of fire is an example of event occurring after the balance sheet date. The event does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the date of balance sheet and therefore requires no specific adjustments in the financial statements. However, paragraph 8.6 of AS 4 states that disclosure is generally made of events in subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise at the balance sheet date.
In the given case, the loss of assets in a factory is considered to be an event affecting the substratum of the enterprise. Hence, as recommended in paragraph 15 of AS 4, disclosure of the event should be made in the report of the approving authority.

2. a)

	₹
Cost of purchase(1,00,000*100)	1,00,00,000
Direct labour	10,00,000
Variable overhead	1,00,000
Fixed overhead (100000-40625)*85000/95000	53125
Total cost of production	1,11,53,125
Cost of closing stock per unit (1,11,53,125/85000)	131
Net realizable value	Rs.105

Since the net realizable value is less than cost, closing stock will be valued at Rs.105 . Therefore closing stock Is Rs. 5,25,000 (5000*105)

b) Cash flow statement of X Ltd for the year ended 31 March 2014

		₹ '000
Cash flow from operating activities		
Cash receipt from customers		2800
Cash payment to suppliers		(2000)
Cash paid to employees		(100)
Cash payment for overheads		(200)
Cash generated from operations		(500
Income tax paid		(250)
Net cash from operating activities	--------	250
Cash flow from investing activity		
Payments for purchase of fixed assets		(200)
Proceeds from sale of fixed assets		100
	-----------	100
Net cash used in investing activities		
Cash flow from financing activity		
Proceeds from issuance of equity shares		300
Bank loan repaid		(300)
Dividend paid		(50)
	---------	(50)
Net increase in cash		100
Cash at beginning of the period		50
Cash at end of the period		150

c)

	₹
Cost incurred till 31st March 2014	64,99,000
Prudent estimate of additional cost of completion	32,01,000
Total cost of construction	-------------
	97,00,000
Less: contract price	85,00,000
Total foreseeable loss	---------------
	12,00,000

According to Para 35 of AS 7 (Revised 2002), the amount of ₹ 12,00,000 is required to be recognized as expenses

Contract work in progress = ₹ 6499000 *100/9700000 = 67%

Proportion of total contract value recognized as turnover as per AS 21 of AS 7 on construction contracts is 67% of ₹ 85 lakhs = ₹ 56.95 lakhs

d) Calculation of segment results

	Sales ₹	Expenses ₹	Segment result ₹
Food products	10,000	7,170	2,830
Plastic and packaging	1,240	800	440
Health and scientific	690	444	246
Other	364	400	(36)

Information

	Food and plastics ₹	Plastic ₹	Health ₹	Others ₹	Total ₹
Segment assets	15,096	4,000	1,400	1,364	21,860
Segment assets as a % of total assets of all segments	69.06%	18.30%	6.4%	6.24%	
Segment results	2,830	440	246	(36)	3480
Combined result of all segment in profits	2,830	440	246		3516
Combined result of all segment in loss				36	
Segment result as a % of higher of profit or loss in absolute amount (3516)	80.49%	12.51%	7%	1.02%	
Segment revenue	10,000	1,240	690	365	12,294
Segment revenue as a % of total revenue of all segments	81.34%	10.09%	5.61%	2.96%	

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

3. Consolidated balance sheet of Angel Ltd and its subsidiaries Bolt Ltd and Canopy Ltd as on 31st Dec 2014.

Liabilities	₹	₹	Assets	₹	₹
Share capital (Equity shares of Rs. 100 each)		15,00,000	Goodwill		
Minority interest (W.N.6)			Angel Ltd. 2,50,000		
Bolt Ltd	3,97,396		Bolt Ltd 5,80,000		
Canopy Ltd	2,31,250	6,28,646	Canopy Ltd 450000	1280000	
Reserves (200000+14844+2083)		2,16,927	Add: Cost of control (W.N7)	155833	1435833
Profit and Loss account		7,62,260	Plant and Machinery		
Sundry creditors			Angel Ltd	4,00,000	
Angel Ltd	2,00,000		Bolt Ltd	2,50,000	
Bolt Ltd	2,50,000		Canopy Ltd	3,25,000	975000

Canopy Ltd	1,00,000	5,50,000			
			F&F		
Bills payable	50,000		Angel Ltd	2,00,000	
Less: Mutually held	50,000	Nil	Bolt Ltd	1,50,000	
			Canopy Ltd	1,40,000	4,90,000
			Stock in trade		
			Angel Ltd	1,00,000	
			Bolt Ltd	1,50,000	
			Canopy Ltd	1,60,000	
				4,10,000	
			Less: Provision for unrealized profit	3000	407000
			Sundry debtors		
			Angel Ltd	1,40,000	
			Bolt Ltd	70,000	
			Canopy Ltd	70,000	2,80,000
			Bills receivable		
			Angel Ltd	50,000	
			Bolt Ltd	20,000	
				70,000	
			Less: Mutually held	50000	20000
			Cash in hand		
			Angel Ltd	10,000	
			Bolt Ltd	10,000	
			Canopy Ltd	10,000	30,000
			Cash in transit/dues from Bolt Ltd (W.N.8)		20,000
		36,57,833			36,57,833

Disclosure of minority interest as per AS 21
Amount of equity attributable to minorities on the date of investment i.e 1.7.2013

Particulars	Bolt ₹	Canopy ₹
Share capital	2,50,000	1,50,000
Share in capital reserve as on 1.1.13	25,000	12,500
Share in capital profits as on 1,.1.13	(12500)	7500
Share in capital profits for the period 1.1.13 to 30.6.13	31250	12500
	293750	182500
Total amount of equity attributable to minorities	476250	

Disclosure in accordance with AS-21 minority interest as on 31.12.2014

	₹
Amount of equity as on the date of investment 1.7.2013	4,76,250
Add: Moment in equity and proportionate share of profit less dividend from the date of investment 31.12.14	1,52,396
	6,28,646

Working notes

1. Ascertainment of profits for the year 2014

Particulars	Angel Ltd ₹	Bolt Ltd ₹	Canopy Ltd ₹
Balance as on 1st jan 2013	50,000	(50,000)	30,000
Add: Profit earned during 2013	3,00,000	2,50,000	1,00,000
	3,50,000	2,00,000	1,30,000
Less: Dividend declared	1,50,000	1,00,000	60,000
	2,00,000	1,00,000	70,000
Less: Transfer to reserve	1,00,000	25,000	25,000
	1,00,000	75,000	45,000
Profits for the year 2014 (bal fig)	4,00,000	2,00,000	2,05,000
Balance as on 31st dec 2014	5,00,000	2,75,000	2,50,000

2. Undistributed profits for the year 2013

Particulars	Bolt ₹	Canopy ₹
Profits for the year 2013	250000	`1,00,000
Less: Dividend declared	100000	60,000
	1,50,000	40,000
Less: Transfer to reserve	25,000	25,000
	1,25,000	15,000

3. Analysis of profits

Particulars	Capital profit ₹	Revenue reserve ₹	Revenue profit ₹
Canopy Ltd			
Reserve as on 1st jan 2013	50,000		
Transfer to reserve in the year 2013 (75000-50000)/2	12500	12500	
P&L balance as on 1st jan 2013	30,000		
Profits for 2013 remaining undistributed (100000-25000-60000)/2	7500		7500
Profit for the year 2007(250000-30000-15000)			205000
	100000	12500	212500
(a)			
Minority interest (1/4 od A)	25000	3125	53125
	75000	9375	159375
Share of angel (1/6th of A)	16,667	2083	35417
Share of bolt	58333	7292	123958

Bolt ltd			
Reserves as on 1st jan 2013	1,00,000		
Transfer to reserve (125000-100000)/2	12500	12500	
P&L a/c – balance dr as on 1st jan 2013	(50000)		
Undistributed profits for 2013 (250000-25000-100000)/2	62500		62500
Share in profits of Canopy Ltd	58333	7292	123958
Profit for the year 2014			2,00,000
(B)	183333	14844	289843
Less: Minority interest (1/4 of B)	45833	4948	96615
Share of Angel Ltd	137500	14844	289843

4. Consolidated P&L account of Angel Ltd

Particulars	₹	₹
Profit and Loss account balance as on 31.12.2014		500000
Add: Share in revenue profits of Canopy Ltd		35417
Share in revenue profits of Bolt Ltd		289843
		825260
Less: Pre-acquisition dividend		
Angel Ltd ½(75000+10000)	42500	
Bolt ltd ½ of Rs.35000	17500	60,000
		765260
Less: Unrealised profit in closing stock (20/120*18000)		3000
		762260

5. Consolidated reserves of angel ltd

	₹
Reserves	2,00,000
Add: share in revenue reserves of Canopy Ltd	2083
Add: Share in revenue reserve of Bolt Ltd	14844
	216927

6. Minority interest

	Bolt Ltd ₹	Canopy Ltd ₹
Share capital	250000	150000
Share of capital profits	45833	25000
Share of revenue reserves	4948	3125
Share of revenue profits	96615	53125
Total	397396	231250
Grand total		628646

1. **Cost of control/goodwill**

	₹	₹
Cost of investment (90000+150000+520000)		1570000
Less: Dividend attributable to pre-acquisition for 6 months (75000+45000)/2		60000
		1510000
Less: face value of shares		
Bolt ltd	750000	
Canopy ltd	450000	
Capital profits		
Bolt ltd	137500	
Canopy ltd	16667	1354167
		155833

2. **Cash in transit/dues from Bolt Ltd**

	₹	₹
Due to Angel Ltd		
From Bolt Ltd	120000	
From Canopy Ltd	80000	200000
Due by Angel Ltd		
To Bolt Ltd	100000	
To Canopy Ltd	80000	180000
		20000

PRIME ACADEMY
40^{TH} SESSION PROGRESS TEST
STRATEGIC FINANCIAL MANAGEMENT

No. of Pages: 5 **Total Marks: 75**
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PART- A

1. Arrange the following in chronological order
   i. Payment date
   ii. Last cum dividend date
   iii. First ex dividend date
   iv. Declaration date
   v. Record date
      a. (iv),(ii),(iii),(v)&(i)
      b. (ii),(iii),(iv),(i)&(v)
      c. (iii),(i),(ii),(v)&(iv)
      d. (i),(ii),(iii),(iv)&(v).

2. The objective of dividend policies is
   a. To increase the wealth of the share holders
   b. To increase the wealth of the Board of Directors
   c. To decrease the wealth of the firm
   d. To decrease the share market price of the company.

3. If K>R what is the nature of the company?
   a. Growth
   b. Decline
   c. Normal
   d. Can't say

4. Under the basic approach to dividend , if r =K, the optimum payout is
   a. 100%
   b. 0%
   c. Indifference
   d. 50%

5. When the expected dividend is more than the actual dividend the market price would normally
   a. Increase
   b. Stay constant.
   c. Fall
   d. May be increase or decrease.

6. Which of the following is not an assumption of Gordon's model
   a. The firm has a perpetual life
   b. Rate of return on the firm's investment varies with leverage.
   c. Cost of capital remains constant.
   d. Tax does not exist.

7. According to Gordon's model , if the dividend payout is 100 %, the market price share will be equal to
   a. EPS * Ke
   b. Ke / EPS
   c. EPS / 1+Ke
   d. EPS / Ke

8. What will be market price per share as per Gordon's model, If DPS is per share ₹ 100, Growth rate is - 5% and the Ke is - 10%
   a. ₹ 2,100
   b. ₹ 2,000
   c. ₹ 1,000
   d. ₹ 1,050

9. 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
   a. 15
   b. 10
   c. 20
   d. 5

10. Compute DPS if dividend policy is treated as a residual decision and company the Prefers to maintain debt equity ratio of 1:3. Assume PAT – ₹ 20,000.Capex – ₹ 10,000 No. of shares is 10,000.
    a. 1.75
    b. 1.25
    c. 1.00
    d. 1.50

11. Under the radical approach if dividends are taxed at a higher rate than capital gains, the investor will prefer the company which gives,
    a. More capital gains.
    b. More dividend
    c. Both a and b.
    d. Neither a & b.

12. Risk in capital budgeting means
    a. Possibility of negative npv
    b. Not knowing the outcomes
    c. Possibility that the actual outcome differs from the expected outcome
    d. All of the above

13. Risk adjusted discount rate (RADR) is
    a. Risk free rate
    b. Cost of capital/ cut off rate
    c. Cost of debt
    d. Cost of capital + risk premium

14. Under Certainty equivalent (CE) approach, discount rate used is
    a. Risk free rate
    b. Cost of capital
    c. RADR
    d. None of the above

15. Under which of the following approaches to dividend a minimum dividend is contemplated
    a. Constant payout plan
    b. Constant dividend rate plan
    c. Constant dividend plus plan
    d. None of the above

16. If the sensitivity of a project to size is 14%, inflows is 12%, life is 20% and cost of capital is 120%, the project is most sensitive to
    a. size
    b. Cost of capital
    c. Inflow
    d. Life

17. Decision tree approach is used in

    a. Proposals with longer life
    b. Sequential decisions
    c. Independent cash flows
    d. None of the above

18. Which of the following statements is true?

    a. A risky situation is one in which the probability for the occurrence or non-occurrence of an event cannot be assigned
    b. Higher the standard deviation, better is the project
    c. In Sensitivity Analysis, the NPV of the proposal is adjusted for risks.
    d. None of the above

19. Direct quote_________ currency is the commodity and ______ is the price
    a. Home, foreign
    b. Foreign, home
    c. Depends on the country where you live.
    d. None of the above

20. A quote which is indirect for the USA is said to be in ______ terms
    a. American
    b. European
    c. Indian
    d. None of the above

21. If the probability of material price increasing over 5% is 0.50 and that of Labour cost increasing over 5% is 0.30, the probability that both material and labour cost increase over 5% is
    a. 8%
    b. 15%
    c. 6%
    d. 17%

22. Determine the probability that the NPV in a project will be greater than zero if the estimated NPV and standard deviation were ₹ 2,400 and ₹4000 respectively.
    a. 22.57%
    b. 27.43%
    c. 72.57%
    d. 77.43% **(2 Marks)**

23. Inflation rate in India is 9% and Kuwait is 3%. Spot rate is 159.20-.30Rs per Kuwaiti Dinar. At what rate can u exchange one Kuwaiti dinar after 18 months? be:
    a. ₹ 173.45
    b. ₹ 168.47
    c. ₹ 173.55
    d. None of the above **(2 Marks)**

PART B (50 Marks)

Answer all questions

1. (a) 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 **(6 Marks)**

   (b) 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. **(7 Marks)**

   (c) A firm's profit after tax is ₹ 50 lakhs. The number of shares outstanding is ₹ 10 lakhs. Company plans an investment at the end of the year amounting to ₹ 100 lakhs. The current market price is ₹ 20/- per share and the cost of equity is 15%. Should the company declare ₹ 4 per share as dividend or should it not declare any dividend? Explain with numbers assuming the Modigliani-Miller model works. **(7 Marks)**

2. Aeroflot airlines is planning to procure a light commercial aircraft for flying class clients at an investment of ₹ 50 lakhs. The expected cash How after lax for next three years is as follows :
   The company wishes to consider all possible risk factors relating to an airline.
   The company wants to know –
   (i) the expected NPV of this proposal assuming independent probability distribution with 6 per cent risk free rate of interest, and
   (ii) the possible deviation on expected values.

   (10 Marks)

3. On January 28, 2005 an importer customer requested a bank to remit Singapore Dollar (SGD) 25,00,000 under an irrevocable LC. However due to bank strikes, the bank could effect the remittance only on February 4, 2005. The interbank market rates were as follows :

		Jan-28	Feb-01
Bombay US$1	=	₹ 45.85/45.90	45.91/45.97
London Pound 1	=	US$1.7840/1.7850	1.7765/1.7775
Pound 1	=	SGD 3.1575/3.1590	3.1380/3.1390

The bank wishes to retain an exchange margin of 0.125%. How much does the customer stand to gain or lose due to the delay?(Calculate rate in multiples of .0001).

(10 Marks)

4. X ltd has an internal rate of return of 20%. It has declared a dividend @ 18% on its Equity shares having face value of ₹ 10 each. The payout ratio is 36% and Price Earnings ratio is 7.25. Find the cost of equity using Walter's model. Also compute the optimum payout ratio and maximum price using Walter's model.

(10 Marks)

PRIME ACADEMY
40th SESSION – FINAL – PROGRESS TEST - STRATEGIC FINANCIAL MANAGEMENT
SUGGESTED ANSWERS

PART A

1	2	3	4	5	6	7	8	9	10	11	12
a.	a.	b.	c.	a.	b.	d.	a.	D (₹ 25)	b.	a.	c.

13	14	15	16	17	18	19	20	21	22	23
d.	a.	c.	c.	b.	d.	b.	b.	b.	c.	b.

PART B

1. (a)

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 NZD at spot
₹ 50,000 = 50,000/51.1680 = 977.173 NZD at 1 month forward rate

(b)

(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

(c) Calculation of share price

- when dividend is declared:

$$P_0 = \frac{P_1 + D_1}{1 + K_e}$$

P1 = 20(1+.15) – 4 = ₹19

- when dividend is not declared:

P1 = 20(1+.15) – 0= ₹23

(i) Calculation of No. of shares to be issued:

(₹ in lakhs)

Particulars	If dividend declared	If dividend not declared
Net Income	50	50
Less: Dividend paid	40	—
Retained earnings	10	50
Investment budget	100	100
Amount to be raised by issue of new shares (i)	90	50
Market price per share (ii)	19	23
No. of new shares to be issued(m)	4,73,684	2,17,391

(ii) Substituting in the formula :

nP0 = (n+ m) P1- I + X1/ (1 + ke)

If dividend is declared: (10L +4,73684)19-10L+50L/1.15 = ₹20 Lakhs approx

If dividend is not declared: (10L +2,17,391)23-10L+50L/1.15 = ₹20 Lakhs approx

Value of the firm remains the same whether dividend is declared or not.

2.

I. Initial outflow = ₹ 50 Lakhs

II. In between flows

Year 1			**Year 2**			**Year 3**		
CFAT	**p**	**CF x p**	**CFAT**	**p**	**CF x p**	**CFAT**	**p**	**CF x p**
15	0.1	1.5	15	0.1	1.5	18	0.2	3.6
18	0.2	3.6	20	0.3	6	22	0.5	11
22	0.4	8.8	30	0.4	12	35	0.2	7
35	0.3	10.5	45	0.2	9	50	0.1	5
	Exp. CF	24.4		Exp. CF	28.5		Exp. CF	26.6

III. Expected NPV

Year	Cash flow	PVIF	DCF
0	(50.00)	1	(50.00)
1	24.40	0.943	23.02
2	28.50	0.890	25.36
3	26.60	0.840	22.33
Expected NPV		20.72	

IV. Calculation of standard deviation (uncorrelated CFs)

Year 1		**Year 2**		**Year 3**	
x-24.4	dx^2 xp	x-28.5	dx^2 xp	x-26.6	dx^2 xp
-9.4	8.836	-13.5	18.225	-8.6	14.792
-6.4	8.192	-8.5	21.675	-4.6	10.58
-2.4	2.304	1.5	0.9	8.4	14.112
10.6	33.708	16.5	54.45	23.4	54.756
	53.04		95.25		94.24
PVIF(6%,					0.705

2N)	0.890		0.792		
	47.21	+	75.45	+	66.44
Variance	189.09				
SD=	13.75	Lakhs			

3. On January 28, 2005 the importer customer requested to remit SGD ₹ 25 lakhs.
Product is SGD and customer buys so bank sells relevant rate Ask(INR/SGD)
= A (INR/USD) * A(USD/Pound) * 1/B(SGD/P)

US $ 1	=	₹ 45.90
Pound 1	=	US$ 1.7850
Pound 1	=	SGD 3.1575

Therefore, SGD 1 = $\frac{\text{Rs. } 45.90 * 1.7850}{\text{SGD } 3.1575}$

SGD 1 =	₹ 25.9482
Add: Exchange margin (0.125%)	₹ 0.0324
	₹ 25.9806

On February 4, 2005 the rates are

US $	=	₹ 45.97
Pound 1	=	US$ 1.7775
Pound 1	=	SGD 3.1380

Therefore, SGD 1 = $\frac{\text{Rs. } 45.97 * 1.7775}{\text{SGD } 3.1380}$

SGD 1 =	₹ 26.0394
Add: Exchange margin (0.125%)	₹ 0.0325
	₹ 26.0719

Hence, loss to the importer
= SGD 25,00,000 (₹ 26.0719 – ₹ 25.9806)

= ₹ 2,28,250

4. 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

PRIME ACADEMY
40^{th} SESSION PROGRESS TEST
ADVANCED AUDITING AND PROFESSIONAL ETHICS

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

PART - A

Part A is mandatory and in Part B Question 1 is Compulsory. Answer any two from the rest.
Working notes should form part of the answer
Wherever necessary suitable assumptions may be made by the Candidates

I. Choose the correct answer

1. 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

2. 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 consideration. Such risk is called as
   a) Audit risk
   b) Inherent risk
   c) Assessed risk
   d) Significant risk

3. 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

4. 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

5. 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

(5 x 1 = 5 Marks)

II. State whether the statement is Correct or Incorrect:

1. Audit risk is risk that auditor will express an inappropriate audit opinion when the financial statements are materially misstated.
2. Audit files are required to maintained for a period of not less than 10 years from the date of the auditor's report
3. Operational auditing is a systematic process involving logical, structured and organized series of procedures.
4. Companies Act, 2013 contains the fundamental law regarding the formation and workings of the cooperatives society in India.
5. Management audit is always performed by board of directors. **(5 x 1 = 5 Marks)**

III. Match the following auditing standards

	Standard Number		Standard Name
1	SA 505	A	Responsibility f joint auditors
2	SA 560	B	Audit documentation
3	SA 299	C	External confirmation
4	SA 230	D	Analytical procedures
5	SA 520	E	Subsequent events

(5 x 1 = 5 Marks)

IV. Explain the following terms in brief with reference to standards of auditing:

1. Those charged with governance
2. Audit Sampling
3. Control risk
4. Subsequent events
5. Tolerable misstatement

(5 x 2 = 10 Marks)

PART B **(50 Marks)**

1.
   a) Under what circumstances, an auditor is required to submit a special report to the registrar of cooperative societies. **(4 Marks)**
   b) While auditing Box limited, you observe certain material financial statements assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements **(6 Marks)**
   c) "operating auditing is not different from internal auditing" –Discuss in detail **(5 Marks)**
   d) While verifying the employee records in a company, it was found that major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws. **(5 Marks)**

2.
   a) State the special features of co-operatives societies audit **(10 Marks)**
   b) POR. Co limited has not inclided in the Balance sheet as on 31 March 2014 a sum of Rs. 1.50 crores being amount in the arrears of salaries and wages payable to the staff for the last 2 years as a result of successful negotiations which are going on during the last 18 months and concluded on 30 April 2014. The auditor wants to sign the said Balance Sheet and give the audit report on 31 May 2014. The auditor came to know the result of the negotiations on 15 May 2014. **(5 Marks)**

3.

a) BCD limited, requires you to organize a Management audit program. Briefly state a plan of action. **(10 Marks)**

b) Thunder limited replaced its statutory auditor for the financial year 2013-14. During the course of audit, the new auditor found a credit item of Rs. 5 lakhs. On enquiry the company explained him that it is a very old balance. The creditor had neither approached for the payment not he is traceable. Under the circumstances, no confirmation of the credit balance is available. **(5 Marks)**

4.

a) A Director of Star limited, draws an advance of USD 200 per day in connection with the foreign trip undertaken on behalf of the company. On his return he files a declaration stating that entire advance was expended without any supporting or evidence. Star limited books the entire expenses on the basis of such declaration . As the auditor of Star limited, how do you deal with this? **(10 Marks)**

b) Mr. P have been appointed as operational auditor of M/s Books & Magazine Limited and observed a totaling error in invoice of Rs. 1,000. He has not taken care of the same saying that this is out of scope of his work. Comment. **(5 Marks)**

PRIME ACADEMY
40th SESSION - FINAL - PROGRESS TEST
ADVANCED AUDITING AND PROFESSIONAL ETHICS
SUGGESTED ANSWERS
PART-A

I.

1. (a) Sufficient and appropriate records of the basis for the auditors report
2. (d) Significant risk
3. (c) Enhance the degree of confident if intended users in the Financial Statements
4. (a) Assist in understanding the business and in identifying areas of potential risk
5. (a) Analytical procedure

II.

1. True
2. False
3. True.
4. False
5. False.

III.

	Standard Number		Standard Name
1	SA 505	A	External confirmation
2	SA 560	B	Subsequent events
3	SA 299	C	Responsibility f joint auditors
4	SA 230	D	Audit documentation
5	SA 520	E	Analytical procedures

1. Those charged with governance
   The person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector undertakings or an owner-manager.
2. Audit Sampling
   The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.
3. Control risk - The risk that a material misstatement that could occur will not be prevented, or detected or corrected, on a timely basis by related internal controls
4. Subsequent events- Events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.
5. Tolerable misstatement - A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population

PART B

1.

A. Special Report by Auditor to Registrar of Co-operative Societies: Under the following circumstances, an auditor has to issue special report to the Registrar of Co-operative Societies
(This report should be in addition to the regular report)-
   (i) (a) Any member of the managing committee is involved in personal profit making by using the properties or assets of the society, resulting into the loss to the society.
   (b) Frauds are detected from the society's transactions.
   (ii) There is mismanagement in the society and the principles of co-operative are not maintained by the management.
   (iii) In the respect of audit of Urban Co-operative Banks, disproportionate advances to vested interest groups. Such as relative of management, and deliberate negligence about the recovery there of cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.

B. As per SA 450 "Evaluation of Misstatements Identified during the Audit",mis statements may result from
   (i) An inaccuracy in gathering or processing data from which the financial statements are prepared.
   (ii) An omission of an amount of disclosure.
   (iii) An incorrect accounting estimate arising from overlooking or clear mis interpretationof facts and
   (iv) Judgements of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies thatthe auditor considers inappropriate.

C. Internal auditing is an activity carried out by the internal staff of the organisation to meet the management requirements of information. The definition of internal auditing as given by the Institute of Internal Auditors of New York, in fact, is so wide in its scope that it covers both operational and management auditing. According to the Institute of Internal Auditors, "the overall objective of internal auditing is to assist all members of management in the objective discharge of their responsibilities, by furnishing them with objective analysis, appraisals, recommendations and pertinent comments concerning the activities reviewed. The internal auditor, therefore, should be concerned with any phase of business activity wherein he can be of service to organisation". According to the definition, the overall objective of internal auditing is to assist all members of management in the objective discharge of their responsibilities, by furnishing them with objective analysis, appraisals, recommendations and relevant comments concerning the activities reviewed. The internal auditor, therefore, should be concerned with any phase of business activity wherein he can be of service to the organisation. Naturally, when an auditor is concerned with the appraisal of operations, he would be performing the role of an operational auditor. Another important point that this definition throws up is that operational auditing is essentially a function of internal auditing staff. Traditionally, the internal auditing was concerned with the financial transactions only. It was during early 1940's, the concept of operational auditing came into existence. According to Cadmus "operational auditing is not different from internal auditing, it is merely an extension of internal auditing into operational areas. It is characterised in both financial and operational areas – by the auditor's approach and state of mind". The main objective of operational auditing is to verify the fulfillment of plans and sound business requirements as also to focus on objectives and their achievement as against the performance yardsticks evident from in the management objectives, goals and plans, budgets records of past performance, policies and procedures. Industry standards can be obtained from the statistics provided by industry, associations and government sources. It should be appreciated that the standards may be relative depending upon the situation and circumstances; the operational auditor may have to apply them with suitable adjustments. It might appear from the above that an internal auditor is not concerned with operational aspects and operational auditor is, not concerned with financial aspects which is not so. Because traditionally, internal auditors had been engaged in a sort of protective function, deriving their authority from the management. They examined internal controls in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are not there; they checked the accounting books and records to see, whether the internal checks are properly working and the resulting accounting data are reliable. They also looked into the aspect of safety of the assets and properties of the company. Some element of operational auditing could be found even in these traditional functions of internal auditors, specially in the context of fraud, wastage and loss. Internal auditors emboldened by their ability to appraise financial and accounting control gradually started extending their field to cover non-accounting control as well. On the other hand, it should not be assumed, that, since an operational auditor is concerned with the audit of operations and review of operating conditions, he is not concerned with the financial aspects of transaction and controls. A point has already been made that the special expertise acquired by the operational auditor, that enables him to view the controls and operations from the management point of view, can be carried back to his review of the financial areas. In the matter of cash transactions, the operational auditor will look into such aspects as the quantum of cash in hand (by relating it to the requirement of cash to be held) carried generally or the use of cash not immediately required. Also he will review the operational control on cash to determine whether maximum possible protection has been given to cash. Similarly, in the audit of inventories, he would have management policy. In pure administrative areas on inventory, he will see whether adequate security and insurance arrangements exist for protection of inventories. Thus, over a period of time, the scope of internal auditing was widened to cover not only accounting and financial operations but other operations such as marketing, personnel, production, etc. As per the modern definition of internal auditing, there is no difference between the two. However, still some auditors believe that there might exist difference between the two on account of perception as far as scope of the two is concerned which in fact is not true as evident from the foregoing analysis.

D. Compliance with Other Laws: As per SA 250, "Consideration of Laws and Regulationsin an Audit of Financial Statements", the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.Further, non-compliance with other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for in the financial statements, but are not considered to have a direct effect on the financial statements.

   In the instant case, major portion of the labour employed in the company was child labour. While questioning by auditor, reply of the management that it was outside his scope of financial audit to look into the compliance with other laws is not acceptable as it may have a material effect on financial statements.Thus, auditor should ensure the disclosure of above fact and provision for the cost offines, litigation or other consequences for the entity. In case if the auditor concludes that non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statement.

2.

A. Special features of Co-operative Societies Audit: The special features of co-operative societies audit, to be borne in mind in general while conducting the audit are as follows-

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

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

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

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

(v) Adherence to Co-operative Principles: The auditor will have to ascertain in general,how far the objects, for which the co-operative organisation is set up, have been achieved in the course of its working. The assessment is not necessarily in terms of profits, but in terms of extending of benefits to members who have formed the society.Considered from the viewpoint of social benefits it may be looked into that how far the sales could be effected at lower prices. For the achievement of these activities, cost accounting methods, store control methods, techniques of standard costing, budgetary control etc. should be adopted. However, these modern techniques are mostly not in application and as such in practice a wide gap is found in the goals to be achieved and the actual achievements. While auditing the expenses, the auditor should see that they are economically incurred and there is no wastage of funds.

Middlemen commissions are, as far as possible, avoided and the purchases are made by the committee members directly from the wholesalers. The principles of propriety audit should be followed for the purpose.

(vi) Observations of the Provisions of the Act and Rules: An auditor of a co-operative society is required to point out the infringement with the provisions of Co-operative Societies Act and Rules and bye-laws. The financial implications of such infringements should be properly assessed by the auditor and they should be reported. Some of the State Acts contain restrictions on payment of dividends, which should be noted by the auditor.

(vii) Verification of Members' Register and examination of their pass books: Examination of entries in members pass books regarding the loan given and its repayments, and confirmation of loan balances in person is very much important in a co-operative organisation to assure that the entries in the books of accounts are free from manipulation. Specifically in the rural and agricultural credit societies, members are not literate and as such this is a good safeguard on their part. Of course this checking will be resorted to on a test basis, which is a matter of judgment of the auditor.

(viii) Special report to the Registrar: During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society, he may report these special matters to the Registrar, drawing his specific attention 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 mis-management like 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.

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

(x) Discussion of draft audit report with managing committee: On conclusion of the audit, the auditor should ask the Secretary of the society to convene the managing committee meeting to discuss the audit draft report. The audit report should never be finalised without discussion with the managing committee. Minor irregularities may be got settled and rectified. Matters of policy should be discussed in detail.

B. This is the external confirmation, covered by SA 505 “External confirmation”. The identities of creditors are not traceable to confirm the credit balance as appearing in the financial statement of the company. It is also not a case of pending litigation.

It might be a case that an income of Rs.4 lakhs had been hidden in previous year/s. The statutory auditor should examine the validity of the credit balance as appeared in the company’s financial statements. He should obtain sufficient evidence in support of the balance. He should apply alternative audit procedures to get documentary proof for the transaction/s and should not rely entirely on the management representation. Finally, he should include the matter by way of a qualification in his audit report to the members.

3.

A. Organizing a Management Audit for K Ltd.: The key requirement for a successful Management audit program would be the approval and support of the top management to initiate. Accordingly the following shall be the matters that should be considered while organizing the Management Audit of K. Ltd.

Devising the statement of policy - The management’s support must be reflected clearly and categorically in the company’s highest policy statement. The policy statement should be quitespecific. It should spell out clearly the scope and status of the management/operationa lauditing within the enterprise, its authority to carry out audits, issue reports, makere commendations, and evaluate corrective action. The statement of policy should lay down in clear terms the scope of activities to be performed by the management auditor. The scope of activities is the most basic requirement for building up a successful management audit programme both for small as well as a large organisation. Thus, a comprehensive statement ofpolicy provides definite understanding to management concerning the nature of audit to be performed and the scope and details of audit work to be carried out. This then will become the charter under which the management auditor should operate. In this charter, will be set forth,for the rest of the company to see, how executive management regards the purpose, mission and authority of the function of management auditor within the company. The statement must afford the auditor all the authority he needs yet does not assign responsibility which he cannot conceivably carry out. The statement must categorically say that the management auditor is capable of reviewing administrative and management controls over any activity within the company. However, he should not be expected to extend his activities to the evaluation of performance of professional and technical activities calling for specialised knowledge and skills and suggest remedies unaided by people competent to undertake such evaluation.

Location of audit function within the organisation - Some organisations depending upon their size and nature of have established a separate department of audit specialists where the head of the department reports directly to the top executive. In certain cases, the audit group may be a part of the activities of management services department, administrative control department or some other unit of organisation. The more important question, however, is that the function should be as entirely independent as possible of pressure from various groups in the enterprise. The greater the independence, greater is the freedom to work effectively.Therefore, it is better to place the auditing function quite high in the organisation. Theminimum requirement for the auditing organisation is to report to an officer whose status is such that he can command prompt and proper consideration of the auditor’s opinion and recommendations. Preferably that officer should be a member of the Board. One of the controversies that is usually raised is whether the management auditor should report to the finance director, to whom he may be administratively responsible or to the managing director where he has no administrative responsibility. A third opinion would like the auditor to report to an audit committee, comprising of senior executives of the company who are preferably Board members. A different school of thought would like auditors to report to both the finance director and the audit committee. Though the controversy rages and no definite solution can be arrived at, it is felt that the controversy regarding which of these persons the management auditor should report to is not much substance where independence exists. Independence ofthe management auditor is not necessarily related to the person/persons he reports. His independence is entirely dependent on the management's attitude towards audit, the credibility the management auditor has with the management and the management's positive will to listen to criticism for self betterment.

Allocation of personnel - Whatever be the size of the enterprise, it is important that all persons selected and assigned to audit possess a good understanding of auditing theory, athorough knowledge of the fundamentals of both organisation and management, the principles and effective methods of control, and the requirements for conducting scientific appraisal."General Guidelines on Internal Auditing" issued by the Institute also emphasise these qualifications for an auditor whose area extends beyond the review of financial controls. As the management auditor is expected to evaluate operational performance and non-monetary operational controls, he should possess basic knowledge of the technology and commercial practices of the enterprise, an enquiring, analytical, pragmatic and imaginative approach and athorough understanding of the control system. The management auditor should also have a basic knowledge of commerce, law, taxation, cost accounting, economics, quantitative methods and EDP systems. Knowledge in these areas would be adequate for him to identify problems and to determine steps to be taken when a problem is identified. It does not mean that management audit should be assigned to engineers, computer experts and others. Rather persons having sound accounting background along with general knowledge of other relevant disciplines are best suited to perform this job. Because the profession of accountancy basically teaches a systematic and analytical approach to a problem, it is this methodical approach which is the guiding note to an audit function of review of controls. In personal characteristics individuals assigned to the job should have an inclination towards analysis, a high degree of imagination and an ability to write and express themselves clearly and logically.

Staff training programme - A continuous training programme is necessary to achieve quality in performing audit assignments because the management auditor must keep a breast of new ways to improve auditing standards. An effective training programme enables staff to assume additional responsibilities and advancements in the organisation. Thus the programme acts as an incentive for drawing capable people into the department and keeping them.

Time and other aspects - The time required to carry out a management audit will vary,depending upon the extent and nature of assignment. For example, the time required toperform an audit of the entire activities of an organisation's purchasing department might take a few weeks, while an audit of the entire business could take several months. Much depends upon the size of the activity. An appraisal of a plant's standard cost system might also simultaneously include an appraisal of the departmental budgetary control system. In a study of the results of sales contacts and selling efforts in the field, one might find it feasible to study the expense reports and other costs incurred in making contacts. In the evaluation of the method of scheduling production in a plant, one might well take a good look at the sales department's method of compiling and preparing the sales forecast. The time and cost wil vary for each assignment, depending upon the nature of the assignment, the number of auditors assigned to perform the work, and whether or not more specialists in a particular field are required. An audit of a production planning and control department, for example because of its size and other factors, could require an audit staff of several persons and, in addition, a specialist in production planning and one in production control. If an assignment is one which requires technical assistance of a nature unavailable within the audit group, it might be advisable to seek a qualified outside consultant to perform the work.

Frequency - Having specified various approaches to management audit, including its scope and its staffing requirements the last item that should be considered before undertaking such an audit is its frequency. Prime consideration should be given to the nature of the organisation. Is the company in a fast-changing industry where there is great accent on the latest technology in the company's products and/or services? When the organisation is subject to rapid change or the total resources utilised are expensive, the frequency of management auditing should be greater than when it does not undergo rapid changes or the resources employed are not high in value. In essence, management audits should be made often enough to provide protection against growing problems. On the other hand, they should not be so frequent as to lead to repetitious results of questionable value.To get an idea of the optimum frequency of such an audit, it might be worthwhile to look at financial audits. Customarily, financial audits are conducted annually. They are highly programmed, since an internal control questionnaire is utilised to attest to accounting methods and procedures. By contrast, a management audit should be considered from a longer timeframe. For an organisation, that is subject to rapid changes or consumes a great amount ofhigh-cost resources, a two-years basis might be adequate to protect it from managerial and operational problems becoming entrenched or too large. For those organisations in a relatively stable industry, the frequency of audit can be every three years. In no case should the interval be allowed to exceed three years.

B. This case requires attention to SA 560 "Subsequent Events", AS 4 "Contingencies and Events occurring after the Balance Sheet Date" and AS 29 "Provisions, Contingent liabilities and Contingent Assets".As per AS 4 "Contingencies and Events occurring after the Balance Sheet Date",adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. Similarly as per AS29 "Provisions, Contingent liabilities and Contingent Assets", future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the will occur.In the instant case, the amount of `1.50 crores is a material amount and it is the result of an event, which has occurred after the Balance Sheet date. The facts have become known to the auditor before the date of issue of the Audit Report and Financial Statements.The auditor has to perform the procedure to obtain sufficient, appropriate evidence covering the period from the date of the financial statements i.e. 31-3-2010 to the date of Auditors Report ie.31-05-2010. It will be observed that as a result of long pending negotiations a sum of ` 1.50 cores representing arrears of salaries of the year 2008-09and 2009-10 have not been included in the financial statements. It is quite clear that the obligation requires provision for outstanding expenses as per AS 4 and AS 29.As per SA 560 "Subsequent Events", the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.So the auditor should request the management to adjust the sum of `1.50 crores by making provision for expenses. If the management does not accept the request the auditor should qualify the audit report.

4. A. SA 500 "Audit Evidence" states that an auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base his option.Section 227 (IA) (e) the Companies Act, 1956 requires an auditor to report when personal expenses have been charged to revenue account.In the context of the facts of case, ascertain whether the payment made by the

company for the foreign trip form an “allowance” or “reimbursement”. An allowance is a fixed sum of money allowed or the basis of specified criteria. No evidence supporting the expenditure is required for payment of allowance to the director. On the other hand, if the payment is reimbursement should be against actual expenditure.The director concerned should provide proof of expenditure. Since the director has given only a declaration, the auditor should ascertain other relevant facts as to whether the advance paid is pursuant to the policy of the company which is based on approximate estimation of the expenditure normally incurred by a person of the status of a director and the same is applicable to persons of a similar status within the company. If the auditor considers the advance taken is reasonable then the declaration can be considered adequate, otherwise he may have to call for additional documentary evidences.

B. Scope of Operational Audit: Operational auditing is a systematic process involving logical, structured and organized series of procedures. It concentrates on effectiveness,efficiency and economy of operations and therefore it is future oriented. It does not end with the reporting of the findings but also recommends the steps for improvement in future.

The main objective of operational auditing is to verify the fulfilment of plans and sound business requirements as also to focus on objectives and their achievement objectives;the operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems, and prospects and its environment. Above all, his mind should be open and active so as to be able to perceive problems and prospects, and grasp technical matters.In carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues; he will have to get the assistance of norms and standards in every operating field to be able to objectively judge a situation. The norms and standards should be such as are generally acceptable or developed by the company itself.To a traditional internal auditor, a loss of ` 1,000 caused by a wrong totaling of invoice is important and this is that he looks for. But for an auditor engaged in the review of operations, carrying out of a proper maintenance programme of the machines is of greater importance because considerable production loss due to machine breaks down can thus be prevented. In both the cases, the auditor’s objective is to see that the business and its profitability do not suffer from avoidable loss, but, nevertheless, there is a distinct difference in approach. But it should not be assumed, that, since an operational auditor is concerned with the audit of operations and review of operating conditions, he is not concerned with the financial aspects of transaction and controls.Hence, contention of operational auditor that totaling error in invoice of ` 1,000 is out of scope is not correct as operational audit is being carried out to ensure that all the management functions like planning, organizing, staffing, directing and controlling are working effectively and efficiently. Such kind of error is very much in scope because such an existence of error indicates that control system (controlling function) is not sound.

PRIME ACADEMY
40th SESSION - PROGRESS TEST
CORPORATE AND ALLIED LAWS

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

PART - A

I. Advise on the following situations as per the Companies Act, 2013:

(i) A company wants to transfer more percentage of profits to reserves.

(ii) A company wants to declare dividends out of past reserves instead of current year profits.

(iii) A company wants to provide depreciation higher than the rates provided in Schedule II of the Companies Act, 2013.

(iv) Mr. Q, a Director of PQR Limited proceeding on a long foreign tour, appointed Mr. Y as an alternate director to act for him during his absence. The articles of the company provide for appointment of alternate directors. Mr. Q claims that he has a right to appoint alternate director.

(v) The Board of Directors of M/s Infotech Consultants Limited, registered in Calcutta, proposes to hold the next board meeting in the month of May, 2014. Can the board meeting be held in Chennai, when all the directors of the company reside at Calcutta? **(5 x 3=15 Marks)**

II. State with reference to the relevant provisions of the Companies Act, 2013 whether the following persons can be appointed as a Director of a company

(i) Mr. A, who has huge personal liabilities far in excess of his Assets and Properties, has applied to the court for adjudicating him as an insolvent and such application is pending.

(ii) Mr. B, who was caught red-handed in a shop lifting case two years ago, was convicted by a court and sentenced to imprisonment for a period of eight weeks.

(iii) Mr. C, a Former Bank Executive, was convicted by a court eight years ago for embezzlement of funds and sentenced to imprisonment for a period of one year.

(iv) Mr. D is a Director of DLT Limited, which has not filed its Annual Returns pertaining to the Annual General Meetings, held in the calendar years 2011, 2012 and 2013. **(10 Marks)**

PART B **(50 Marks)**

Answer any five out of six from below.

1. (a) X, a Director of MJV Ltd., was appointed on 1st April, 2011, one of the terms of appointment was that in the absence of adequacy of profits or if the company had no profits in a particular year, he will be paid remuneration in accordance with Schedule V. For the financial year ended 31st March, 2014, the company suffered heavy losses. The company was not in a position to pay any remuneration but he was paid ₹ 50 lacs for the year, as paid to other directors. The effective capital of the company is ₹ 150 crores. Referring to the provisions of Companies Act, 2013, as contained in Schedule V, examine the validity of the above payment of remuneration to X.

   (b) A company wants to include the following clause in its Articles of Association:
   "Each director shall be entitled to be paid out of the funds of the company for attending meetings of the Board or a Committee thereof including adjourned meeting such sum as sitting fees as shall be determined from time to time by the Directors but not exceeding a sum of ₹ 30,000 for each such meeting to be attended by the Director." You are required to advise the company as to the validity of such a clause and the correct legal position under the provisions of the Companies Act, 2013.

2. (a) Mr. Loma, an Indian National desires to obtain foreign exchange for the following purposes:
   (i) Payment of commission on exports under Rupee State Credit Route.
   (ii) Gift remittance exceeding US Dollars 10,000.
   Advise him whether he can get foreign exchange and if so, under what condition?

(b) A Company incorporated in United Kingdom established a branch at Chennai. What is the residential status of the Chennai branch? The Chennai branch proposes the purchase some immovable property at Chennai for the purpose of its business. Is it a 'Capital Account Transaction' within the meaning of section 2(e) of the Foreign Exchange Management Act, 1999? Are there any restrictions under the Foreign Exchange Management Act, 1999 in respect of such acquisition?

3. (a) XYZ Ltd. is a foreign collaborator in ABC Ltd incorporated in India under the Companies Act, 2013. The foreign collaborator holds 49% of the shareholding. The Board meetings of ABC Ltd are usually held in India and sometimes meetings of the Board are called at a very short notice for which there is a provision in the Articles of Association that during such situations notices of the meetings of the Board can be sent by e-mail. State in this connection whether such a provision in the Articles of Association of a foreign collaborated company is valid within the purview of the provisions of the Companies Act, 2013.

(b) Mr. DRT is a director of PCS Ltd. The said company is having sufficient liquid funds and Mr. DRT is in dire need of funds. In order to mitigate the hardship of Mr. DRT the board of directors of PCS Ltd. wants to lend ₹ 5 lakhs to him and ₹ 2 lakhs to his wife. State whether such loans can be given and if so under what conditions. What would be your answer if the company PCS LTD would have been PCS Private Ltd.

4. (a) Mr. Ravindranathan is holding the post of Director in three companies out of which Good luck Colors Limited is one. For the financial year ended on 31st March, 2014, Good luck Colors Limited failed to pay interest on loans taken from a financial institution and also failed to repay the matured deposits. On 1st June, 2014, Mr. Ravindranathan accepting the post of Additional Director in Soma Footwear Limited, submitted a declaration that the disqualification specified in Section 164 of the Companies Act, 2013 is not applicable in his case. Decide whether the declaration submitted by Mr. Ravindranathan to Soma Footwear Limited is in order.

(b) Mr. SDR, a shareholder in JKP Ltd. holding ten equity shares of ₹ 10 each fully paid up wants to give a special notice to the company for removal of Mr. EDM, a Director of JKP Ltd. without stating any reason in the notice. You are required to state as per the provisions of the Companies Act, 2013 and/or any decided case law whether Mr. SDR is entitled to do so.

5. (a) The Annual General Meeting of ABC Limited declared a dividend at the rate of 30 percent payable on paid up equity share capital of the Company as recommended by Board of Directors on 30th April, 2014. But the Company was unable to post the dividend warrant to Mr. Ranjan, an equity shareholder of the Company, up to 30th June, 2014. Mr. Ranjan filed a suit against the Company for the payment of dividend along with interest at the rate of 20 percent per annum for default period. Decide in the light of provisions of the Companies Act, 2013, whether Mr. Ranjan would succeed? Also state the directors' liability in this regard under the Act.

(b) The Board of Directors of Nimbahera Chemicals Limited proposes to transfer more than 10% of the profits of the company to the reserves for the current year. Advise the Board of Directors of the said company mentioning the relevant provisions of the Companies Act, 2013.

6. Examine with reference to the provisions of the Foreign Exchange Management Act, 1999 whether there are any restrictions in respect of the following:-

(i) Drawal of Foreign Exchange for payments due on account of Amortization of loans in the ordinary course of business.

(ii) A person, who is resident of U.S.A. for several years, is planning to return to India permanently. Can he continue to hold the investment made by him in the securities issued by the companies in U.S.A.?

(iii) A person resident outside India proposes to invest in the shares of an Indian company engaged in plantation activities.

PRIME ACADEMY
40th SESSION – FINAL - PROGRESS TEST- CORPORATE AND ALLIED LAWS
SUGGESTED ANSWERS
PART – A

I. Advise on the following situations as per the Companies Act, 2013:

(i) The first proviso to 123 (1) of the Companies Act, 2013 provides that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company. Therefore, under the Companies Act, 2013 the amount transferred to reserves out of profits for a financial year has been left at the discretion of the company acting vide its Board of Directors. Therefore, the company is free to transfer any part of its profits to reserves as it deems fit.

(ii) The second proviso to section 123 (1) of the Companies Act, 2013 permits a company to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves subject to the rules prescribed in this behalf. The Companies (Declaration and Payment of Dividend) Rules, 2014 provide for the rules for declaring dividends out of the reserves as under:

a) The rate of dividend declared does not exceed the average of the rates at which dividend was declared by it in the 3 years immediately preceding that year. However, this rule will not apply if a company has not declared any dividend in each of the three preceding financial year.

b) The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves does not exceed an amount equal to 1/10th of the sum of its paid-up capital and free reserves as appearing in the latest audited financial statement.

c) The amount so drawn must first be utilized to set off losses incurred in the financial year before any dividend in respect of equity shares is declared.

d) The balance of reserves after such drawal shall not fall below 15% of its paid-up capital as appearing in the latest audited financial statement.

(iii) The rates contained in Schedule II to the Companies Act, 2013 are the minimum rates below which companies are not permitted to charge for depreciation and therefore there is no bar in providing a higher rate of depreciation. However, it is advisable to give a statement to the effect that the management has estimated life of the asset which requires higher rate of depreciation to be provided than rates prescribed under schedule II to the Companies Act, 2013.

(iv) Under section 161(2) of the Companies Act, 2013 the Board of Directors of a company may, if so authorized by its articles or by a resolution passed by the company in general meeting, appoint a person, not being a person holding any alternate directorship for any other director in the company, to act as an alternate director for a director during his absence for a period of not less than three months from India. From the above provision it is clear that the authority to appoint alternate director has been vested in the board of directors only and that too subject to empowerment by the Articles. Therefore, Q is not authorized to appoint an alternate director and the appointment of Mr. Y is not valid.

(v) There is no provision in the Companies Act, 2013 under which the board meetings must be held at any particular place. The Companies Act lays down the provisions for holding meetings by video conferencing, sending notices, procedures at the meeting etc. Therefore, there is no difficulty in holding the board meeting at Chennai even if all the directors of the company reside at Calcutta and the registered office is situated at Calcutta provided that the requirements regarding the holding of a valid board meeting and the other provisions relating to the signing of register of contracts, taking roll calls, etc. are complied with.

II. State with reference to the relevant provisions of the Companies Act, 2013 whether the following persons can be appointed as a Director of a company

The first 3 cases stated in the question are based on the provisions of Section 164 (1) of the Companies Act, 2013 and the fourth case is dealt with in section 164 (2) of the said Act. Based on the provisions of the said sections, each case can be discussed as follows:

(i) Section 164 (1) (c) states that a person shall not be eligible for appointment as a director of a company if he has applied to be adjudicated as an insolvent and his application is pending. Therefore, in the present case, Mr. A cannot be appointed as a Director of a Company – whether public or private.

(ii) Section 164 (1) (d) states that a person shall not be eligible for appointment as a director of a company if he has been convicted by a court for any offence involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of the sentence. In the present case, although the sentence was only two years ago, but the period of sentence was only eight weeks, i.e., less than six months. Hence, Mr. B does not come under the purview of this disqualification and can be appointed as a director ofa company.

(iii) The third case also falls within the provisions of section 164 (1) (d). In this case the imprisonment was for a period of one year, i.e., for more than six months, but since more than five years have elapsed from the expiry of the sentence, Mr. C is no longer disqualified and can be appointed as a director of a company.

(iv) Section 164 (2) states that a person who is or has been a director of a company which has not filed the financial statements or annual returns for any continuous three years, then such a person shall not be eligible either to be appointed as a director of other company or reappointed as a director in the same company. In the present case, DLT Limited has failed to file annual returns. Hence, the disqualification for Mr. D is attracted and he cannot be appointed as a director in other company nor can he be reappointed in the same company.

PART B

1. (a) Under Part II of Schedule V to the Companies Act, 2013, the remuneration payable to a managerial personnel is linked to the effective capital of the company. Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may, without Central Government approval, pay remuneration to the managerial person not exceeding ` 60 Lakhs in the year in case the effective capital of the company is between ` 100 crores to 250 crores. The limit will be doubled if approved by the members by special resolution and further if the appointment is for a part of the financial year the remuneration will be pro rated. From the foregoing provisions contained in schedule V to the Companies Act, 2013 the payment of Rs. 50 Lacs in the year as remuneration to Mr. X is valid in case he accepts it as under the said schedule he is entitled to a remuneration of Rs. 60 Lakhs in the year and his terms of appointment provide for payment of the remuneration as per schedule V.

   (b) The Companies Act, 2013 vide section 197 (5) provides that the sitting fee payable to directors for attending meetings of the Board or committees thereof will be decided by the Board subject to limits prescribed by the Central Government in rules framed in this behalf. The limit prescribed by the Central Government is Rs. 1 Lakh per meeting and may be different for independent and non independent directors. Hence, the clause in the Articles proposed in the case given, does not make any sense under the Companies Act, 2013.

2 (a) Under provision of Section 5 of FEMA 1999, certain Rules have been made for drawal of foreign exchange for current account transitions. As per these rules, foreign exchange for some of the current account transaction is prohibited. As regards some other current account transaction foreign exchange

can be drawn with prior permission of the C entral Government while in case of some other current account transaction, the prior permission of Reserve Bank of India is required.

1. As regards item no. 2 i.e., the payment of commission on export under Rupee State Credit Route, such payment is prohibited as referred in First Schedule to Foreign Exchange Management (Current Account Transaction) Rules 2000. Hence Mr. LOMA cannot withdraw for the said purpose.

2. The item referred here is covered by Third Schedule to Foreign Exchange Management (Current Account Transaction) Rules 2000. As per this schedule, gift remittance exceeding USD 5,000 per beneficiary per annum requires permission of RBI. Since the amount involved here is more than USD 5000, Mr. LOMA can draw foreign exchange after permission from RBI.

(b) According to section 2(v)(iii) of FEMA, 1999, person resident in India inter alia means an office, branch, or agency in India owned or controlled by a person resident outside India. The company incorporated in U.K is a person resident outside India [Section 2(v)(ii) read with section 2(w) of the FEMA] as it is not a body corporate registered or incorporate in India. As the Chennai branch is branch in India is owned and controlled by the U.K Company is resident outside India, the Chennai branch is resident is India under section 2(v) (iii) stated above Capital account transaction.

In the case of a resident in India, capital account transaction means a transaction which alters the assets or liabilities outsides India. The Chennai branch (is resident in India) acquires immovable properly at Chennai (is in India). Hence this acquisition is not a capital account transition within the meaning of section (2(e) of FEMA. Section 6(3) empowers RBI to restrict or regulate the acquisition of immovable property in India by a person resident outside India. Hence there is no restriction in acquisition of immovable property in India by Chennai branch.

3 (a) In terms of the proviso to section 173(3) of the Companies Act, 2013 a meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting. No exception is made for any class or classes of companies. Further, under section 173(3) a meeting of the Board shall be called by giving not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means. If we examine the above provision, it is clear that the notice shall be sent by hand delivery or by post or by electronic means.

Hence, the sending of notice by e mail is an ordinary mode of sending notice of a board meeting under the Companies Act, 2013. Therefore, in the given case the shorter notice is legally permitted with the only condition being the presence of the quorum and at least one independent director. The provision of the Articles in this regard is not relevant as the position is amply clarified in the Act itself.

(b) Loan to Director and his relative: According to section 185 of the Companies Act, 2013, no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person.

Thus, in the instant case, if PCS Ltd. wants to lend ` 5 Lakhs to Mr. DRT who is a director in PCS Ltd. and ` 2 Lakhs to his wife, then it is in violation of section 185 of the Companies Act, 2013. It does not matter that PCS Ltd would have been PCS Private Ltd. as Section 185 of the Companies Act, 2013 is applicable to both Public and Private companies.

4 (a) According to section 164 (2) of the Companies Act, 2013, a person who is or has been a director of a company which:

a. has not filed the financial statements or annual returns for any continuous three financial years; or
b. has failed to repay the deposits accepted by it or interest thereon on due date or redeem its debentures on due date or pay dividends declared and such failure continues for one year or more.

shall not be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

The disqualification specified in section 164 (2) of the Companies Act, 2013 is not applicable in matters of loan from public financial institutions.

However, as Good luck Colours Limited has failed to repay its deposits on due date and the said failure continues for more than one year, Mr. Ravindranathan is disqualified under the said section. sThe declaration submitted by him therefore, is not in order and he is not eligible to the appointment as Additional Director in Soma Footwear Limited.

(b) The problem as stated in the question is governed by the provisions of section 169 (1) of the Companies Act, 2013. Further, sub-section (2) of the said section states that a special notice is required of any resolution to remove a director. The section does not put any condition in respect of the number of members or their shareholding for the giving of the special notice and furnishing any reason therefore. However, the provisions of section 169 (1) and (2) must be read with the provisions of section 115 which deal with resolutions requiring special notice and section 102 of the Companies Act, 2013 which requires an explanatory statement to be annexed with every resolution passed in respect of a special business. It must be understood that apart from the ordinary businesses conducted at an AGM every other business conducted either at an AGM or at any other general meeting of members will fall within the category of “special business” and hence must be accompanied by an explanatory statement under section 102 of the Act. Section 102(1)(b) states that the explanatory statement to every resolution proposed to be passed for a special business must include all necessary information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon. Therefore, Mr. SDR cannot give a special notice without full details and facts of the case.

5 (a) Under section 123(4) of the Companies Act, 2013 the amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend. Section 127 of the Companies Act, 2013 lays down the penalty for non payment of dividend within the prescribed time period. Under section 127 where a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within thirty days from the date of declaration to any shareholder entitled to the payment of the dividend:

a every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment which may extend to two years and with fine which shall not be less than one thousand rupees for every day during which such default continues; and b 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. Therefore, in the given case Mr Rajan will not succeed in his claim for 20% interest as the limit under section 127 is 18% per annum.

(b) The first proviso to 123 (1) of the Companies Act, 2013 provides that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company. Therefore, under the Companies Act, 2013 the amount transferred to reserves out of profits for a financial year has been left at the discretion of the company acting vide its Board of Directors. Therefore the company is free to transfer any part of its profits to reserves as it deems fit.

6. **Capital Account Transactions**: All the transactions referred to in the question are capital account transactions. Section 6(2) of FEMA, 1999 provides that the Reserve Bank may in consultation with the Central Government specify the permissible capital account transactions and the limit upto which foreign exchange will be allowed for such transactions.

Amortization of Loan: According to proviso to section 6(2), the Reserve bank shall not impose any restriction on the drawal of foreign exchange for certain transactions. One such transaction is drawal of foreign exchange for payment due on account of amortization of loans in the ordinary course of business. Hence this transaction is permissible without any restrictions.

Person resident in USA returning permanently to India: When the person returns to India permanently, he becomes a resident in India. Section 6(4) provides that a person resident in India may hold, own, transfer or invest in foreign currency, foreign security, etc. if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India. In view of this, the person who returned to India permanently can continue to hold the foreign security acquired by him when he was resident in U.S.A.

Investment in shares of Indian company by non-resident: Reserve Bank issued Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000. Regulation 4(6) of the said Regulations prohibits a person resident outside India from making investment in India, in any form, in any Company or partnership firm or proprietary concern or any entity, whether incorporated or not, which is engaged or proposes to engage in agricultural or plantation activities. Hence it is not possible for a person resident outside India to invest in the shares of a plantation company as such investment is prohibited.